

When Debt Becomes a Problem: A Literature Study

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Executive Summary

This literature study gathers and synthesises information on household debt problems from the national and international literature. Its aim was to review the literature so as to provide definitions of key terms, estimate (for the first time) the size and scale of debt problems in New Zealand, discuss possible reasons why some people fall into debt problems, assess the likely impact this has on individuals and families, outline possible avenues for tackling debt problems, and suggest where there are information gaps. It has been written to provide a foundation for considering future government and non-government policies relating to the issue of over-indebtedness.

Since at least the early 1970s there has been a credit revolution. New technology facilitating the widespread use of credit cards, and the financial deregulation policies of many countries in the 1980s and 1990s, have provided consumers with far greater ease and access to credit. The increasing availability of credit has been matched by a consequent increase in levels of borrowing. From a social and economic perspective this raises questions about the impacts (both positive and negative) this has had on individuals and families, particularly for those with lower incomes.

Size and scale

Indebtedness

The Reserve Bank of New Zealand calculates that, as at December 2003, total household financial liabilities in New Zealand amounted to almost \$106 billion. Most of this stock of debt (80%) is in the form of mortgages. However, \$3.8 billion is from credit cards (4% of the total), \$3.9 billion from hire purchase loans (4% of the total), and approximately \$600 million is from store cards and non-hire-purchase store credit. According to the Household Savings Survey (HSS), the balance between mortgage and non-mortgage debts is broadly similar to that for the USA and for Canada. Age and debt are strongly correlated, with younger adults in general being more indebted (and over-indebted) than older people.

Over-indebtedness

Over-indebtedness is difficult to measure, with at least 12 different analytical approaches commonly used. A cross-comparative survey of European Union countries estimated that on average 16% of these populations were over-indebted. In Canada one in six households where the major earner was aged under 65 fell behind two or more months on a bill, loan, rent or mortgage repayment. In a survey for the Department of Trade and Industry in the UK, a quarter of respondents reported being in financial difficulties and 18% had been in arrears one or more times in the previous year. Seven percent of respondents in this survey reported being in financial difficulties for more than a year (a sign of more serious debt problems). A survey for the Citizens Advice Bureau found that 26% of the population struggle from time to time with keeping up payments and credit commitments, and 11% have more serious problems (a quarter of whom were currently falling behind with some bills or credit commitments).

In New Zealand the lack of direct surveys of over-indebtedness means that it is not possible to confidently assert the proportion of the population who are over-indebted and the sub-set who have crisis or unmanageable debts. However, data from the HSS, the

2000 Living Standards Survey (LSS) and visits to budgeting advisors do allow some tentative estimates.

According to the HSS, just under 16% of New Zealand economic units (non-partnered individuals and couples) have negative net worth (ie their liabilities exceed their assets). A third of these economic units have as their main source of income state benefits other than superannuation. These individuals may have low levels of human capital (such as educational qualifications and skills) to improve their financial situation. Just under two-thirds of those individuals and couples with negative net worth have wages and salaries as their main source of income. A significant proportion of these individuals may also have low levels of human capital. Very few economic units where the main source of income is New Zealand superannuation have negative net worth (which ties in with the strong correlation between age and debt).

The 2000 LSS suggests that around 15% of the population have, over the course of a year, some money troubles in that they have had to borrow money from family or friends to meet everyday living costs, and/or are spending more than they are receiving, and/or believe that they do not have enough money to meet everyday needs. Between 8% and 12% of the population have been unable to keep up payments for their mortgage or rent, and/or to utility companies, and/or to hire-purchase, credit card or store card companies. Six percent stated that they had received assistance in the form of food, clothes or money from community organisations such as churches.

Data from the New Zealand Federation of Family Budgeting Services (NZFFBS), the largest network of budgeting assistance providers in New Zealand, show that in 2002/03 there were almost 35,000 applications for assistance. There has been a gradual decline in the number of applications over the last five years, although the dollar amount of arrears per client has increased. The NZFFBS database does not show what proportion of these applicants are clients who sought help, left the service and then reapplied in the same year (although the management of this organisation thought that this proportion is relatively small). If all these applicants were separate cases from separate family units, this would amount to around 2% of all New Zealand households. This assumption clearly needs to be treated with caution. It should also be recognised that although the NZFFBS is the largest provider of budgeting assistance, there are also other suppliers, especially in Auckland and Christchurch, and the figures obviously do not include the proportion of people with severe debt problems who never seek help.

Although there is a lack of robust data on debt problems in New Zealand, the evidence suggests that the pattern in New Zealand may be broadly similar to that of other OECD countries. A tentative working assumption is that up to 15% of New Zealand households may be over-indebted (in the sense of struggling to meet their financial commitments to pay monies owed) at some point during any 12-month period, a third of whom may have longer-term problems requiring external intervention.

Financial exclusion

This is concerned with the numbers and proportions of people who do not use particular services or who make use of non-mainstream services, and so is hard to measure. In New Zealand, beneficiaries require a bank account to receive their payments, so the proportion without any banking facilities is likely to be small. However, the 2000 LSS suggests that 17% of the population could not obtain \$1,500 in an emergency (including borrowing money from credit cards or family members) and 36% could not obtain

\$5,000. Anecdotal evidence from budgeting organizations is that there has been an increase in the number of specialist non-status finance firms who cater to low-income families. These organisations charge far higher interest rates than mainstream providers such as banks and credit card companies (at least in part because of the greater risk of default among their clients), but there is no research on the size, scope, impact or approaches of this industry.

Reasons for debt problems

Within the international literature there are five broad explanatory approaches to explain why some people have debt problems while others, sometimes in apparently similar circumstances, do not. These are: demography; income levels; life events; over-commitment and money management skills; and structural factors (such as the lending practices of credit firms and the role of government). There is no clear consensus in the literature about the relative importance of these factors, but most surveys acknowledge correlations between debt problems and demography (especially young age) and economic profile. Households that are most at risk include those that have low incomes, have few financial and human assets, are tenants rather than homeowners, consist of non-partnered individuals and where there are dependent children: in short, the people who are most likely to be living in deprived circumstances. The extent to which problem debtors are the victims of life events, or else are facing difficulties caused by poor money management skills, is not clear from the literature. Factors such as gambling, alcoholism or drug addition as causes of over-indebtedness are barely considered in the mainstream debt literature.

Impacts of debt problems

Research on the impacts of debt problems is also limited. It is especially difficult to separate out the impacts of debt from those of low income and poverty. However, within the literature four broad categories of the impact of debt are described: financial hardship; poor health (physical and mental); family stress, stigma and social exclusion; and barriers to employment. Being over-indebted obviously has financial implications in terms of the ability to make ends meet, but it also appears to have negative impacts on (especially mental) health, and may be linked to suicide. For some it is a “dark cloud” that blights their lives and can have a major impact on their family relationships, although others seem to cope with their situations far better. Being over-indebted can also reduce the financial advantages of returning to work and may act as a barrier to employment. Finally, some individuals may take debt avoidance strategies – such as living in over-crowded cheap housing to reduce expenditure, or partaking in crime or other socially undesirable behaviour – which may also have negative outcomes (eg, on health and education).

Approaches to tackling debt

The literature study identifies six preventive policies that have been adopted or considered by other countries: legislation and/or guidelines for the consumer credit industry; improving access to affordable credit; improved policies for private companies (such as credit and utility companies); education and financial literacy strategies; money advice services; and managing debts to government. A seventh approach, the role of asset-based welfare, may also have potential long-term benefits. An eighth approach –

which, surprisingly, is little discussed in the international literature – is to raise income levels for low earners and beneficiaries. From a policy perspective there is a balance between, on the one hand, protecting individuals and their families from undue stress and from unscrupulous lending, and on the other, stifling competition and the ability of individuals to borrow money.

Managing debts to government

Given the potentially negative social outcomes caused by over-indebtedness and financial exclusion, there is scope for government to review its own policies and practices in regard to debts owed to the Crown. Within the New Zealand literature there is some discussion on the role of Courts and on the recent increases in the number of unpaid infringement penalties reaching the Courts. There is also discussion of the role of emergency government loans to low-income families. Finally, there is some literature from the UK about the possibilities of improving the co-ordination of government debt establishment and collection policies. In particular, there may be possibilities for centralising government collection and the management of monies owed to it. Such approaches would require very careful planning.

Information gaps

There is an absence of robust data on household debt problems in New Zealand. Further research could involve direct, dedicated surveys of people with debt problems, although in the absence of these, further quantitative data mining of the HSS, the Household Economic Survey and the 2000 LSS (and the 2004 LSS and the Survey of Family, Income and Employment) would add to the knowledge base. There is a need for further specialist, specific research and analysis on debts owed to the state; for example, Court-imposed fines and infringement penalties, tax debts (to the Inland Revenue Department), hardship loans (to the Department of Work and Income) and housing arrears (to Housing New Zealand Corporation). There is also a need for qualitative data to find out about the impact of debt problems and the views of the governmental and non-governmental agencies that are most engaged with this issue. Finally, there is a need for research on the non-status and alternative lending industries (that specialise in lending money to low income people), and on the debt establishment and collection policies and practices of utility companies.

Part One: Introduction and Definitions

There has been a credit revolution. As part of a global phenomenon – driven by new credit card technology and the financial deregulation policies of the 1980s and 1990s – consumers can now access credit far more easily than ever before (Draut and Silva 2003, Manning 2000). The increasing ease of credit has been matched by ever-higher levels of consumer borrowing. From a social and economic perspective there are questions about the impacts (both positive and negative) this has had on individuals and families, particularly those with lower incomes.

Debt is often imbued with highly negative connotations. Shakespeare's Polonius (in *Hamlet*) famously advised, "neither a borrower, nor a lender be", while the Old Testament exhorts against usury against the poor and one's "brother".¹ Charles Dickens brought to the public consciousness the horrors of debtors' prisons (in one of which his father had been an inmate) in *Little Dorrit*, while in *David Copperfield* Mr Micawber is of the firm opinion that:

Annual income twenty pounds, annual expenditure nineteen pounds nineteen shillings and sixpence, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and sixpence, result misery.

At the same time, borrowing money can be viewed more positively. In 1971 a UK royal commission concluded that, on balance, consumer credit is "beneficial, since it makes a useful contribution to the living standards and the economic and social wellbeing of the majority of the British people" (Berthoud and Kempson 1992: 1).

From an economic perspective, two related concepts help explain why borrowing money can be considered a normal and optimal response to individuals' changing income and asset levels. The first is that borrowing money allows individuals to smooth their consumption patterns over time. It allows people to obtain products – such as houses, consumer durables or tertiary education – much sooner than they would otherwise have been able to if they had been forced to delay such purchases until they had the full amount (Cameron 1994). It may also allow individuals to cope with a sudden but temporary loss of income, such as that caused by illness, a change of employment or the arrival of a new baby. If individuals with the ability to repay their loans are financially excluded from borrowing money, this may have negative consequences.

The second concept is the life-cycle income model. According to this hypothesis, individual adults typically borrow when they are younger, save as they grow older, and deplete their financial resources in retirement.² This pattern can be affected by factors such as low income, unemployment and illness, which may decrease or prevent the ability to save, and also increase liabilities. Nonetheless, according to Betti et al. (2001: 1), being in debt is normal consumer behaviour and a certain level of debt is inevitable for most people. In any event, the life-cycle hypothesis certainly seems to explain much of the distributions shown in Part Two of this report and means that broad statements about levels of borrowing need to be qualified by an understanding of the types of

¹ Exodus 22: 25, Leviticus 25: 36–37, Deuteronomy 23: 19–20.

² For a discussion of this in a New Zealand context see, for example, Gibson and Scobie 2003, Scobie and Gibson 2003.

individuals who have debts and thus the likely extent of any difficulties they may have in repaying monies owed.

The extent to which household indebtedness may be having negative consequences has been raised at both a national and international level. In New Zealand the Reserve Bank regularly publishes aggregate figures of household indebtedness, which have shown a marked increase over recent decades. New Zealand households currently have liabilities amounting to almost \$106 billion. A report by Statistics New Zealand (2003), *The Net Worth of New Zealanders*, provided for the first time details of the proportions of debt that individuals and groups hold. This showed that in 2001 16% of economic units had negative net worth (ie, their liabilities exceeded their assets).³ In 2003 the New Zealand Council of Christian Social Services released a report, *The Dynamics of Debt for Low Income Families* (Williams and O'Brien 2003). This report argued that debt can have "disastrous" impacts on individual wellbeing, families and relationships, physical and social deprivation and child development. Internationally, concerns about debt have been strongest in the UK, where the Department of Trade and Industry (DTI) established a task force to tackle over-indebtedness. The UK Government's *National Action Plan on Social Inclusion 2003–05* has identified over-indebtedness as a key area requiring intervention (Department for Work and Pensions 2003).

Despite the apparently growing interest in household debt problems, little is known about debt from a New Zealand policy perspective. There is little information on household debt problems, the impacts they may be having and the reasons why people may enter this situation. In particular, no studies have sought to estimate the size of household debt problems or to review possible policy solutions adopted by other jurisdictions. There is also confusion about terminology, especially in relation to differences between key terms such as "debt" and "over-indebtedness".

When Debt Becomes a Problem analyses national and international literature to review the knowledge of household debt problems and to provide a foundation for policy debates on how to improve the situation. The specific aim was to review national and international literature on debt, so as to:

- provide working definitions and explanations of commonly used terms such as "debt", "indebtedness" and "over-indebtedness" (see below)
- provide, for the first time, an indication of the size and scale of household debt repayment difficulties in New Zealand (Part Two)
- outline possible reasons why people go into debt, and provide a profile of those individuals who are most likely to have debt repayment difficulties (Part Three)
- assess the impact of debt, especially for low-income families (Part Four)
- outline possible strategies and approaches for tackling debt (Part Five)
- discuss how governments across the world have sought to better manage the collection of monies owed to them by their own populations (Part Six)
- suggest where there are information gaps and future research needs (Part Seven).

This study is based on material collected by the Ministry of Social Development Information Centre, which searched the following sources: Information Centre

³ See also Skilling and Waldegrave 2004.

Catalogue, Index New Zealand, National Bibliographic Database, EconLit, Sociological Abstracts, Social Sciences Index, PsycINFO, Australian Family and Society Abstracts, CareData, and Department for Work and Pensions' Research Report Series.

Definitions

Deciding whether or not “debt is a growing problem” (Sharpe and Bostock 2002: 3) depends to a great extent on how the term is defined. Within the literature, however, relatively few studies have attempted to define their terms, while those that have, acknowledge there is no universally accepted terminology. In their cross-European study of consumer indebtedness, Betti et al. (2001: 8) state that “there is currently no general agreement on either definition or measurement for consumer over-indebtedness”. Similarly, the UK Department of Trade and Industry Task Force on Tackling Overindebtedness (2003: 12) acknowledged that there was “no generally accepted definition of overindebtedness and inadequate information on which to base one”. Or, in the words of a report specifically commissioned by the Ministry of Social Development on debts owed to it by individuals who are no longer beneficiaries, “debt means different things to different people” (Berkana Consulting Services Ltd 2002: 9).⁴ This terminological confusion has hindered meaningful debates about debt, and so defining key terms is a core requirement of this literature study.

Within the literature, articles have (implicitly or explicitly) tended to follow one of two broad approaches: those that follow dictionary or accounting terminology, and those that seek to follow common understandings in popular, academic or policy discourses.

Debt and over-indebtedness

1. Dictionary definitions

According to the *Dictionary of Economics*, debt can be defined as:

A sum of money or other property owed by one person or organization to another. Debt comes into being through the granting of credit or through raising loan capital. Debt servicing consists of paying interest on a debt. (Bannock et al. 1989: 104)

The *Macmillan Dictionary of Modern Economics* defines debt as:

An obligation or liability arising from the borrowing of finance or the taking of goods or services “on credit” (ie, against an obligation to pay later). Depending on the terms of the transactions, interest is payable at specified periods on most forms of debt ... (Pearce 1986: 98)

Butterworths New Zealand Law Dictionary has:

A certain sum due from one person to another, either (1) by record, eg, judgment, (2) under specialty or deed, or (3) under simple contract, either oral or in writing. (Spiller 1995: 82)

⁴ See also Morris 1996.

Within New Zealand, the most important survey to incorporate issues of debt is the 2001 Household Savings Survey (HSS). The key summary publication arising out of this survey, the *Net Worth of New Zealanders* report (Statistics New Zealand 2003), follows an accounting-style terminological approach, with debt simply referring to monies owed, with no reference to any individual financial problems repayments may be causing.

2. The “common assumption” definitions

A second type of definitional approach is based on how terms are most commonly used within popular discourse and in certain strands of policy and academic literature. For example, Lea et al. (1993: 86) acknowledge the fuzzy distinctions between terms such as “credit” and “debt”, but rather than following strict dictionary definitions of the terms, they attempt to define them using a basis of willingness and ability to repay monies loaned:

... by “credit” we usually imply an arrangement to borrow money over some more or less defined period, with an assumption that repayment is within the borrower’s means at all times ... In contrast, “debt” implies an obligation that the borrower is either unable to discharge or is trying to avoid discharging, at least at the time when it should be discharged.

Lea et al. (1993) comment that people who owe money they ought to pay, but cannot at the moment, may still be short of a debt crisis. They may be confident that the debt can be discharged at a later date, or else they may be choosing to delay a payment for as long as possible; for example, to retain liquidity: “Crisis debt arises when there is no prospect of paying off or even reducing accumulated debts, which are often increasing steadily” (Lea et al. 1993: 86). In a later attempt to distinguish between credit and debt, Lea (2002: 139) acknowledges that in accounting terms, credit and debt are mirror images of each other: “if I am under contract to pay you money, the money is a credit as far as you are concerned and a debt as far as I am concerned; you are my creditor and I am your debtor.” Nevertheless, he argues that this approach differs from how these terms are used in everyday speech and in most of the research on the economic psychology of debt. Therefore, in his definitions, credit is used for situations involving an arrangement for deferred payment agreed between buyer and seller, as in the form of a house mortgage, hire purchase or when borrowing money from a door-to-door moneylender. In contrast, debt is a situation “where payment has been deferred by the buyer without the seller’s agreement” (Lea 2002: 140).

The approach of Lea (2002) and Lea et al. (1993) closely follows Berthoud and Kempson’s (1992)⁵ now classic study of credit and debt in the UK. These authors (emphasis in original) distinguished between “*credit*, which is the money that people borrow, and *debt* which is commitments that are causing them financial problems. We can assume that people want ‘credit’, but they do not want ‘debt’” (Berthoud and Kempson 1992: 2).

There are three broad difficulties with this type of approach. The first is that these definitions are somewhat *ad hoc* and differ from strict dictionary or accounting terminology. They are also not universally acknowledged in the literature. The second is that their approach differs from how the term has been used in New Zealand, especially

⁵ See also Berthoud 1989, Ford 1991, Gordon and Pantazis 1997.

in the *Net Worth of New Zealanders* report (Statistics New Zealand 2003). It also differs from how other governments have used the term, so that, for example, the UK's Performance and Innovation Unit (2002: 137) unambiguously argues that, "debt is not the same as over-indebtedness." The third difficulty is that it is hard to meaningfully quantify differences between "credit", "debt" and "crisis debt". This was a particular issue for Betti et al. (2001: 2), who opted for a definition based on people's perceptions of debt: "A person is over-indebted if he or she considers that he or she has difficulties in repaying debts, whether consumer debt or a mortgage". This type of approach was (although not explicitly stated) also taken by the UK DTI task force on over-indebtedness.

Financial exclusion

Most of the debt literature is concerned with individuals who are suffering hardship due to the amount of money they have borrowed, and their difficulties meeting the costs of repaying the principal and the generated interest. However, a related problem identified in some studies is financial exclusion.

There are few definitions of financial exclusion, but most studies relate it to difficulties some low-income families face in accessing affordable credit. Financially excluded people may not have a bank account and are either unable to obtain money to smooth out their consumption patterns (eg, at times of crises, such as temporary loss of employment) or they are unable to use mainstream, high-street credit facilities and are thus forced to purchase money from "loan sharks" or other non-status finance firms.⁶ Such suppliers may charge far higher interest rates than high-street lenders – sometimes extortionately high (Kempson and Whyley 1999a and b, NACAB 2000a). Such operators typically supply loans to individuals with a poor credit rating that mainstream suppliers would not lend to due to higher risks of default. The net result is that low-income families may have to pay far more for their finance than those who are better off. If their loans are structured (or restructured) to be paid off over a long period of time, the compounded interest payments can be extremely high.

According to Whyley (2002), financial exclusion has sometimes been ignored as a social policy issue because borrowing is seen as a luxury rather than a necessity. However, Whyley argues (2002: 9) that while many poor people would prefer not to borrow money due to concerns about meeting repayments, it is sometimes inevitable: "research has clearly illustrated that, while credit use among low incomes may not be desirable, it is often unavoidable. Indeed, borrowing can be a key strategy in making ends meet." On a more structural level, Betti et al. (2001) argue that, across Europe, countries that lack easy access to credit may suffer economically.

Report definitions

While there are no universally accepted definitions of debt – or related terms such as "over-indebtedness" and "financial exclusion" – the process of trying to define these does reveal four key issues that such terms needs to encompass: first, the overall stock of money owed, regardless of any financial or other stresses making repayments (interest and/or principal) may be causing; second, those individuals who are

⁶ See, for example, Collard et al. 2001, Jones 2001, Whyley 2002.

experiencing negative social outcomes due to their debt repayment difficulties; third, the extent of crisis repayment situations where individuals cannot cope, or reasonably be expected to cope, with their financial liabilities; and fourth, lack of access to cheap/affordable monies for borrowing. Thus, given the arbitrary nature of definitions, there is scope – indeed a requirement – for individual projects to define their own terms.

Following Betti et al.'s (2001) recommendation to adopt terms that can most easily be measured and compared internationally, the following definitions are provided.

- **Credit:** money lent, which an individual intends to repay (often in a set period of time and at a set rate).
- **Debt:** financial liabilities, regardless of how these are incurred. It incorporates all debts, ranging from money owed in the form of mortgages, hire purchase agreements and door-to-door money lenders, to government fines and fraud. Alternative terms are “indebtedness” and “liabilities”. There are, however, important conceptual and policy distinctions between debts with collateral (such as mortgages), debts without collateral (such as from credit cards), government-imposed debt (such as court-imposed fines), and debt for investment (such as business or student loans).
- **Net worth:** the balance between assets and liabilities (net worth equals assets minus liabilities). It excludes human capital (ie, non-tangible assets people may have gained; for example, through education). Individuals with a negative net worth have liabilities greater than their assets, and may thus be in a financially precarious position, especially if they do not have the skills to improve their situation.
- **Over-indebted:** is where individuals are having difficulties meeting the costs of paying monies owed and are therefore at risk of suffering consequent negative social outcomes such as impacts on health, family relationships and standards of living.
- **Crisis debt or unmanageable debt:** individuals in this situation have debt problems that are out of control. Their expenditure is consistently exceeding their income and they are unable to resolve their debt problems, at least without considerable outside intervention, such as from budgeting advisors.
- **Financial exclusion:** a situation where individuals who through a poor credit rating, geographical isolation or other factors cannot access mainstream credit sources such as banks and credit card companies. They consequently are either unable to make use of credit or else resort to borrowing money from non-status finance firms (such as “loan sharks”). An alternative term sometimes used in the literature is “under-indebtedness”.

In addition to these core definitions, there are numerous other definitions related to the broad issue of debt which are not the subject of debate within the literature. The following, which is by no means an exclusive list, are other potentially useful terms. They are summaries of meaning, rather than full definitions (for which relevant legislation should be referred to). They are primarily drawn from common New Zealand government usage and from standard dictionary definitions, especially *The New Shorter Oxford English Dictionary* and the *Oxford Advanced Learners Dictionary*.

- **Alternative lenders:** voluntary organisations that lend money to lower-income families at no or low interest rates.

- **Arrears:** money owed that has not been paid at the right time and is still outstanding.
- **Bankrupt:** an insolvent debtor; a person who is hopelessly in debt; specifically, an insolvent person whose estate is administered and distributed for the benefit of all of his or her creditors by a court of law.
- **Bankruptcy:** the state of being, or fact of becoming, bankrupt.
- **Civil debt:** private debt between individuals or legal entities. It excludes “criminal debt” resulting from the imposition of monetary penalties in the form of court fines, infringement fines, court-ordered reparation to victims, and costs and fees ordered by a court in criminal cases. Judgment debts are where courts have made a monetary order against a civil debtor to a creditor.
- **Default:** failure to pay something that is required by law, especially paying a debt.
- **Delinquency:** non-payment of a debt when due.
- **Infringements:** “instant tickets”, issued by more than 130 prosecuting agencies in New Zealand, which generally give offenders 56 days to pay before filing with courts for enforcement.
- **Non-status lenders:** operators who specialise in lending money to individuals with a poor credit rating. Non-status lenders typically charge far higher interest rates than mainstream lenders.
- **Personal insolvency:** where an individual has been deemed to have insufficient assets to meet the costs of servicing their liabilities.
- **Summary instalment orders:** these provide for court intervention in those cases where people are willing, but unable, to pay their debts. The effect of a summary instalment order is to stay all legal proceedings against the debtor.

Part Two: Size, Scope and Trends

Understanding over-indebtedness requires, firstly, an appreciation of the current size and scale of money owed (ie, levels of indebtedness). Ideally this should be from both a longitudinal and an international perspective. Household indebtedness is officially recorded by the Reserve Bank of New Zealand, and this provides the most accurate source for aggregate figures. However, the 2001 Household Savings Survey (HSS) also provides much useful information on household debt. The HSS is primarily useful for examining the proportions of debt that individuals and groups hold. The aggregate levels of debt recorded by the HSS are far lower than those from official sources. There are several likely explanations for this, including survey respondents not including debts such as credit card bills that are paid off in full at the end of each month, as well as a tendency for individuals to under-report other debts (see Tudela and Young 2003). Aggregate and average debt levels from the HSS should therefore be considered from a comparative rather than an absolute basis.

While data from the Reserve Bank and the HSS provide detailed information on indebtedness, they do not directly report on over-indebtedness. Measuring over-indebtedness is difficult, especially given the lack of a universally accepted calculation method. Indeed, there are at least 12 ways of measuring over-indebtedness that can be drawn from the literature, involving the analysis of:

- debt-to-income ratios
- debt-to-assets ratios
- net worth composition
- credit card usage by low-income families
- credit delinquency rates
- court judgments and mortgage repossessions
- bankruptcy
- multiple debts
- utility disconnections
- enquiries at budgeting advisory centres
- direct surveys of repayment difficulties
- use of government loan schemes for low-income people.

Each of these provides information on over-indebtedness, but they are all problematic and open to critique. They are also, for the most part, measures of the process of becoming over-indebted, rather than measures of the outcomes associated with having problem debts. Given the complexities, no single measurement indicator is ever likely to be completely effective. The challenge is to find an appropriate suite of indicators that can determine the likely proportion of the population facing debt repayment difficulties. Such indicators will need to operate within the context of available (or realistically achievable) data sources.

Measuring financial exclusion is even more problematic than measuring over-indebtedness. Effectively, it involves measuring the absence of credit where needed, as well as the use of alternative and non-status money suppliers (such as pawnbrokers and door-to-door money lenders), about whom often little is known.

Measuring debt

According to Betti et al. (2001), indicators on consumer indebtedness and over-indebtedness can be classified under three broad categories: macro, micro and legal.

Macro data generally come from the banking system, and are a by-product of the credit reporting requirements of financial institutions. Commonly used macro indicators include debt-to-asset and debt-to-income ratios and levels of credit card borrowing. Within New Zealand, information of this type is provided by the Reserve Bank of New Zealand.

Micro data relates to either sample surveys (periodic or one-off) of general household expenditure, savings and net worth, or dedicated surveys of over-indebtedness. Within New Zealand the most useful micro data source for analysing debt is the 2001 HSS (see Statistics New Zealand 2003). This involved interviews with 5,374 economic units (2,392 non-partnered individuals and 2,982 couples), with a Māori booster sample. It can be compared – although with important caveats – with findings from the 1999 Canadian Survey of Financial Security, which had a sample size of 22,999 dwellings, and the US Surveys of Consumer Finances, which are carried out every three years and which each involve more than 4,000 interviews.

Comparing international surveys is inherently difficult because of different social and economic environments (Statistics New Zealand 2003). In particular, differences in concepts and collection methods can have major impacts on results. For example, the three surveys just mentioned have different concepts of households, so that while the HSS selected the individual adult who represented the household on a random basis, the Canadian and US surveys chose to interview the head of the household. This affects the demographic characteristics assigned to the households in each of the surveys.

The HSS was a one-off survey of the net worth of New Zealanders. However, Statistics New Zealand is currently in the process of collecting data for the Survey of Family, Income and Employment (SoFIE), which will include many of the same questions as the HSS and will provide longitudinal data over the eight years that it is due to run.

In addition to the HSS (and SoFIE when available), useful information can also be drawn from the New Zealand Living Standards Surveys (LSS) (see Ministry of Social Development 2002). The 2000 survey included a section on financial status. Although this does not directly refer to over-indebtedness, it indicates the proportion of the population who are facing troubles meeting consumer credit obligations and are, in general, spending more than they are earning. A 2004 LSS is currently under way, which includes some specific questions on debt as part of its aim to explain the “why” (as opposed to the “what”) of people’s living standards.

It may also be possible to draw useful information from the Household Economic Survey (HES). This measures interest payments on monies borrowed, such as on credit cards. By looking at how this affects households’ income levels, it may be possible to derive a measure of “debt poverty”: the extent to which meeting interest payments pushes people into poverty. No such analysis has been carried out, but this offers a useful avenue for further research.

A second type of micro data is dedicated sample surveys of over-indebtedness. These allow individuals and household economic units to describe subjectively their own financial position and the extent to which they may or may not be facing repayment difficulties. This was the preferred measurement approach of the UK DTI task force on over-indebtedness. No such specific survey has ever been commissioned in New Zealand, although the 2000 and 2004 LSS do include questions on respondents' views of their abilities to meet financial payment obligations.

Legal data refers to information available about consumer payment defaults. This may refer to legal action taken to recover debts – such as court judgments against debtors or bankruptcies – and thus provides evidence of the end stage or final outcomes of problem debts.

These three categories provide a useful way to acknowledge the types of information sources that lie behind often-quoted debt indicators. Nevertheless, in practice the categories overlap so that measures such as debt-to-income and debt-to-asset ratios can be measured from both macro and micro approaches, sometimes giving different results (see below). Given the need to find appropriate indicators for New Zealand, but also to understand their inherent strengths and weakness, this section highlights the most important and commonly used international approaches for measuring indebtedness, over-indebtedness and financial exclusion on a case-by-case basis.

Levels of indebtedness

1. Overall debt composition

Measuring total levels of indebtedness (ie, the total stock of money owed) is most accurately achieved through macro data collected by the Reserve Bank of New Zealand (2004a). As at December 2003 the Bank calculated total household financial liabilities (including mortgages) as being almost \$106 billion. Most of this stock of debt is in the form of mortgages, although \$3.8 billion is from credit cards (4% of the total), \$3.9 billion from hire purchase loans (4% of the total), and approximately \$600 million from store cards and non-hire-purchase store credit. By contrast, the HSS (based on survey data) estimates total indebtedness in 2001 as being only \$68 billion (the Reserve Bank calculated total household liabilities in 2001 as being \$83 billion). The HSS is most useful for looking at the proportions of debt types. It shows that 80% of total household debts are in the form of mortgages, 10% are bank debts, 5% are student loans and 3% are credit cards (see Table 1).

Table 2 shows that the overall proportion of mortgage to non-mortgage debts is similar for New Zealand, the USA and Canada. There are differences within “other debt”, although Statistics New Zealand (2003) warns that the components of this category should be regarded as interchangeable.

Table 1: Debt composition in New Zealand

Debt type	Proportion of economic units with debt (%)	Proportion of total debt value (%)
Mortgage	29	80
Bank debts	24	10
Student loan	16	5
Credit card	46	3
Hire purchase	18	1
Other debt	6	1
Total	–	100

Source: Statistics New Zealand 2003

Table 2: Debt composition in Canada, the USA and New Zealand*

	Canadian family units (%)	US family units (%)	NZ economic units (%)
Mortgage/property loan			
Own home	66	72	–
Other	11	8	–
<i>Sub-total</i>	<i>77</i>	<i>80</i>	<i>80</i>
Other debt			
Instalment loans / hire purchase	–	13	1
Other lines of credit and bank loans	6	0	10
Credit card balances etc.	3	4	3
Student loans	3	–	5
Vehicle loans	6	–	–
Other	4	4	1
<i>Sub-total</i>	<i>22</i>	<i>21</i>	<i>20</i>
Total	100	100	100

Source: Statistics New Zealand 2003

* Figures are rounded so may not add up to 100.

2. Debt composition by population characteristics

Overall debt composition provides a useful lens for revealing the borrowing characteristics of household economic units. Ideally, of course, data should be collected longitudinally (which SoFIE will do), and there are also drawbacks in terms of the limited categories of debt collected (eg, information on debts to state agencies). This subsection reports on debt composition by *age*, *ethnicity*, *number of dependent children* and *income*, and is drawn from tables supplied by Statistics New Zealand from their analysis of the HSS. Credit card debt is often used as a proxy for overall non-mortgage-related consumer borrowing, and is thus discussed in the next section.

Age

As would be predicted by the life-cycle hypothesis, age and indebtedness are positively correlated: younger people are more likely to have debts – and larger debts – than older people. Individuals and couples aged 25–44 were the most likely age cohort to have mortgage debt, bank liabilities, hire purchase agreements and to have borrowed money on their credit cards. Couples in this age bracket were also the most likely group to have a student loan.

Ethnicity

Ethnicity is also correlated with indebtedness.⁷ Note that in the HSS there is a high sampling error for groups other than Māori and European/Pākeha because of the relatively small size of these populations. Gibson and Scobie (2003) also show that after allowing for factors such as age, income, occupation and region, differences between ethnic groups revealed by the HSS may not be statistically significant. On the basis of the raw data, however, Pacific people are the ethnic group with the highest proportion of bank debt: 31% of non-partnered individual Pacific people and 44% of Pacific couples have bank liabilities. Māori and Pacific people are most likely to have hire purchase debt, although median amounts are similar for all ethnic groups. Note that these findings contradict Waldegrave et al.'s (1999) study of 401 low-income households. They found that Pākeha households were more likely to have debts than Māori or Pacific households. This study was far smaller than the HSS.

Number of dependent children

Debt holdings are also correlated with the number of dependent children. Non-partnered individuals with one or two children are more likely to have mortgage, bank and hire purchase debts than non-partnered individuals without children. However, this is strongly influenced by the fact that the youngest (18–24) and oldest (65 and over) age groups are the least likely to have children and are also the groups least likely to hold mortgage debt (see Table 3).

Table 3: Selected debt holdings for non-partnered individuals and couples, by number of dependent children, New Zealand

	Mortgage (%)	Bank debt (%)	Hire purchase (%)
Non-partnered individuals			
No children	15	19	11
1 or 2 children	25	32	33
Average	17	21	15
Couples			
No children	34	22	17
1 or 2 children	54	31	25
3 or more children	48	39	31
Average	42	27	21

Source: Statistics New Zealand 2003

⁷ Ethnic data as reported in Statistics New Zealand 2003 are based on a “prioritised” measure so that individuals are only assigned to one ethnic group.

Income

The associations between income and levels of liabilities are also of obvious importance. In their study of low-income families, Waldegrave et al. (1999) found that 64% of households were “in debt” (excluding mortgages), which ranged from only \$19 to up to \$20,000. One-fifth of the overall sample found it very difficult to pay household running costs due to debt, with a further quarter stating that this was quite difficult.

Findings from the HSS reveal that a large number of individuals with low incomes owed money. For example, 66,000 non-partnered individuals earning between \$1 and \$15,000 had bank liabilities, 32,300 had hire-purchase debts and 95,200 had student loan debts. This latter figure highlights the correlation between income and age. Student loans permit people to invest in their futures, and thus high levels of debt by younger people may not necessarily be a problem if they are offset by higher levels of human capital. This said, not all qualifications will lead to positive career developments and some individuals will inevitably accumulate high student debts that they have difficulty paying off. Moreover, there may be long-term issues associated with student debts, such as decreases in home ownership rates or an increase in the age of child-bearing.

3. Credit card usage

Credit card usage is often used as a marker of levels of indebtedness and, by implication, over-indebtedness. Partly this is due to the relative frequency of macro data source reporting, and the apparently dramatic trends in credit card usage these testify to over the past 30 years (Draut and Silva 2003, Manning 2000). In the United States, Yoo (1998) notes that consumer revolving credit outstanding, which includes consumer credit card debt, increased from US\$247 billion in the first quarter of 1991 to US\$514 billion by the second quarter of 1997. In Australia, a research report commissioned by Visa (KPMG 2002), using data from the four major banks, showed that as at March 2001 there were 9.58 million bank-issued credit cards, an increase of 46% over the previous seven years. By December 2000 the amount of credit card debt was AUS\$17.4 billion.

In New Zealand, official source data from the Reserve Bank of New Zealand (2004b) show that, on average in June 2004, New Zealanders owed \$3.7 billion on their personal (ie excluding business) credit cards, around 70% of which was non-interest bearing. In July 2001 the figure was \$2.9 billion. Overall, the Reserve Bank (2004a) calculates that credit card debt has increased from 2% of total credit in 1982 to 4% in 2004.⁸

The HSS shows that 34% of non-partnered individuals and 59% of couples had credit card debt. Median credit card debt was highest for those in the 35–44 years age bracket and lowest for those aged 65 and over. Median credit card debt was also highest for those earning between \$50,001 and \$100,000 per year for individuals, and over \$200,001 for couples (see Table 4). A report commissioned by Visa in New Zealand found that 52% of account holders pay off their accounts without paying interest for the majority of the year (BearingPoint 2003).

⁸ See also Thorp and Ung 2000.

Table 4: Credit card debts, by income, New Zealand

Income	Number of people	Median credit card debt (\$)
Individuals		
Loss or zero	..S	..S
\$1–15,000	69,700	*500
\$15,001–50,000	197,200	*800
\$50,001–100,000	37,000	*1,300
\$100,001 or more	**7,100	**1,000
Not specified	**1,800	**1,100
Total	313,900	800
Couples		
Loss or zero	**2,200	**900
\$1–15,000	*14,700	**800
\$15,001–50,000	163,400	1,000
\$50,001–100,000	221,000	1,600
\$100,001–150,000	49,800	*2,000
\$150,001–200,000	*14,600	**1,500
\$200,001 or more	*17,300	*3,500
Not specified	*20,100	**1,100
Total	503,000	1,500

Source: Statistics New Zealand 2003

* denotes a relative sampling error greater than 30% but less than or equal to 50% (data should be used with caution).

** denotes a relative sampling error of greater than 50% (data too unreliable for most practical purposes).

..S denotes cell contains fewer than 5 respondents and data are not provided.

Individual numbers may not add up to the totals due to rounding errors.

Despite apparently dramatic increases in credit card usage, it should be noted that in New Zealand this only accounted for a small proportion of total household debt (4%). Moreover, as raised in Part One, the increasing use of credit cards is not necessarily a negative phenomenon if these are being used wisely by people who can afford to make repayments (BearingPoint 2003). In any case, universal credit cards date back to 1950, so it is not surprising to see their usage increase, particularly following financial deregulation in New Zealand (and in most other Western countries) in the 1980s and 1990s. There is now also competition between credit card companies to recruit and retain customers, hence the increasing use of reward points that can be put towards, for example, the purchase of airline tickets.

Levels of over-indebtedness

Over-indebtedness is a sub-category of indebtedness, with only a proportion of people with financial liabilities having difficulties making repayments. Measures of indebtedness provide insights into the types of people who may be, or are at risk of becoming, over-indebted. However, there is also a range of more specific approaches, such as analysing ratios of debt-to-income, ratios of debt-to-assets, credit card delinquency rates and enquiries to budget advisory organisations. These tend to be process rather than

outcome measures. The strengths and weaknesses of each measure are discussed as a basis for producing a suite of indicators to describe the extent of over-indebtedness in New Zealand.

1. Debt-to-income ratios

One of the most widely used approaches for measuring over-indebtedness or potential over-indebtedness at a national level involves determining the extent of household liabilities (eg, consumer credit, bank loans and other loans) and/or debt-servicing levels as a proportion either of income or disposable income. The logic is that if people have very high levels of debt relative to their incomes, then they may already be in financial trouble or may be vulnerable to adverse shocks such as interest rate rises. However, the changing use of credit that has characterised modern economies means that an increase in levels of borrowing relative to incomes would be expected: the key questions are at what rate the ratio is changing and at what level it becomes unsustainable.

In Canada, Myatt and Murrell (1998) report a rise in the proportion of debt to personal disposable income from 73% in 1985 to 115% in 1995. In the UK, the Bank of England likewise reported a figure of 115% for the end of 2002 (Hamilton 2003). In Australia, the ratio of household debt to disposable income more than doubled from 50.5% in December 1990 to 122% in September 2002, prompting the following quote in *The Economist* under the title "Living in never-never land":

The profligacy of American and British households is legendary, but Australians have been even more reckless, pushing their borrowing to around 125 percent of disposable income ... there are now concerns that unsustainable rates of borrowing will sooner or later end in tears. (Living in never-never land 2003, cited in La Cava and Simon 2003: 2)

In New Zealand, the Reserve Bank (2004a) calculates that at December 2002, household financial liabilities amounted to 120% of personal disposable income (132% in 2003). This compares with figures of 70% in 1992 and 45% in 1982.

Debt-to-income ratios offer an apparently simple (and thus advantageous) way of measuring over-indebtedness, but there are serious problems with this approach. For example, there are questions as to whether increased borrowing – which explains the increase in debt-to-income ratios – is driven by those who can most afford this. If those on higher incomes are borrowing more, this may be of less concern than if the rise is being driven by those on lower incomes who may be more vulnerable if, for example, interest rates rise. In addition, debt-to-income measures typically ignore household assets, thus taking little account of individuals' smoothing of consumption over time. If individuals are paying a high proportion of their incomes in repaying their debts, but monies are being invested (eg, in paying off a mortgage), then a high debt-to-income ratio may actually be positive. This said, having a high proportion of wealth in the form of housing may have other risks. Hull (2003) warns that New Zealanders hold a very high proportion of their wealth in housing, which may leave New Zealanders vulnerable to economic downturns:

... high indebtedness leaves households vulnerable to changes in interest rates as when rates rise, debt servicing costs rise and households are forced to spend more of their disposable income servicing debt. Finally, in a severe

downturn, if households are forced to default on their home mortgages and other bank debt, there may be an adverse impact on the banking sector. (Hull 2003: 1)

In Australia, La Cava and Simon (2003) analysed data from the 1993/94 and 1998/99 Household Expenditure Survey and the Household, Income and Labour Dynamics in Australia (HILDA) survey of 2001. These surveys include questions on households' financial fragility, measured by indicators such as ability to pay utility bills, whether items have been pawned or sold due to a shortage of money, or going without meals (for similar measures in New Zealand, see measure 11 below).

Between 22% and 30% of Australian households reported having at least one measure of financial stress, most commonly difficulties paying utility bills. La Cava and Simon argue that from 1998/99 to 2001, the increase in debt-to-income ratios is mostly accounted for in increased borrowing among non-fragile households. Financially unconstrained households increased their debt-to-income ratios from 51% to 67%, a larger increase than for financially fragile households, whose debt-to-income ratios increased from 61% to 69%. La Cava and Simon argue that there is thus little evidence that Australian households are more fragile than ever before. This said, the fact that there is an increase at all in debt-to-income levels of financially fragile households may be of concern.

There are also difficulties in how debt-to-income ratios are calculated. According to Myatt and Murrell (1998), increases in credit card purchases typically show up as increases in household debt even when the entire balance is regularly paid off each month. This therefore skews the figures and thus the potential size of any problem debt (this is a potential problem with debt-to-asset ratios too: see below). This is more an issue for ratios calculated using micro rather than macro data sources. For example, in the USA, analysis by the Federal Reserve Bank estimated that total scheduled loan payments (interest plus minimum repayments) for all households divided by disposable personal income increased by 1% to about 14% from 1998 to 2001 (Aizcorbe et al. 2003). This figure was based on aggregate macro data collected from credit card companies and major banks. However, if a similar equation is constructed but using micro periodic data, a different figure is produced. Aizcorbe et al. (2003) analysed data from the 2001 Survey of Consumer Finances and came up with a debt-to-income ratio of 12.5%. Contrary to the method using aggregate data, the SCF-derived figure showed a decline of 1.9% between 1998 and 2001.

2. Debt-to-assets ratios

Given the difficulties with income-based ratios, an obvious solution is to construct ratios using assets instead. Statistics New Zealand (2003) provides this figure for New Zealand (16%) using data from the HSS, and they compare this with Canada (16%) and the USA (14%), which shows that the three countries are very similar.

Despite advantages, debt-to-asset ratios also have drawbacks. The first is that individuals may have high debts and low assets (and thus be in negative net worth), but if they are investing in, say, tertiary education by taking out student loans, this may again be considered to be positive (both for the individual and for society as a whole through the creation of a more skilled workforce). Effective debt-to-asset ratios thus need to include measurements of human capital (see Gibson and Scobie 2003). This said,

measures of human capital (similar to other long-term investments) capture potential future gains and may ignore real difficulties that individuals with high student and other debts may face. Moreover, if individuals invest in educational qualifications that fail to deliver long-term financial rewards in the workplace (eg, because their degrees are not valued by employers), they may have a considerable stock of debt, but little opportunity to repay this (see Part Four).

A second difficulty is that while debt-to-asset ratios may allow international comparisons (although there are methodological difficulties in doing this), they provide no indication of whether a ratio of, say, 16% is too high, too low or about right. Such ratios also hide the composition of debt by different types of repayments and the number of people with high debt-to-asset ratios.

3. Net worth composition

Examinations of net worth provide greater insights into levels of over-indebtedness than do simple debt composition measures. Net worth is the balance between assets and liabilities. Instead of seeking to encompass this within a single measure (such as the ratio of debt-to-assets), analysis of net worth composition paints a picture of the types of people whose debts outweigh (or are close to outweighing) their assets. Individuals who have negative or low net worth are likely to be among those who are over-indebted or are at risk of becoming over-indebted. This is especially so for individuals whose human capital is low, and thus have limited options and abilities to obtain or restore financial security. Nonetheless, having low or negative net worth is not necessarily the same as being over-indebted.

Statistics New Zealand (2003) found that non-partnered individuals had an estimated net worth of \$91.112 billion, whereas couples had \$257.867 billion. However, there was a considerable gap between the groups with the highest and lowest net worth levels. While the total value held by the lowest decile of all households (decile 1) was -\$3.303 billion, for the highest (decile 10) it was \$194.5 billion. The largest absolute gap was between deciles 9 and 10, where the total net worth doubled. Overall, 215,300 non-partnered individuals had negative net worth (ie, almost a quarter of all non-partnered individuals), while 66,300 couples had negative net worth (around a twelfth of all couples). This means that around 16% of all economic units in New Zealand have liabilities that exceed their assets. A further 316,600 non-partnered individuals had a net worth of between \$0 and \$20,000 (a third of all non-partnered individuals), while 87,800 couples had a net worth of between \$0 and \$20,000 (a tenth of all couples); which is to say that around 23% of all economic units have low (but not negative) net worth.

Although comparisons are difficult, New Zealand's poor seem to hold lower proportions of total net worth than the poor in Canada or Australia. In Canada the bottom 30% of all families by net worth had only 1% of family net worth. In Australia, the bottom 30% (ranked by income) also had 1% of household net worth. In New Zealand, the bottom 30% did not hold any positive net worth. In New Zealand, 16% of economic units had negative net worth, compared to only 6% of families in Canada and 8% in the USA (Statistics New Zealand 2003). Why the proportion of households with negative net worth is higher in New Zealand than in Canada and the USA is not clear.

Tables 5–8 show negative and low net worth by age, ethnicity, highest educational qualification and main source of income. Note that net worth excludes Māori assets, and

that figures for couples are combined net worth. It should also be recognised that other factors are not held constant in these tables. For example, Table 5 on age does not factor in the effect of, say, qualifications or region: thus, the relationships indicated in Tables 5–8 are not necessarily statistically significant. Nonetheless, they do provide a useful foundation for considering possible drivers of over-indebtedness.

Table 5 shows the clear relationship between age and net worth, re-affirming the importance of the life-cycle model in any consideration about levels of over-indebtedness. More than two-fifths of all individuals and couples aged 18–24 have negative net worth. This contrasts with those aged 65 and over, where only 1% of couples have negative net worth and only a further 8% are worth between \$0 and \$20,000. Couples are generally far less likely to have negative or low net worth than non-partnered individuals.

Table 5: Negative and low net worth, by age, New Zealand

Age group (years)	Net worth		Sum (of total net worth in age band)
	Negative Number of people (percentage of age band)	\$0- 20,000	
Individuals			
18–24	118,900 (43)	133,200 (49)	274,100
25–44	77,000 (25)	120,400 (39)	311,900
45–64	*15,300 (8)	35,000 (19)	187,600
65+	**4,100 (3)	*28,100 (18)	157,300
Total	215,300 (23)	316,600 (34)	930,900
Couples			
18–24	*15,300 (43)	*10,700 (30)	35,200
25–44	40,500 (11)	50,500 (13)	381,600
45–64	*9,000 (3)	*16,200 (5)	312,700
65+	**1,500 (1)	*10,400 (8)	126,400
Total	66,300 (8)	87,800 (10)	855,900

Source: Statistics New Zealand 2003

* denotes a relative sampling error greater than 30% but less than or equal to 50% (data should be used with caution).

** denotes a relative sampling error of greater than 50% (data too unreliable for most practical purposes).

..S denotes cell contains fewer than 5 respondents and data not provided.

Note: figures may not add up to totals due to rounding errors.

Table 6 shows the breakdown by ethnic group. Note that, in particular, this table is not age-standardised, and the results are therefore probably skewed by the younger age profiles of the Māori and Pacific populations. Nonetheless, from the raw data at least, Pacific people are more than twice as likely as European/Pākeha to have negative net worth. Māori are slightly better off than Pacific people, but not by much. In terms of median levels of net worth, European/Pākeha couples have \$209,900 compared with only \$34,700 for Māori, and only \$11,100 for Pacific people. There is a more even distribution of net wealth – as measured by the ratio of mean net worth to median net worth – among European/Pākeha than among Māori and Pacific people (Statistics New Zealand 2003).

Table 6: Negative and low net worth, by ethnic group, New Zealand

Ethnic group	Net worth		Sum (of total net worth in ethnic band)
	Negative Number of people (percentage of ethnic group band)	\$0- 20,000	
Individuals			
European/Pākeha	126,200 (19)	193,600 (30)	653,500
Māori	52,400 (34)	68,300 (44)	155,600
Pacific	**19,500 (37)	*21,900 (42)	*52,100
Asian	**11,500 (20)	**29,400 (51)	*57,200
Other	**5,700 (46)	**3,400 (27)	**12,500
Total	215,300 (23)	316,600 (34)	930,900
Couples			
European/Pākeha	34,300 (5)	44,700 (7)	672,500
Māori	16,300 (19)	21,200 (25)	85,500
Pacific	**11,300 (27)	*12,700 (30)	42,100
Asian	**3,600 (9)	**6,500 (16)	39,700
Other	..S	**2,700 (17)	*16,200
Total	66,300 (8)	87,800 (10)	855,900

Source: Statistics New Zealand 2003

See Table 5 for an explanation of symbols used.

Table 7 shows the breakdown by highest educational qualification. This is a useful surrogate for human capital: highly qualified individuals should be better placed to move out of a situation of negative or low net worth than those without such skills (although not all qualifications lead to well-paid, sustainable employment). Nonetheless, at first glance Table 7 appears to be counter-intuitive: negative net worth is more likely to be associated with having a post-school degree than having no qualifications. However, these figures reflect a life-cycle cohort effect. They pick up a high proportion of younger adults who have not been in employment for long and are still paying off debts acquired while students. When it comes to median net worth levels, for couples with a degree this amounts to \$241,800 compared to only \$134,800 for couples with no qualifications (Statistics New Zealand 2003).

Another examination of net worth composition is by main source of income. Similar to highest educational qualifications, this provides a lens through which to identify individuals who are least likely to escape from having low or negative net worth.

Table 7: Negative and low net worth, by highest educational qualification, New Zealand

Highest educational qualification	Net worth		Sum (of total net worth in qualification band)
	Negative Number of people (percentage of highest qualification band)	\$0- 20,000	
Individuals			
No qualification	37,100 (15)	102,200 (40)	254,200
School qualification	76,600 (25)	117,700 (39)	303,700
Post-school qualification	57,400 (25)	53,200 (24)	225,100
Post-school degree	*32,900 (29)	*35,800 (32)	112,200
Other qualification	**10,100 (29)	*7,600 (22)	*34,400
Not specified	..S	-	..S
Total	215,300 (23)	316,600 (34)	930,900
Couples			
No qualification	17,900 (9)	29,800 (14)	209,200
School qualification	*21,700 (9)	29,000 (12)	233,300
Post-school qualification	*14,700 (6)	*16,400 (6)	266,700
Post-school degree	**9,200 (7)	**10,900 (9)	125,200
Other qualification	**2,600 (13)	**1,300 (6)	20,100
Not specified	..S	..S	**1,300
Total	66,300 (7)	87,800 (10)	855,900

Source: Statistics New Zealand 2003

See Table 5 for an explanation of symbols used.

Table 8 shows that a third of non-partnered individuals and couples on income support (other than superannuation) have negative net worth, and a further two-fifths are worth between \$0 and \$20,000. Overall, 84,100 economic units have income support as their main source of money and also have liabilities that exceed their assets: this amounts to a third of the 16% of all New Zealand economic units that have negative net worth. Some 167,800 economic units have wages and salaries as their main source of income and have negative net worth: this amounts to just under two-thirds of all non-partnered individuals and couples with negative net worth. While many of these households may include people with high levels of human capital to resolve their situation, others will not. Determining these proportions would require further unit analysis of the HSS. Very few economic units with New Zealand superannuation as their main source of income have negative net worth. This once again reflects the life-cycle hypothesis, although it should be noted that those older people that do have financial difficulties can suffer particularly adverse outcomes (see Ministry of Social Development 2002).

Table 8: Negative and low net worth, by main source of income, New Zealand

Main income source	Net worth		Sum (of total net worth in income band)
	Negative	\$0- 20,000	
	Number of people (percentage of income band)		
Individuals			
Wages & salaries	121,800 (26)	178,600 (39)	461,700
Self-employment	..S	**6,500 (14)	*45,900
New Zealand superannuation	**4,200 (3)	*25,500 (19)	132,700
Other superannuation, pension and annuities	-	**1,200 (9)	*13,200
Other income support	69,900 (35)	82,500 (41)	198,900
Investment income	-	..S	*18,800
Other regular or one-off income	**5,000 (19)	**8,000 (30)	*27,000
Not specified	**13,000 (40)	**13,900 (43)	*32,700
Total	215,300 (23)	316,600 (34)	930,900
Couples			
Wages & salaries	46,000 (9)	62,600 (12)	512,400
Self-employment	**1,900 (1)	**1,400 (1)	140,800
New Zealand superannuation	**1,300 (1)	*9,900 (10)	101,600
Other superannuation, pension and annuities	-	..S	*10,300
Other income support	*14,200 (30)	*10,400 (22)	47,900
Investment income	-	-	*18,900
Other regular or one-off income	..S	..S	*9,800
Not specified	**2,900 (20)	**2,300 (16)	*14,200
Total	66,300	87,800	855,900

Source: Statistics New Zealand 2003

Table refers to major source of income (before tax) over the previous 12 months.

See Table 5 for an explanation of symbols used.

4. Credit card usage among low-income families

Overall credit card usage is an indicator of levels of indebtedness. However, focusing on their use by low-income families provides an insight into whether or not reported figures are worryingly high, about right or perhaps even too low. One way of determining this is to examine longitudinal changes in the profiles of users. According to Yoo (1997, 1998⁹) three-quarters of American households had at least one credit card in 1995, compared with just under two-thirds in 1983. During the same period, the proportion of people in the lowest income decile group who owned a credit card increased by more than half. Draut and Silva (2003) report that average credit card debt for families earning less than US\$10,000 increased by 84% between 1989 and 2001.

⁹ See also Lee 2002, Zhu and Meeks 1994.

Using data from the US Panel Study of Income Dynamics survey, Wagmiller (2003) argues that the median stock of debt of the very lowest income families doubled between 1984 and 2001. However, his figures also show that these families have actually had falling debt levels since 1994, in contrast to better-off families, whose median stock of debt has continued to increase. Yoo makes the point that increases in credit card ownership for the lowest decile group in the USA between 1983 and 1995 can partly be explained by the very low starting base of 19% in 1983. In 1995 those in the highest income group were still three times more likely to own a credit card than those in the poorest group (see Table 9).

Table 9: Households with credit cards, by income percentiles, 1983–1995, USA

Percentile	1983 (%)	1989 (%)	1992 (%)	1995 (%)
0–10	19	21	26	32
10–20	33	39	42	44
20–30	47	54	66	63
30–40	57	64	68	70
40–50	66	72	67	74
50–60	74	84	82	84
60–70	82	87	88	90
70–80	88	91	90	93
80–90	91	94	94	97
90–100	97	98	96	99
Total survey	64	70	72	75

Source: Yoo 1998

According to Yoo (1998), most of the growth in credit card spending in the USA cannot be accounted for by the increased proportion of households with credit cards. Indeed, in 1998 nearly half of credit cards did not carry a balance, suggesting that many people either pay off their debts every month or else use their credit cards for emergency or occasional use only.¹⁰ Yoo argues that most of the credit card debt increase can be accounted for by higher average debts on credit cards, and this was mostly driven by increased usage among upper-income households.¹¹ In Australia KPMG (2002) argue that credit card debt has remained at a similar proportion of overall household debt over the last decade, and the growth in usage reflects the increased wealth of Australian households.

Yoo identifies an increasing use of credit cards among lower-income households in the USA: these individuals accounted for 39% of the growth between 1992 and 1995, compared to 35% between 1989 and 1992, and only 25% between 1983 and 1989. Data from the US 2001 Survey of Consumer Finances seems to support this trend further. Aizcorbe et al. (2003)¹² report that 76% of families had a credit card in 2001 and that usage increased for those with incomes below the 60th percentile and decreased for those above that line. Likewise, usage increased for non-homeowners and Hispanic families, but decreased for non-Hispanics and those who owned their own home.

¹⁰ For similar findings in New Zealand, see BearingPoint 2003; in the UK see Department of Trade and Industry Task Force on Tackling Overindebtedness 2003.

¹¹ See also Hurst et al. 1998, Lee 2002, Wulff 1988.

¹² See also Draut and Silva 2003.

The growth in credit card balances among low-income families reported by Yoo (1997, 1998) and Draut and Silva (2003) once again raises the question of whether this is “good” or “bad”. According to Bird et al. (1999), there is no evidence that added credit card debt in the US has increased the financial distress of lower-income households. Still, they argue that poor families are far more vulnerable to an economic downturn than they were at the end of the 1980s, and are thus much more likely to become dependent on the social assistance system: “The debt situation of the poor has quietly made the social policy consequences of a recession much more severe” (Bird et al. 1999: 126). If interest rates rise, debt servicing costs will increase, potentially tipping the balance for individuals who can currently manage their debts (although perhaps at a stretch) to them becoming over-indebted. A similar argument is made by the UK DTI task force on over-indebtedness:

The historically high levels of borrowing are ... problematic for only a small number of people at present. 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. (Department of Trade and Industry Task Force on Tackling Overindebtedness 2003: 10–11)

On the other hand, it could be argued that having greater access to mainstream credit means that poor families would be better able to smooth out their consumption patterns; for example, following short-term unemployment or the birth of child. At the very least, they would be less dependent on non-status credit lenders, whose interest charges are often far higher than high-street credit lenders.

5. Credit delinquency rates

Rather than looking at overall credit card usage, an attractive alternative (at least on first appearances) is to examine credit card debt repayment problems. Kennickell et al. (2000, cited in Pyper 2002) report that in the USA the 1998 Survey of Consumer Finances showed that 8.1% of families with debts were 60 days or more behind in a payment at least once a year. The incidence ranged from 15.1% for the lowest income group to only 1.5% for the highest. By 2001, Aizcorbe et al. (2003) show the proportion of families with debts making late repayments had declined to 7%. Although not strictly comparable, Canadian data from the 1999 Survey of Financial Security showed that one in six families where the major earner was aged under 65 fell behind two or more months on a bill, loan, rent or mortgage repayment (Pyper 2002). According to KPMG (2002), only 0.6% of all credit card holders in Australia go into default and only 0.46% pay only the minimum monthly amount required six or more times a year. In the UK, the proportion of consumer credit accounts in arrears has remained static at around 5% of all accounts since 1996 (Edwards 2003). In New Zealand, BearingPoint (2003) found that 1.5% of the total volume of credit card transactions in March 2003 became longer-term (more than 60 days past the due date) delinquent debts. By contrast, 12% of the New Zealand population (25% of beneficiaries) according to the 2000 Living Standards Survey stated that they could not keep up with payments for such things as hire purchase, credit cards or store cards (see also measure 11 below).

Delinquency rates are limited in their usefulness as an overall proxy for over-indebtedness. Falling levels of late payments and defaults could reflect low-income families increasingly being denied credit by mainstream lenders and thus could be an indicator of financial exclusion (see later). KPMG (2002) acknowledge that the low

delinquency rates in Australia may reflect credit card companies' conservative approach to lending, and the exclusion – and arguably over-exclusion – of potentially risky customers. Better profiling of potential delinquent households may push low-income families into more risky and costly usage of credit and perhaps increase dependence on government.

In New Zealand, Baycorp holds the database of consumer credit histories. In a 1999 survey they found that of the 1 million credit inquiries made in the previous six months, 22.8% produced a report with an “adverse” credit record (Baycorp 1999). Thus, almost a quarter of applications for mortgages, credit cards, hire purchase agreements or other credit had been made by people who had failed to meet all their obligations in the past. This report noted that the adverse figure was high by international standards. For example, in the USA adverse rates for consumer credit checks are typically around 10% of enquiries. This may only in part be explained by the strength of credit reporting in New Zealand.

6. Court judgments and mortgage repossessions

Another approach to measuring over-indebtedness is to look at court judgments and/or mortgage repossessions. As with delinquency rates, this offers an insight into end-stage debt problems: debt has become so bad that debtors have been taken to court and have been forced to pay recompense. In England and Wales there was a 36% decrease in the number of county court judgments between 1995 and 2001 (Department of Trade and Industry Task Force on Tackling Overindebtedness 2003). In 1999, 1.76 million summonses for money judgments were issued, 1.71 million of which were default actions (Performance and Innovation Unit 2002). Similarly, mortgage repossessions in the UK decreased by two-thirds from 32,770 in 1997 to 11,970 at the end of 2002 (Edwards 2003). In New Zealand, the comparable figure from the Department for Courts (2003) is that in 2002/03 there were 60,000 to 65,000 applications for distress warrants, orders for examination and other civil enforcement applications actioned. The figure for 2001/02 was 62,000 to 67,000.

Despite the attractiveness of analysing data on court judgments, trends are often misleading due to procedural changes affecting the ease and effectiveness of legal action. For example, in the UK Edwards (2003) suggests that the decline in court judgments may be due to creditors increasingly using “informal” pressure to seek repayments rather than resorting to the court system. This may reflect increases in court costs and a general perception that the enforcement of judgments is inefficient. This has led to the Lord Chancellor's Department (2003) undertaking an extensive review of enforcement policies.

7. Bankruptcy

The ultimate legal outcome of over-indebtedness is bankruptcy, whereby no reasonable prospect of debt repayment is possible and so debts are dissolved under court protection. The stigma attached to bankruptcy (historically this would have led to incarceration in a debtors' prison) as well as the difficulty of obtaining credit afterwards has meant that this has been a measure of last resort (Canner and Lockett 1991). Nevertheless, in England and Wales the number of individual insolvencies increased from 26,271 in 1996 to 29,775 in 2001 (The Insolvency Service 2003). In Canada, Myatt

and Murrell (1998) report consumer (ie, non-business-related) bankruptcies reaching an all-time high. In New Zealand there were 2,672 bankruptcies (of all types) in 2002 compared to 1,883 bankruptcies in 1990; however, there has been a decline since 1998, when 3,224 cases were recorded (Ministry of Economic Development 2003a). Nonetheless, Myatt and Murrell point out that bankruptcy statistics have a strong cyclical component. While business may go bankrupt during a recession, if there were no bankruptcies this could actually be a negative sign if it meant that businesses were unwilling to take risks. Of more concern are consumer bankruptcies (see INSOL International 2001). It should also be noted that changes in legislation can have a major impact on bankruptcy trends. For example, in Canada the 1992 Bankruptcy and Insolvency Act liberalised the conditions for personal bankruptcy. This highlights the difficulties of making international comparisons.

8. Multiple debts

A different approach to measuring over-indebtedness is to use the presence of multiple debts. The DTI Task Force on Tackling Overindebtedness (2003¹³) identified a strong relationship between individuals reporting debt repayment difficulties and being in arrears and having four or more credit commitments (excluding mortgages, and credit or store cards where the balance is paid off by the due date). Kempson et al. (2004) show that in the UK, only 8% of families who owed nothing on consumer credit were in arrears on household bills, but this rose to 23% among those with three or more credit commitments.

In New Zealand, the HSS has broad indicators of the extent to which individuals owe money to different categories of creditors (mortgages, credit cards, hire purchase etc.), but it does not provide information on sub-categories of debt.

9. Utility disconnections

The extent of utility disconnections offers another potentially useful insight into levels of over-indebtedness. Clearly if a person has their gas, water, telephone or electricity cut off then their debts have reached an unmanageable state. However, disconnection trends are often more strongly influenced by institutional policy than by sheer numbers of problems, and can thus be misleading (Herbert and Kempson 1995).¹⁴ There are no published data on utility disconnections in New Zealand, although it should be possible to amalgamate information from the various utility companies. According to the 2000 LSS, 11% of the population could not keep up with payments for electricity, gas or water during the previous 12 months (see also measure 11).

10. Enquiries at budgeting advisory centres

Budgeting advisory organisations play a crucial role in assisting individuals and households to manage their finances, especially when these have reached crisis point. Changes in the number of clients they see provide an insight into levels of over-indebtedness, although this may simply be due to other outside factors such as better

¹³ See Kempson 2002

¹⁴ See also Rowlingson and Kempson 1993.

publicity or increased funding allowing organisations to expand their services (Edwards 2003).¹⁵

The UK's Citizens Advice Bureaux believe that problems relating to personal indebtedness are worsening, with a 24% increase in new enquiries from 1997/98 to 2001/02. Enquiries about consumer credit debts (such as from loans and credit cards) rose by 47% over the same period (Edwards 2003) (see Table 10).

Table 10: New Citizens Advice Bureaux debt enquiries, 1997–2002, UK

Type of debt enquiries	1997/98	2001/02	% change 1997/98– 2001/02
Consumer	465,194	683,677	47
Housing	138,695	125,392	-10
Utility	93,144	90,118	-3
Tax	73,906	75,944	3
Benefits	29,132	38,442	32
Legal	24,896	23,537	-5
Employment	17,072	16,620	-3
Relationship	17,107	12,189	-29
Total	862,019	1,066,509	24

Source: Edwards 2003

The New Zealand Federation of Family Budgeting Services (NZFFBS) is the main group in this country to provide advice to people with debt problems. In Wilson et al.'s (1997) survey of 169 clients who use NZFFBS services, the average total debt (before advice) of beneficiaries was \$4,451 and for wage earners was \$7,979. In their 1995 survey, Wilson et al. (1995) found that one-quarter of beneficiaries and 7% of wage earners were judged to be beyond the capacity of the service to help.

Although the NZFFBS does not formally publish statistics, it does keep updated aggregate records such as of the total number of applications for assistance made and the major categories of debts owed. It has trend data dating back to 1991/92. Staff do acknowledge that data are more robust for the last few years, although even then figures should be treated with caution. The key figure in this account is that in 2002/03 there were 34,990 client applications for assistance.¹⁶ Of these, 8,710 were existing clients whose cases were carried forward and 26,378 were new (12,625 who required on-going assistance and 13,753 who wanted one-off help). However, these figures could include clients who registered for assistance on more than one occasion or in different centres. There is no way to check what proportion of “double-counting” the figure of 34,990 includes, although management at the NZFFBS believe that the majority are separate individuals. Budget advisors report that the vast majority of individuals who seek their

¹⁵ See also Mannion 1992.

¹⁶ A report by the Ministry of Consumer Affairs (2000, cited in Williams and O'Brien 2003) stated that in 1999, 91,700 people applied for budgeting help from the NZFFBS. In fact, this figure does not refer to the number of people who applied for assistance, but rather to separate data collected by the NZFFBS on the total number of contacts made by all their clients (including all visits and telephone conversations); ie, one client could require numerous visits to resolve their situation. The equivalent figure to this for 2002/03 is 274,422, although this figure has little analytical value other than for internal NZFFBS planning.

advice have unmanageable debt problems, rather than being people who simply require generic financial assistance.¹⁷ If each of these applications were from separate individuals from discrete households this would constitute just under 2% of all New Zealand households. This figure should clearly be treated with caution given the unknown quantity of double counting, but it should also be noted that there are other budgeting advice organisations that are not federated with the NZFFBS (particularly in Auckland and Christchurch), and these figures also do not include those people who require help but due to embarrassment or other factors never apply for formal assistance.

Table 11 shows a steady decline in the number of applications, from a peak of more than 50,000 in 1997/98 to just under 35,000 in 2002/03. However, the total amount of arrears presented by new clients has increased, with those individuals requesting budgeting assistance owing more in late payments than ever before.

Table 11: Applications for budgeting assistance to the New Zealand Federation of Family Budgeting Services, 1997/98- 2002/03

	2002/03	2001/02	2000/01	1999/2000	1998/99	1997/98
Number of clients carried forward	8,710	9,683	10,501	10,895	n/a	n/a
New clients requiring ongoing assistance	12,625	13,521	16,217	17,891	24,700	27,803
New clients requiring one-off assistance	13,753	12,220	11,565	11,471	14,847	22,993
Total number of clients	34,990	35,337	38,077	40,214	39,547	50,796
Total arrears of new clients (\$million)	59.8	56.4	50.1	55.8	56.4	43.7

Source: New Zealand Federation of Family Budgeting Services

The NZFFBS data also show that around 70% of their clients are beneficiaries, although there has been an increase in recent years in the proportion whose principal income source at the time they sought advice was wages/salaries. Clients tend to be relatively young, with almost 40% aged between 26 and 35. The NZFFBS does collect some data on the categories of debts owed by a sample of their clients, including debts owed to government, but NZFFBS warns that the high variations in these amounts from year to year mean that these are too unreliable to include without further analysis. However, the surveys of applicants to food banks by the New Zealand Council of Christian Social Services do find debts to government to be significant. For example, their poverty indicator project summary report for the second quarter of 2003 found that more than half of food-bank clients were in debt in five of the seven centres analysed, with debts to the Department of Work and Income particularly significant (NZCCSS 2003; see also Table 25).

¹⁷ Note that in 1999 beneficiaries in New Zealand seeking a third hardship grant from the Department of Work and Income were compelled to see a budgeting advisor. This policy was in place for only a few months before being cancelled, with no evaluation carried out. Forcing individuals to go to voluntary organisations for budgeting advice was seen as counter-productive.

11. Direct surveys of repayment difficulties

Considering the range of difficulties associated with most indicators of over-indebtedness, arguably the most powerful method is to ask people directly whether or not they are facing debt repayment difficulties. This was the preferred approach in Betti et al.'s (2001) cross-comparison of over-indebtedness in European Union countries, using the European Union's harmonised Household Budget Survey and the European Community Household Panel dataset. Betti et al. argue that although their measure is subjective – and thus prone to error due to different people's interpretations of whether or not they are facing repayment difficulties – there does not appear to be a substantial group of people who hide their difficulties from official surveys. Using this method, Betti et al. estimate that in 1996, 23% of all households were indebted, defined as the proportion who had loans other than mortgages. They also estimated that 16% of all households (amounting to 53 million households) were over-indebted, in that they had difficulties repaying loans, including mortgages (see Table 12). Nonetheless, the difficulties of making international comparisons identified earlier also apply here.

Table 12: Indebted and over-indebted households, 1996, European Union

Country	Percentage of indebted households (%)	Percentage of over-indebted households (%)
Austria	15	12
Belgium	18	15
Denmark	43	19
Germany	22	13
Greece	9	49
Spain	19	23
France	33	15
Ireland	29	25
Italy	8	11
Luxembourg	35	12
Portugal	13	13
Finland	29	21
United Kingdom	34	18
European Union-15	23	16

Source: Betti et al. 2001

Columns 2 and 3 are not comparable because they use different data sources. In particular, column 3 includes mortgages, but column 2 does not. This explains why Greece has a greater proportion of over-indebted than indebted households. Sweden and the Netherlands were not included in this table due to lack of data.

The UK task force on over-indebtedness survey (Kempson 2002) found that 24% of all households reported being in some kind of financial difficulties in the previous 12 months and 20% were still in difficulties at the time of the interview. Eighteen percent of households had been in arrears one or more times with their household commitments. Fifteen percent had borrowed money in the previous 12 months to pay off creditors or to make ends meet.

The DTI survey showed that over the previous 12 months as many households escaped financial difficulties as entered them. However, around 7% had been in financial

difficulties for more than a year. The length of time in which households face financial difficulties is likely to be key to the outcomes they experience. Among other factors, households in debt for a long time are likely to have reduced any assets they may have held, potentially making them more reliant on outside assistance, such as from the state or from voluntary sector organisations.¹⁸ Five percent of all households were spending more than 25% of their gross income on consumer credit. Six percent of all households were spending more than 50% of gross income on consumer credit and mortgages. These two measures are both strongly associated with reported levels of financial problems.

A survey commissioned by the Bank of England of just under 2,000 adults found that 10% of debtors reported that their unsecured debt was a heavy burden on their households. Such individuals were most likely to be younger (54% were aged between 15 and 34), to have low incomes (53% earned less than £17,500), to be living in rented accommodation (77%) and to be in a lower socio-economic group (only 11% were classified as having professional or managerial occupations) (Tudela and Young 2003). A similar-sized survey by MORI (2003) for the UK Citizens Advice Bureaux found that 26% of respondents struggle from time to time with keeping up payments and credit commitments (but are currently keeping up with all their requirements), 8% state that it is a constant struggle to do this (but are currently keeping up with all their requirements), and 3% are currently falling behind. Those most likely to be struggling are those with dependent children, as well as younger and unemployed people.

In New Zealand the 2000 LSS did not directly ask questions on over-indebtedness and arrears, but it did include a series of questions that show the proportions of the population facing difficulties in meeting financial commitments.¹⁹ Table 13 shows the proportion of the population, by source of income (those on income-tested benefits, in receipt of New Zealand superannuation and market income), who reported being unable to keep up utility, mortgage or rent, and hire-purchase, credit cards or store card payments. According to the survey, 8% of the population have difficulties making rent or mortgage payments, 11% have difficulties making payments for gas, electricity or water, and 12% are in the same situation in regard to hire-purchase, credit cards or store cards. Table 13 also shows that a far greater proportion of people on income-tested benefits have difficulties with these types of financial commitments than those on market incomes. For example, 30% of beneficiaries stated they could not keep up payments to utility companies and 25% stated this for hire-purchase, credit card and store cards. Only a very small proportion of people receiving New Zealand superannuation (1% or 2%) stated they could not keep up these payments.

Table 14 also shows data on difficulties making payments, but breaks this down by family ethnicity.²⁰ Here – unsurprisingly given their lower income levels – Maori and (in particular) Pacific people are far more likely to state they are unable to meet payments than Europeans.

¹⁸ For a related discussion on poverty, see Alcock 1993.

¹⁹ These data are drawn from cross-tabulations provided by the Centre for Social Research and Evaluation at the Ministry of Social Development: 7,284 people were interviewed in three separate surveys, with figures shown weighted for the total New Zealand population (see Ministry of Social Development 2002).

²⁰ The ethnicity categories are not mutually exclusive; ie, respondents who stated more than one ethnicity are included in the totals for each of these groups.

Table 13: Unable to make payments during the previous 12 months, by income source, New Zealand*

	Percentage unable to keep up payments		
	Electricity, gas or water	Mortgage or rent	Hire-purchase, credit card or store cards
Income-tested benefits	30	20	25
NZ superannuation	2	1	1
Market income	8	7	11
Overall average	11	8	12

Source: Living Standards Survey 2000

* The analysis divided the population into three mutually exclusive groups: (1) those in economic family units where there was receipt of an income-tested benefit in the last 12 months and no-one was in full-time employment at the time of the survey; (2) those in economic family units where there was receipt of New Zealand superannuation; and (3) those in economic family units in neither of the above two categories and therefore receiving income primarily from market sources (see Ministry of Social Development 2002). Note also that Tables 13–15 are not controlled for other potentially influencing factors, particularly income.

Table 14: Unable to make payments during the previous 12 months, by family ethnicity, New Zealand

	Percentage unable to keep up payments		
	Electricity, gas or water	Mortgage or rent	Hire-purchase, credit card or store cards
Maori	23	16	23
Pacific people	28	24	27
Other	6	6	11
European	8	5	8
Overall average	11	8	12

Source: Living Standards Survey 2000

The LSS also included questions to indicate the proportions of people who have had to rely on financial assistance from friends and family, who received food, clothes or money from community organisations such as churches, or pawned or sold something to meet everyday living costs during the previous 12 months. Table 15 shows this data by income source. Those on income-tested benefits were the most likely group to answer in the affirmative to these questions, with 43% stating that they had borrowed money, 24% that they had pawned or sold something and 19% that they had received support from community organisations. For the overall population, around 1 in 6 (16%) borrowed money from friends or family (although this may include a significant proportion of students), 1 in 12 or 13 (8%) pawned or sold something, while around 1 in 20 (6%) required community support.

Table 15: Strategies to meet living costs, by income source, New Zealand

	Borrowed money from family or friends to meet everyday living costs	Pawned or sold something to meet everyday living costs	Received help in the form of food, clothes or money from a community organisation such as a church
Income-tested benefits	43	24	19
NZ superannuation	1	<1	<1
Market income	12	6	4
Overall average	16	8	6

Source: Living Standards Survey 2000

Sixteen percent of New Zealanders also recorded that over the last year they had spent more money than they had received most months, although this would be expected for superannuitants who will be gradually spending assets acquired over their life-course. Fifteen percent of the population (and 47% for those on income-tested benefits) stated that they did not have enough money to meet everyday needs such as accommodation, food, clothing and other necessities.

Overall, the LSS suggests that around 15% of the population have, over the course of a year, some money troubles in that they have had to borrow money from family or friends to meet everyday living costs, are spending more than they are receiving, and believe that they do not have enough money to meet everyday needs. Between 8% and 12% of the population have been unable to keep up payments for their mortgage or rent, and/or to utility companies, and/or to hire-purchase, credit card or store card companies. Six percent stated they had received community assistance in the form of food, clothes or money.

12. Use of government emergency or hardship benefits

A final approach for measuring levels of over-indebtedness is to examine the use of emergency government benefits and loans for low-income families. There is likely to be a relationship between an increased usage of such benefits and levels of over-indebtedness. However, as Mackay (1995) points out, increases in the number of loans distributed most likely reflect changes in government policy. Mackay discusses how emergency payments increased in the early 1990s following cuts in benefit levels. Simmers and McGurk (1999) also argue that the Government will not provide loans to individuals who they consider are unlikely to repay them. As such, individuals who are so indebted that they are considered a poor risk would not be included: according to Simmers and McGurk, they are “too poor to help”.

While trends in government loans is a poor indicator of general trends in over-indebtedness, examining this data still provide useful information about how the state lends money given the sizeable numbers of people involved (see also Part Six). In New Zealand the state provides emergency or hardship assistance in two ways. The first is through Special Benefits, which may be paid as a weekly benefit or as a lump sum. The second consists of assistance that is only available as a lump sum: Special Needs Grants, Recoverable Assistance Programme grants and benefit advances.

Table 16 shows trends in hardship assistance between 1998 and 2003. It includes all benefit advances, all recoverable assistance payments and Special Needs Grants (recoverable and non-recoverable) other than Transition to Work assistance and Student Allowance Transition Grants. It shows an increase in non-recoverable Special Needs Grants given out, from 308,817 in 1998/99 to 382,066 in 2002/03. Recoverable assistance has similarly increased, from 265,242 in 1998/99 to 340,746 in 2002/03.

Table 16: Trends in lump sum or hardship assistance payments, New Zealand

Type of assistance	Number of emergency or hardship assistance payments				
	1998/99	1999/2000	2000/01	2001/02	2002/03
<i>Non-recoverable lump sum emergency or hardship assistance</i>					
Special Needs Grants (non-recoverable)	308,817	341,819	364,053	374,540	382,066
<i>Recoverable lump-sum hardship assistance</i>					
Special Needs Grants (recoverable)	11,278	14,156	14,815	12,993	14,450
Recoverable Assistance programme	3,974	6,833	9,660	12,072	13,017
Benefit advances	249,990	259,349	285,086	298,985	313,279
<i>Total recoverable assistance</i>	<i>265,242</i>	<i>280,338</i>	<i>309,561</i>	<i>324,050</i>	<i>340,746</i>
Total lump-sum hardship assistance	574,059	622,157	673,614	698,590	722,812

Source: Ministry of Social Development 2004

Levels of financial exclusion

In terms of measuring financial exclusion, there is less literature than for indebtedness and over-indebtedness. The high level of applications producing adverse credit reports found by Baycorp (1999, see earlier) suggests that a sizeable proportion of families may have difficulties obtaining credit. Beyond this information source, there are two other principal ways of analysing levels of financial exclusion. The first is to take a macro data approach and look at the development of non-mainstream financial institutions, while the second is to survey households directly on their use, or lack of use, of low-income credit.

1. The prevalence of non-mainstream financial institutions

According to the New Zealand Ministry of Consumer Affairs (1999: 17), the consumer credit market can be categorised into four segments:

- *market segment A*: reasonably large transactions secured against secure and tangible assets (usually mortgages supplied by banks and other mainstream financial institutions)
- *market segment B*: smaller-sized transactions secured against the credit-worthiness of the borrower (eg, mainstream credit cards)

- *market segment C*: moderate-sized transactions secured against less secure assets than housing (typically hire purchase)
- *market segment D*: variable-sized transactions to people with poor credit records or few assets (usually provided by fringe financial institutions).

Measuring the size of market segment D would provide a strong indication of the extent of marginal lending in New Zealand. However, according to the Ministry of Consumer Affairs (1999: 17), “there is no comprehensive information on the size of the New Zealand consumer credit market or of the individual segments.” While this still largely holds true, the Reserve Bank of New Zealand provides some indirect data that are relevant (Thorp 2003). Thorp reports that credit unions have increased their total assets fourfold to about \$400 million from the mid-1980s to the current time, although the actual number of these organisations has declined from over 300 to around 60 during that same period.

Credit unions are co-operative savings and loans clubs. People join together to make regular contributions into a pool of savings and the same individuals can draw on this, at a low rate of interest, when they need to.²¹ Other less official versions of credit unions also exist. For example, Jones (2001) discusses the use of “tonnies” in Liverpool, England, where groups of friends or relations save together and take turns to access the money. In Australia, there are community No Interest Loan Schemes (NILS), which provide credit to low-income families.²²

In addition to not-for-profit organisations, there are also a host of commercial lenders. These non-status finance firms specialise in loans to low-income families, including those with poor credit ratings, who would otherwise not be able to access credit. Such firms typically charge far higher interest rates than mainstream providers, at least in part to cover the greater risks of default among their client group. Given their sometimes *ad hoc* nature, their exact size and usage is difficult to establish. Research on the non-mainstream credit market industry is needed.

2. Direct surveys

A second approach to measuring financial exclusion is through direct surveys. In the UK, the Office of Fair Trading published a survey of vulnerable consumers and their use of financial services (cited in Performance and Innovation Unit 2002, Whyley 2002). This showed that only a quarter of very low-income households used high street credit, but, as a group, they were the most likely to use low-income (non-status) credit (including doorstep credit lenders, pawnbrokers, cheque cashing centres and others, such as illegal loan sharks), albeit only 5% did so. They were also the most likely to use non-commercial credit (such as from family and friends, credit unions and the government social fund), with 15% reporting this (see Table 17).

²¹ For a detailed examination of credit unions, see Berthoud and Hinton 1989, Kelly et al. 1990, McArthur et al. 1993.

²² See, for example, Farrow 1997.

Table 17: Households use of credit, by income, UK

	High-street credit (%)	Low-income credit (%)	Non-commercial credit (%)	No credit (%)
All households	66	2	5	27
Very low income	25	5	15	53
Low income	32	3	8	55
Not low income	82	1	3	15

Source: Performance and Innovation Unit 2002

Berthoud and Kempson (1992) estimated that in the UK, 3% of households use doorstep credit companies or pawnbrokers in the course of a year. In their survey of low-income families, Kempson et al. (1994) found that a quarter of their respondents (of a very small sample of 74 households) had used such facilities and half had done so at some point in their lives. Drakeford and Sachdev (2001) suggest that up to 3 million borrowers in Britain use door-to-door credit facilities. It is worth noting, however, that although such facilities are typically negatively portrayed in the media, many of the respondents in Kempson et al.'s survey found them to be a vital source of credit and often far more flexible in repayments than high-street lenders.²³

While Kempson et al. warn against stereotypical and simplistic images of low-income credit, at the same time they note how such lenders typically charge interest rates far higher than on the high street, with borrowers often unaware of just how expensive are these sources of credit. Interestingly, they found among their interviewees that the use of mail order catalogues to purchase goods was by far the most commonly used method of obtaining credit. Contrary to popular belief, credit unions were used far more by middle- than low-income families. In a similar survey of low-income families in Liverpool, Jones (2001) found an identical pattern. However, in the USA Lee (2002) reports an increase in credit unions' market share of credit cards among the poor: in 1995 only 3% of the poor had credit cards issued by credit unions, but by 1998 this had increased to 12%.

Alongside the use of low-income credit, a broader issue is the proportion of individuals and households that have no financial products at all. As Table 17 showed, more than half of low-income families in the UK make no use of credit facilities, compared to around one in four of all households. In terms of assessing the proportion that do not have a current bank account, Kempson and Whyley (1998) acknowledge that this varies enormously depending on how questions are asked and framed, with estimates in the UK ranging from 14.5% to 23% (although the British Bankers' Association puts the figure as low as 5%, see Drakeford and Sachdev 2001).

In New Zealand there are no published statistics on the proportion of households that do not have a bank account. However, the proportion is likely to be low because beneficiaries require, except under exceptional circumstances, a bank account to receive their payments. The LSS did not directly ask about financial exclusion, but there were two questions on the ability of people to obtain \$1,500 or \$5,000 at short notice because of an emergency. Respondents could include the use of credit cards or borrowing money from family. Table 18 shows that, overall, 17% of the population

²³ For a more detailed examination of these issues, see Rowlingson 1994.

believed they could not obtain \$1,500 in an emergency (51% for those on income-tested benefits) and 36% could not obtain \$5,000 (76% for beneficiaries). This measure also hints at levels of over-indebtedness through the proportion of the population who may have debt levels that are too high to permit them to borrow further.

Table 18: Unable to obtain money at short notice in an emergency, New Zealand

	Unable to obtain \$1,500 (%)	Unable to obtain \$5,000 (%)
Income-tested benefits	51	76
NZ superannuation	12	28
Market income	11	29
Total	17	36

Source: Living Standards Survey 2000

Summary

The Reserve Bank of New Zealand calculates that as at December 2003 New Zealand households owed almost \$106 billion. A comparison with other countries is problematic, but the 2001 HSS suggests that New Zealand is broadly similar to Canada and the USA. Levels of indebtedness are correlated with age, ethnicity, number of dependent children and income.

While measuring indebtedness is relatively unproblematic, determining the proportion of people who have debt but who are having problems meeting their repayment commitments is more difficult. Surveys in Europe and Canada suggest that around 15% of households have some debt repayment difficulties. A survey by the Department of Trade and Industry in the UK – the country that has done the most work on over-indebtedness – found that 18% reported being in arrears one or more times in the previous year and 7% had been in financial difficulties for more than a year. The task force also expressed concerns that historically high levels of indebtedness could result in even greater levels of over-indebtedness should there be an economic downturn or a rise in interest rates.

In New Zealand the lack of direct surveys of over-indebtedness means that it is not possible to confidently assert the proportion of the population who are over-indebted and the sub-set who have a crisis of unmanageable debts. Nonetheless, data from the HSS, the 2000 LSS and visits to budgeting advisors do allow some tentative estimates. These suggest that the pattern in New Zealand may be broadly similar to that in other OECD countries. A working assumption is that up to 15% of New Zealand households may be over-indebted (in the sense of struggling to meet their financial commitments to pay their debts) at some point during a 12-month period, a third of whom may have longer-term problems requiring external intervention.

Measuring financial exclusion is even harder than estimating levels of over-indebtedness. Given the increasingly sophisticated credit rating procedures of banks and credit card companies, it is likely that lack of access to affordable credit is a significant issue. In New Zealand there is limited data to measure financial exclusion. However, given that beneficiaries require a bank account to receive their payments, the proportion of households without banking facilities is likely to be small. Data from the 2000 LSS,

however, suggest that 17% of the population could not obtain \$1,500 in an emergency (including borrowing money from credit cards or family members) and 36% could not obtain \$5,000.

Part Three: Reasons for Debt Problems

Social policy approaches designed to deal with over-indebtedness and financial exclusion require an appreciation of the reasons why some people have problem debts. Interwoven with this is the question of what types of individuals are most likely to be in this situation. Within the literature there are five broad explanatory approaches, based on:

- demography and education
- income levels and housing tenure
- life events
- over commitment and money management skills
- structural factors, such as credit-lending practices and the role of government.

These factors inevitably overlap, with debt problems often having multiple, interrelated causes. As Berthoud (1989) and Parker (1990) warn, simplistic stereotypical explanations should be avoided.

Demography and education

The life-cycle hypothesis (see Part One) predicts an inverse correlation between levels of indebtedness and age. Not surprisingly, the same relationship applies to problem debts. For example, in the USA Canner and Lockett (1991)²⁴ note that households headed by someone under the age of 35 are four times as likely to report repayment problems as those headed by someone over the age of 55. However, Draut and McGhee (2003) report that credit card debt for people aged 65 and over increased by 89% between 1992 and 2001, and by 217% for those aged 65–69. In Canada, Pyper (2002) uses data from the 1999 Survey of Financial Security to show that young people are more likely to fall two or more months behind in a bill, loan, rent or mortgage payment than older people. In the UK, Parker (1990) acknowledges the links between age and over-indebtedness, but also notes the importance of having dependent children. Kempson et al. (2004), using the 2002 Families and Children Study in the UK, reports that 18% of families with children had arrears, rising to 22% for those with three children and 31% for those with four or more.

In New Zealand, a survey of over 1,000 bankruptcies reveals that 50% of these between 1997 and 1998 were for people aged between 25 and 40, compared to only 28% for those aged between 41 and 55 (see Table 19). A VISA-sponsored survey of credit card use in New Zealand also found that younger people were the most likely group to fall behind in their payments and to consistently pay interest on outstanding balances (BearingPoint 2003).

²⁴ See also Canner et al. 1995, Zhu and Meeks 1994

Table 19: Sample of bankruptcies, 1 July 1997 to 30 June 1998, New Zealand

Characteristic	% of total bankruptcies
Aged 25–40	50%
Aged 41–55	28%
Married/ de facto	48%
In business during 2 years before bankruptcy	20%
Employed	30%
Receiving Income Support	50%
Bankrupts owning credit cards	Males 30% (48% of whom owned 2 or more credit cards) Females 31% (62% of whom owned 2 or more credit cards)
Second time bankrupts	6%

Source: Ministry of Economic Development 2003b

Educational attainment and marital status are also strongly associated with debt problems. For example, Sullivan (1982, cited in Tokunaga 1993) compared 1,199 people in the USA filing for bankruptcy with 1,254 people with debt but not in financial difficulty and showed that the former were more likely to be younger, to be single or divorced/separated, and not to have a tertiary education. Pyper (2002) similarly acknowledges that those less educated and not married are more likely to have debt problems. In the UK, Edwards' (2003) survey of 900 clients of Citizens Advice Bureaux showed that clients were more likely to be of working age than to be pensioners. Also in the UK, the Office of Fair Trading report on financially vulnerable consumers (cited in Performance and Innovation Unit 2002) shows a very strong relationship between education levels and the use of non-mainstream credit (see Table 20).

Table 20: Use of credit, by education level, UK

Highest educational level	High-street credit (%)	Low-income credit (%)	Non-commercial credit (%)	No credit (%)
Degree/higher degree	92	–	8	7
Higher Education (below degree)	86	2	2	10
A level or equivalent*	74	1	6	19
O level / GCSE (A–C) or equivalent**	81	1	6	11
GCSE (D–G) or CSE (2–5)***	66	3	13	18
Other	70	1	4	25
No qualifications	43	2	4	49

Source: Performance and Innovation Unit 2002

* Advanced level qualifications, often taken at age 18.

** Ordinary level or General Certificate of Secondary Education (which replaced O levels), usually taken at the end of compulsory education at age 16.

*** Certificate of Secondary Education (replaced by GCSEs)

The links between gender and over-indebtedness are also discussed in the literature. In the UK, Morris (1996) notes how women are more likely to pawn goods than men, and

Edwards (2003) comments that women are more likely than men to have debts from catalogues and from door-to-door money lenders. From a New Zealand legal perspective, Bailey (1999) discusses how women are far more likely than men to act as “security” for a loan taken out by their partner (“the principal debtor”). This means that if the principal debtor defaults, the security becomes liable. Women are more likely than men to take on this role due to emotional pressure, rather than because of any potential commercial or financial advantage. If a relationship breaks up, the security is still liable. Bailey uses the term “sexually transmitted debt” to describe this phenomenon.

There is also some discussion within the literature of the links between ethnicity, culture and levels of indebtedness. Herbert (1996) reports that in the UK low-income African–Caribbean households have broadly similar patterns of credit use to low-income households in general. However, among Pakistani communities, attitudes influenced by Islamic teachings (which prohibit usury) affect their use of credit. Among this group the use of high-street credit was low, and there was a preference for local sources of interest-free credit.

In New Zealand, Williams and O’Brien (2003) raise the issue of cultural pressures to borrow money, especially for people from Pacific communities. Williams and O’Brien’s survey was based on eight case studies of low-income families with debt problems. While these case studies may not necessarily be representative, they do indicate the impacts of unmanageable debt and possible reasons why people fall into this state. The authors argue that:

The results demonstrate aspects of culture to be significant in structuring debt and poverty dynamics. One example was the misfit between the cultural systems of Pacific people’s households and the cash economy and credit market in Aotearoa [New Zealand]. (Williams and O’Brien 2003: 39)

One of their case study interviews spoke of borrowing money to pay for consumer items for relatives in Samoa and paying for relatives to visit the family back home. Williams and O’Brien also raise the significant issue of social pressure in Pacific communities to support churches. They argue that supporting churches is linked to social standing, with competition to pay significant amounts to these institutions.

Income and housing tenure

In addition to demographic characteristics, income and housing tenure are also strongly associated with debt problems. Effectively, debt problems are the result of inadequate income in relation to expenditure needs and demands. Thus, Lea et al. (1995: 700) argue that:

When we come to consider the causation of [over-indebtedness], the best hypothesis is that this entire pattern has its origins in economic factors. The key economic variables ... show that [over-indebtedness] is primarily found among people looking after families on low incomes in insecure housing.

Or in the words of Parker in the UK (1990: 201):

Of all the relationships uncovered in the research project, none was more striking than that between [over-]indebtedness and low relative income. It was hard to escape the conclusion that for “primary” debtors, at least, a low income relative to need was the direct cause of [over-]indebtedness, compounded by reliance on expensive credit and fuel.

Income was also raised as the strongest factor in Williams and O'Brien's (2003: 14) study, in which they state: “Debt and poverty are inextricably linked, as living [in] a state of poverty makes people particularly vulnerable to incurring debt.” Williams and O'Brien highlight other factors that may contribute to debt problems, such as the effects of government policies (see later) and personal factors (such as family support structures), but they nonetheless see poverty as the primary driver. BearingPoint (2003) note how those with the lowest credit card limits (\$2,000) were almost eight times more likely to have their credit cards “turned off” than those with the highest credit limits (greater than \$21,000).

Writing in the UK, Parker (1990: 201) warns that “poverty was not always the *whole* explanation, nor should debt be seen as a necessary consequence of poverty.” According to Berthoud (1989: 28), “[over] indebtedness tends to affect families which have *both* low incomes *and* children; among families without children, low income does not seem to make much difference.” Rowlingson and Kempson (1993) and Herbert and Kempson (1995) point to a well-established relationship between utility debts and low income, although this was linked with factors such as age of consumers as well as companies' attitudes to collecting monies owed. Similarly, in their seminal survey of credit and debt, Berthoud and Kempson's (1992) respondents gave insufficient and reduced income as the primary reasons for their debt problems, although several other important factors were listed (see Table 21).

Table 21: Reasons for debt, UK

Reason for debt	Percentage
Insufficient income	25
Reduced income	26
Changes in circumstances	7
Over-commitment	24
Unexpected bills	10
Overlooked payments	8
Withheld payments	8
Creditor action	7
Benefit problems	5

Source: Berthoud and Kempson 1992

Kempson et al. (2004) show that in the UK, the level of arrears was higher among families whose gross incomes were between £7,500 and £15,000 a year than it was amongst the very poorest families earning less than £7,500 (34% compared with 26%). The authors think that this may be attributed to a degree of mis-measurement of incomes or it could reflect differences in housing costs. Only 11% of families earning £35,000 or more were in arrears.

Housing tenure has also been independently linked with debt problems. Kempson et al. (2004) report that in the UK DTI survey of over-indebtedness 36% of tenants were in arrears compared to 15% of homeowners. Homeowners were just as likely to be in arrears on consumer credit commitments as they were to be behind with household bills. However, tenants had a higher level of arrears in household bills than in consumer credit. Bridges and Disney (2004) show that in the UK, 22% of low income tenant couples were unable to keep up repayments on their loans, compared to 12% of home-owning couples. Low income tenant couples were almost four times more likely to have loans from a finance company they could not afford to repay than was the case for home-owning couples.

Life events

A third potential factor that may explain why certain individuals have debt problems is the occurrence of adverse or shock life events. The impact of these events will be affected by their severity, whether they act in combination with other factors, and the particular point in people's life cycle in which they occur. A hypothesis is that low-income families in particular may be able to manage on benefits or low wages, but they are unable to smooth out their consumption patterns in the event of exogenous factors such as pregnancy and the birth of children, loss of employment, death of a partner, illness, or the onset of disability. The literature on this is somewhat contradictory, with no clear consensus on the importance of life events as a driver of over-indebtedness.

In the USA, Agarwal and Liu (2003) discuss the considerable debate as to whether or not unemployment rates are linked to credit card delinquency and bankruptcy. Using a very large sample of 700,000 credit card customers, they argue that county unemployment rates are critical in determining delinquency and bankruptcy.

In Australia, half of the respondents in Ryan's (1992) study of bankrupts gave change in circumstances as the reason for their financial difficulties. Similarly, KPMG (2002) cite figures from the Australian Insolvency and Trustee Service stating that 41% of personal bankruptcies are due to unemployment, 17% to domestic discord and 11% to ill health.

In the UK, two of the six main reasons given by respondents for their financial difficulties in Parker's (1990) survey were loss of the main breadwinner's job and sickness or death of the main breadwinner. Edwards (2003) similarly reports that the most common reasons for seeking budgeting assistance in the UK were job loss, ill health and relationship breakdown. The UK DTI over-indebtedness survey shows that people who had experienced a fall in income in the past 12 months had twice the risk of arrears compared with those whose incomes had remained unchanged (Kempson et al. 2004). However, two-thirds of families whose income had dropped had not fallen into arrears. Moreover, a rise in income was not associated with a reduced level of arrears. Interestingly, the survey showed that, all things being equal, lone parents were no more likely to be in arrears than two-parents families and factors such as separation or having a new baby were not statistically significant.

In addition to general research on debt, there are specialist studies that further suggest the power of sudden life events to cause debt problems. For example, Grant (1995) argues that the onset of disability is often linked to debt because of a sudden drop in income and because financial concerns tend to be neglected at times of personal crises.

Gordon and Pantazis's (1997) Breadline Britain survey found that those with disabilities were no more likely to be in debt than other low-income individuals (although this is likely to be influenced by the older age profile of those with disabilities). Wilcox (2000) found that British women leaving violent relationships were often over-indebted. This was sometimes due to the costs of re-establishing themselves, but also because of the bills that had been in their names from their old relationships. Reading and Reynolds (2001) surveyed 271 families and found a very strong link between maternal depression and worries about debt, while the DTI Task Force on Tackling Overindebtedness (2003) notes the association of the arrival of a new baby and the setting up of a new home as times of major financial difficulties.

In contrast to the evidence that life events are strongly associated with debt problems, in Berthoud and Kempson's (1992) study (see Table 21 above) only 7% of respondents considered that changes in circumstances explained their debt problems. In Rowlingson and Kempson's (1994) study, 14% of respondents listed changes in circumstances as a reason they defaulted on their credit card payments. In New Zealand, Wilson et al.'s (1995) survey of the New Zealand Federation of Family Budgeting Services suggests that gradual factors are the primary determinants of individuals' debt problems:

Unexpected events, involving either loss of income or increased expenses, were regarded as relatively uncommon reasons for clients seeking budget advice. This would suggest that clients' financial difficulties generally arise from gradual accumulation of debt rather than sudden unfavourable events. While budget advisors report that one-off events (such as the final demand on an electricity account) are often the immediate causes of clients seeking budget advice, it is usually a lengthy accumulation of debt and worsening financial situation which turns such events into crises which necessitate budget advice. (Wilson et al. 1995: 114)

In her study of Citizens Advice Bureaux in the UK, Edwards (2003) suggests a middle ground between those who consider that life events are crucial determining factors and those who do not.

A high proportion of clients reported a change of circumstances involving loss of income or increased expenditure as a reason for debt. However when the actual financial effects of these changes were ascertained, in a significant proportion of cases the amount of change in income expenditure was relatively small, around 10 percent of annual income. This suggests that ... a relatively small change turned what were previously manageable payments into debt problems. (Edwards 2003: 3)

From a US perspective, Tokunaga (2003) points out that explanations are sometimes driven by philosophical approaches surrounding who is to blame for debt problems.

In reviewing the literature on credit use, people with credit problems have typically been portrayed in one of two extreme ways. The first is that they are willingly and intentionally abusing their financial obligations, the second is one of an unlucky person stricken with an adverse life event who uses credit extensively because of a weak financial situation ... The "truth" ... appears to be somewhere in the middle. (Tokunaga 2003: 309-10)

Over-commitment and money management skills

Tokunaga (2003) argues that an alternative approach to considering problem debtors as “unlucky” is to assume individuals have responsibility for their predicament. For example, Cameron and Dolby (1991), in their study of case records of Citizens Advice Bureaux (CABx) in Staffordshire, England, argue that:

... the most powerful explanation of the level of debt appears to be the degree of self-control (as captured by the over-commitment variable), a factor not normally included in studies of household behaviour ... Qualitative evidence, from our research, indicates a sharp contrast with *homo economicus* type of behaviour. Individuals often take on other debts, at penurious interest rates, in order to pay off some of their existing creditors. CAB counsellors have told us that individuals shut their eyes to their predicament to the extent of not opening bills which arrive. (Cameron and Dolby 1991: 310–312)

Lea et al. (1995) researched the differences between 583 non-debtors, mild debtors and serious debtors of a UK utility company and noted that:

Non-debtors had more money management skills and facilities (eg, bank accounts) than debtors, and rated their abilities at money management more highly. Debtors had shorter time horizons than non-debtors. Debtors were more likely to buy cigarettes and Christmas presents for children than non-debtors. (Lea et al. 1995: 681)

Of all the explanations provided by clients of Citizens Advice Bureaux in the UK for their debt problems, over-commitment was the most widely given, although multiple factors were also often blamed. Note that very few respondents gave alcohol and drug addiction as reasons for their debt problems, and gambling was not provided as an option (see Table 22).

The DTI Task Force on Tackling Overindebtedness (2003) identifies irresponsible borrowing as a factor behind levels of debt problems: 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 repaying the money will be a struggle; and impulsive shopping and credit card use by people 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. The task force identified three overall factors that were most commonly correlated with being in financial difficulty: having four or more credit commitments (ie, outstanding consumer borrowing, but excluding mortgages, and credit and store cards that are unused or paid off by the due date); spending more than 25% of gross income on consumer credit; or spending more than 50% of gross income on consumer credit and mortgages.

Table 22: Reasons for debt problems given by Citizens Advice Bureaux clients, UK

Reasons for debts	No. of times reason mentioned	% of responses	% of clients giving this reason
Over-commitment	235	16.5	29.7
Job loss	208	14.6	26.3
Low income	185	13.0	23.4
Illness	168	11.8	21.3
Relationship breakdown	160	11.2	20.3
Money mismanagement, budgeting problems	100	7.0	12.7
Major necessary expenses	90	6.3	11.4
Benefit problems	79	5.5	10.0
Drop in income	72	5.1	9.1
Fault of others	49	3.4	6.2
Business-related problems	43	3.0	5.4
Death in the family & death expenses	21	1.5	2.7
Alcohol & drug addiction	14	1.0	1.8
Total	1,424	100.0	180.3

Source: Edwards 2003

Cameron and Dolby (1991) attempt to explain why certain individuals may become over-committed and give as possible reasons cognitive errors (ie, the limited information-processing capacity of the human brain means that people may make bad choices) and motivational errors (eg, people having a particular image of themselves they want to maintain, despite their financial circumstances). In a later article, Cameron (1994) notes that psychologists tend to explain debt problems in terms of personality traits or compensation for past experiences. Such explanations typically involve either some notion of “deviance” (eg, suffering from a high level of obsessiveness-compulsiveness or an addictive personality) or else cognitive dissonance (“this can’t happen to me”). Cameron links these explanations to popular media conceptions about a “culture of indebtedness”, an explanation he partly supports. Similarly, Lea et al. (1993)²⁵ found strong associations between over-indebtedness and psychological factors.

Social and psychological factors were ... found to be related to debt: Serious debtors were less likely to claim Nonconformist, Agnostic or Atheist religious views, and they had slightly more permissive attitudes towards debt, although no group showed a general tendency to approval of debt. They knew more other people who were in debt, and they were less likely to think that their friends or relations would disapprove if they knew they were in debt. (Lea et al. 1993: 85)

²⁵ See also Livingstone and Lunt 1992.

In New Zealand, a survey conducted by Statistics New Zealand of 6,542 adults indicates that a small but significant proportion of the population has gambling problems (Abbott and Volberg 2000).²⁶ Using an official psychiatric definition of pathological gambling as a chronic or chronically relapsing mental disorder, Abbott and Volberg estimated that between 15,400 (0.6%) and 30,700 (1.1%) of New Zealand adults are current problem gamblers, and that an additional 7,300 (0.3%) to 20,100 (0.7%) can be classed as current probable pathological gamblers. Nonetheless, these authors stress that their methodology has high rates of false negatives, so the actual level of problem gambling is likely to be higher. Current problem gamblers account for at least 19% of total reported gambling expenditure, which, according to Department of Internal Affairs statistics, amounted to \$1.3 billion in 2000 (Australian Institute for Gambling Research 2001).

Over-commitment explanations imply individual failings for their own debt problems. However, an alternative approach is to blame money management skills and/or vulnerable individuals being duped by unscrupulous creditors. For example, Richard Syron (1993), president of the Federal Reserve Bank of Boston, reported to the US Subcommittee on Consumer Credit on issues of second mortgage abuses, when households borrow money they cannot afford to repay (often for the purposes of home improvement) and end up defaulting and thus losing their homes. Syron (1993: 279) reports that “some unsophisticated residents, frequently unaware of the value of their assets, fell prey to unregulated and aggressive loan brokers and home improvement contractors.” Similar scams have also occurred in New Zealand through housing buy-back schemes (see later).

Literacy issues and the fear of dealing with financial institutions are highlighted by Aizcorbe et al. (2003), who analysed data from the 2001 US Survey of Consumer Finances. This showed that more than a fifth of respondents did not like dealing with banks, and 6.6% considered they could not manage or balance a cheque account (see Table 23).

Table 23: Reasons for families not having a checking account, USA

Reasons for not having a checking account	Percentage
Do not write enough checks to make it worthwhile	28.6
Minimum balance is too high	6.5
Do not like dealing with banks	22.6
Service charges are too high	10.2
Cannot manage or balance a checking account	6.6
No bank has convenient hours or location	0.4
Do not have enough money	14.0
Credit problems	3.6
Do not need/want an account	5.3
Other	2.1
Total	100.0

Source: Aizcorbe et al. 2003

In Australia, the ANZ bank has published findings from a telephone survey of 3,548 adults and their financial literacy skills (Roy Morgan Research 2003). This found that

²⁶ See also Dyal 2004.

80% believed they were well informed when making a financial decision and 90% said they knew how to use common payment methods such as cheques, EFTPOS and credit cards. The lowest levels of financial literacy were associated with people having low education levels, who were not working or were in unskilled work, had low incomes, had low savings levels, were single, and were either younger (aged 18–24) or older (aged 70 years or above) than the average.

In the UK, a 2001 study for the Basic Skills Agency showed that 11% of people were unable to divide an annual bill of £120 into quarterly payments. Of those unable to do this, 8% had a life assurance policy and 46% had a savings account (Edwards 2003).

In New Zealand, 46% of the population aged 16–65 do not have prose skills at IALS Level 3 (an international standard considered the minimum required for individuals to meet the complex demands of everyday life and work in the emerging knowledge society). Fifty percent do not have quantitative skills – which includes some questions on every-day financial transactions – at IALS Level 3 or above (Ministry of Social Development 2003a).

Wilson et al.'s (1995)²⁷ survey of budgeting assistance in New Zealand suggests that money management is a considerable component of over-indebtedness. Following budget advice, 64% of those that had sought advice had developed a workable budget within three months, and a further 14% had developed interim budgets by the end of this period. Before advice, both beneficiaries and wage earners were on average spending \$20 more each week than they received in income. After advice, beneficiaries' weekly surpluses were \$17 and for wage earners the figure was \$33. For beneficiaries 60% of this change was attributable to increased earnings and 40% due to decreased expenditure; for wage earners these proportions were reversed. For beneficiaries most of the change in income was due to increased wages, although a fifth could be accounted for by increased benefits. For wage earners, a quarter of the change in income was due to more wages, but almost two-fifths was due to increased benefit payments, suggesting that low-income wage earners were not accessing all their entitlements (see also below).

Structural factors

A final explanation discussed in the literature for debt problems relates to structural factors, particularly irresponsible lending and the role of government. Cameron (1994) argues that debt problems are an inevitable part of the capitalist dynamic in which a certain proportion of individuals will inevitably encounter problems. However, there are also criticisms of unfair institutional practices. In the UK the DTI task force on over-indebtedness (in addition to blaming irresponsible borrowing, see above) identified evidence of lenders implicitly or explicitly encouraging debt problems; for example, by automatically raising limits on credit and store cards and on overdraft limits, encouraging people to transfer balances on credit cards, offering low initial interest rates and higher credit limits, reducing minimum payment on credit cards, and issuing cheques that can be used to draw on credit card accounts. According to Sullivan (1982, cited in Tokunaga 2003: 288), 28% of his sample of over-indebted respondents in the USA believed that "credit had been too easy to obtain".

²⁷ See also Wilson et al. 1997.

In New Zealand, as in other countries, the government has a significant role as a collector of monies owed; for example, through the collection of court-imposed fines, child support payments and arrears and tax debts (to Inland Revenue Department), housing arrears (to Housing New Zealand Corporation) and recoverable grants and advances of benefits (to the Ministry of Social Development). Understanding such debts requires specialist research that is largely beyond the scope of this study (although see Part Six). Nonetheless, debts to government have been identified in some of the more general studies. Wilson et al. (1997) identified debts to Inland Revenue and courts as a small, but significant, factor behind why individuals sought budgeting assistance (see Table 24).

Table 24: (Major) debts of New Zealand Federation of Family Budgeting Services' clients in arrears, before budgeting advice

Type of debt	Beneficiaries (% of total debts in arrears)	Wage earners (% of total debts in arrears)
Rent arrears	10.9	1.4
Credit cards	10.4	3.8
Telephone	10.2	4.7
Appliance loans and arrears	6.5	5.1
General (incl. personal loans)	6.5	19.7
Mortgage arrears	5.1	23.6
Electricity	4.9	2.6
Vehicle loans & arrears	3.9	5.5
Inland Revenue	3.9	4.4
Vehicle maintenance	3.4	9.9
Justice Department / District Court	3.1	4.6
Other	31.2	14.7
Total	100.0	100.0

Source: Wilson et al. 1997

The study by Berkana Consulting Services (2002) on non-current beneficiaries (ie, individuals who were on benefit but are now in paid employment) also identified debt to government departments (such as the Inland Revenue Department and courts) as one of three factors that triggered financial crises (the others being basic living costs, and hire purchase and credit card debts). Of those who incurred debts to Work and Income, 34% stated that it was due to Work and Income making a mistake and overpaying their benefit; 27% were late telling Work and Income they had a job; 23% had received a recoverable grant (monies to cover emergency needs or essential large items, but which have to be repaid); and 23% had received an advance on their benefit.

The 1999 report by Simmers and McGurk for the Wellington Downtown Community Ministry argues that Work and Income is a major contributor to why many low-income families become debtors. They argue that a significant amount of supplementary assistance is paid not as a grant but as a loan: "people receive help by becoming debtors" (Simmers and McGurk 1999: v). In addition, they argue that low benefit levels (especially following benefit cuts in 1991) are compounded by the aggressive recovery of

loans and the lack of national guidelines for the recovery of these debts. The lack of benefit take-up by certain groups has also been identified by the Ministry of Social Development (2003b) in its *Statement of Intent*.

The Department of Labour and Ministry of Social Development's (2002) evaluation of the 1999 Domestic Purposes Benefit and Widows Benefit reforms suggested that one factor that may explain sole parents getting into debt was that they were not receiving financial entitlements from Inland Revenue after taking up part-time work. The report raised concerns that Inland Revenue was taking too long to process applications for Family Assistance, especially as these were from a client group who had minimal financial reserves and consequently needed to make immediate claims. Many of these issues are being addressed by the Future Directions, Working for Families package announced by the Government in Budget 2004.

The New Zealand Council of Christian Social Services produces quarterly reports from its Poverty Indicator Project of applicants to food banks in seven locations across New Zealand. For example, its second quarter report of 2003 (New Zealand Council of Christian Social Services 2003) identified a significant proportion of users with debts to government departments. Debts to Work and Income made up the highest proportion of these, ranging from 16% of applicants in Hamilton to 74% in Christchurch (see Table 25).

Table 25: Debts of applicants to food banks, New Zealand

	Southland	Otago	Christchurch	Wellington	Palmerston North	Hamilton	Manukau
% in debt	38	73	90	70	81	18	75
% in debt to Work and Income	22	56	74	52	51	16	51
No. with repayments to Work and Income >\$40/ week	0	5	5	0	11	3	10
% in arrears on utility bills	8	36	84	23	25	8	60
% in arrears with electricity bill	7	27	81	17	16	6	47

Source: New Zealand Council of Christian Social Services 2003

Finally, there may well be an issue of student over-indebtedness. That is, there may be a variety of longer-term effects of student debts; for example, on the ability of younger adults to purchase their own home. However, as the Auditor General's (2000)²⁸ report noted, there is very little information about this, and a detailed analysis of student debts is beyond the scope of this literature study.

²⁸ See also Boddington and Kemp 1999.

Summary

There is considerable debate and little consensus in the literature about the reasons why certain individuals fall into debt problems, while others – sometimes in similar circumstances – manage much better. This said, most surveys acknowledge the very strong associations between debt problems and people's demographic and economic profile. Households that are most at risk include those that have low incomes, few financial and human assets, are tenants rather than homeowners, are non-partnered, and where there are dependent children: in short, the types of individuals who are most likely to be in financial hardship. The extent to which problem debtors are the victims of life events, structural failings or are facing problems because of poor money management skills is not clear from the literature and requires further research. Factors such as gambling, alcoholism or drug addiction as causes of over-indebtedness are barely considered in the mainstream debt literature, despite the significant proportions of the New Zealand population these affect.

Part Four: Impact of Debt Problems

So far, this literature study has set the context for household over-indebtedness in terms of likely size and scope and the possible reasons why some people find themselves with debt problems. This part of the report discusses the impact of debt and therefore reasons why the issue is of concern to policy makers and others.

Within the sizeable body of literature on household debt problems, research on the impact of debt is surprisingly limited. Few empirical studies have been carried out, and so while there is little dispute that debt problems are associated with a range of negative consequences, firm evidence of these is lacking. For example, in New Zealand the lack of publicly available data on the socioeconomic impacts of student loans was made by the Auditor General (2000).²⁹ It is also difficult to determine cause and effect; for example, poor health might result from having debt problems, but it may also contribute to this through limiting access to good-quality employment. Attempting to separate the impacts of debt from those of poverty and low income more generally is also extremely problematic.

Within the literature four broad (but overlapping) categories of the impact of debt are raised:

- financial hardship
- poor health (physical and mental)
- family stress, stigma and social exclusion
- barriers to employment.

However, it should be noted that the debt avoidance strategies of some individuals – such as living in over-crowded households to reduce expenditure, or partaking in criminal or socially undesirable behaviour – could have negative outcomes that are as bad, or worse, than having debt problems *per se*. Edin and Lein (1997) discuss such strategies for single mothers managing on welfare in the USA, but there is no specific literature on this in relation to debt.

Financial hardship

The first, and most obvious, impact of debt problems discussed in the literature is financial hardship. In Waldegrave et al.'s (1999)³⁰ survey of 401 low-income families, respondents referred to debt as a burden that constrains them and makes it very difficult to move out of poverty (see Table 26).

In the UK, the Performance and Innovation Unit (2002) notes how over-indebtedness can lead to a reduced standard of living, with some poor families apparently spending over 90% of their disposable income on paying their debts. At the same time, the report notes that debt problems also have a negative impact on creditors: through defaults and bankruptcies creditors lose at least £600 million a year through unpaid civil judgment debts. In addition, while civil court costs are generally passed on through fees – thus

²⁹ See also Baldwin et al. 1995.

³⁰ See also Povey 2002.

further adding to the financial problems of debtors – the taxpayer also foots some of the bill through payments of public funds for civil cases (amounting to around £60 million per year). Thus, as well as potential benefits for individual debtors, there may be financial incentives for government and creditors to improve the current system of debt enforcement and collection.

Table 26: Difficulties paying household running costs due to debt, New Zealand

Difficulty	Number	% of total sample
Very difficult	82	20.4
Quite difficult	108	26.9
Not very difficult	51	12.7
Not at all difficult	16	4.0
<i>Total with debts</i>	257	64.1
<i>Total without debts</i>	143	35.7
<i>Don't know</i>	1	0.2
Total	401	100.0

Source: Waldegrave et al. 1999

Other financial impacts of debt problems that can occur (at least in some countries) are disconnections from utility services, such as gas, water and electricity (George 1993, Herbert and Kempson 1995, Rowlingson and Kempson 1993). Zhu and Meeks (1994) in the USA point out that being over-indebted means that individuals are less likely to be able to borrow money and to have a decent credit rating. As such, they may end up deeper in debt due to the far higher costs of borrowing from non-status lenders.

Drakeford and Sachdev (2001) point to a Joseph Rowntree Study that showed how those with low incomes in the UK may not be able to afford insurance and are therefore unable to replace items lost or damaged by fire, theft or flood. Such issues, and many others such as lack of money to buy food or heat homes,³¹ are similar to more general issues of financial hardship. Nevertheless, it is worth noting Ryan's (1992) survey of 76 un-discharged bankrupts in Melbourne, Australia. He notes that although debt can have a range of negative outcomes, the financial end stage of over-indebtedness (ie, bankruptcy) can actually be a far more positive experience than the stages leading up to this.

Bankruptcy was a much less traumatic experience (both emotionally and financially) for the respondents than may have been thought. Only a minority of respondents experienced deleterious financial effects, with small numbers of respondents having goods repossessed or seized post-bankruptcy ... Most respondents were positive about their bankruptcy: 77 percent said that it had improved their financial position, 59 percent reported that it had improved their health, 60 percent of married respondents noted an improvement in their marriage and 82 percent reported that it had a positive effect on their family. (Ryan 1992: 223–224)

³¹ See, for example, NCH 1992, Gordon and Pantazis 1997, Ministry of Social Development 2002.

Health

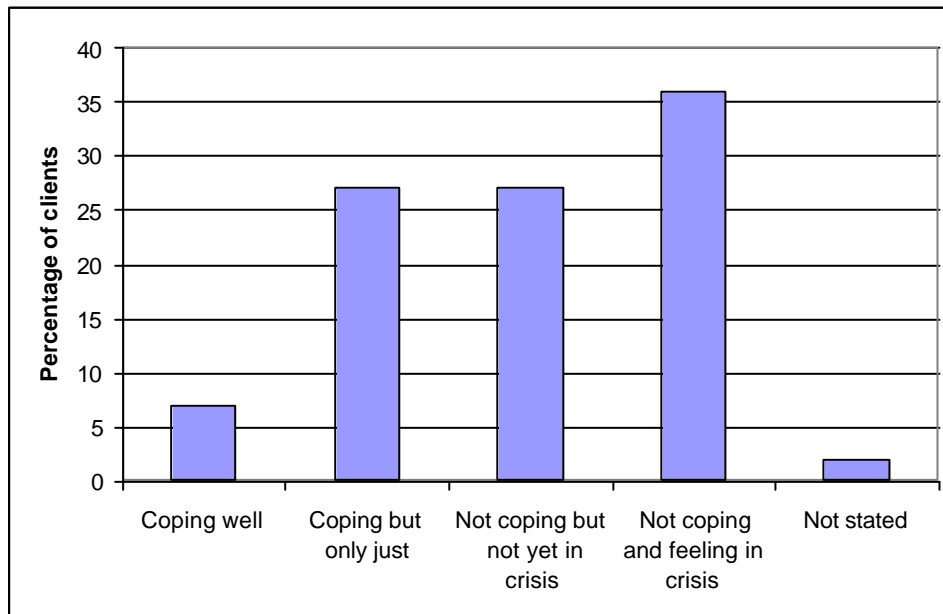
A second type of impact reported in the literature relates to health, especially stress, anxiety and depression. For example, Ryan's (1992) survey of un-discharged bankrupts in Melbourne, Australia, notes that:

Difficulty in repaying debts, in conjunction with the demands of creditors, often results in a highly stressful situation for debtors and their families which can lead to a number experiencing deterioration in health, psychological stress, family and marital strain and adverse effects on work performance ... physical and emotional problems relating directly to financial problems were extensive, with 42 percent feeling tense or anxious and 30 percent who had sleeping problems. At least one quarter of respondents also reported headaches, loss of appetite and an upset stomach as directly attributable to financial problems. Just under two-thirds thought that their money troubles had affected their health and 47 percent had consulted a doctor about such problems. (Ryan 1992: 222)

In Edwards's (2003) survey of more than 900 over-indebted clients of Citizens Advice Bureaux in the UK, 62% mentioned that they were suffering from stress, anxiety or depression.

... unmanageable debt can have devastating consequences. CAB experience is that this can happen irrespective of the amount owed. Depression, ill-health, relationship breakdown, arguments within families, doing without essentials including food, and facing homelessness can all result from a debt problem. (Edwards 2003: 5)

Figure 1: How Citizens Advice Bureaux debt clients felt they were coping with their debt problems, UK



Source: Edwards 2003

Edwards (2003) reports on the stress of living on a very tight budget, such that almost two-thirds of respondents stated that they were not coping with their debts, with three-in-five of these people stating they were not coping and feeling in crisis (see Figure 1).

The study by Berkana Consulting Services (2002) for the Ministry of Social Development reported that:

For some people debt appears to be a significant burden that seems to hang around like a big black cloud. There is a sense of shame at owing money and a sense of stress at not being able to afford repayments. Or to be repaying and therefore not having the money that is needed for everyday living. For others, debt is more part of life and they express a sense of being in control and having confidence that the debt will eventually be repaid. (Berkana Consulting Services 2002: 47)

Parker (1990) reports similar findings, with most respondents in her UK survey stating that their mental health, and to a lesser extent their physical health, was affected by their debt situation. Grant (1995, 2000) reports that respondents with disabilities often ascribed the onset of mental health problems, such as depression and anxiety, to the process of dealing with debt. Moreover, some respondents had contemplated suicide, an issue that Edwards (2003) also identifies. Kempson et al. (2004) cite a UK survey of almost 8,500 individuals. This showed that 38% of those exhibiting moderate depression were in arrears, as were: 34% of those who had ever attempted suicide; 24% of those with mild alcohol dependence; and 49% of those with severe alcohol dependence. Amongst the population overall, 13% of those aged 16–59 had been in arrears in the past year.

Gordon and Pantazis (1997) point out the very strong links within the literature between ill-health and poverty (in their UK survey those who were multiply deprived were five times more likely to be depressed than those who were not in this situation), and thus there is likely to be similar pattern with regard to over-indebtedness.

Although many studies make the links between health and debt, it should be noted that few of these studies are empirically robust. Indeed, most depend on small samples or are principally qualitative surveys. Partial exceptions include Reading and Reynolds' (2001) survey of the links between debt and maternal depression. Through a sample of 271 families with young children, worry about debt proved to be to the strongest independent socio-economic predictor.

Rather than a linear pathway there may be a circular one; worries about debt contribute to making depression worse, while depression causes women to worry more about their debt and deal with them less effectively. Regardless of the direction of the effect, our results demonstrate that being in debt to the extent that it causes worry is intimately related to maternal depression. (Reading and Reynolds 2001: 449)

Drentea and Lavrakas (2000) surveyed 900 adults in Ohio, and found that credit card debt was associated with worse self-reported health. However, the sample size was small, with only 10% of those surveyed in credit card default. Nettleton and Burrows

(1998)³² examine the links between mortgage arrears and health. Using data from the British Household Panel Survey (which surveys 5,000 households), they argue that being in mortgage arrears has an independent effect on subjective wellbeing. Having mortgage debt problems also increases the likelihood that men will visit their general practitioners.

Family stress, stigma and social exclusion

Leading on from the financial and health stresses that debt repayment problems can cause, the literature also alludes – although again with relatively little robust, quantifiable evidence – to pressures on family relationships and to people feeling stigmatised and isolated from their communities. In Ryan’s (1992) interviews with un-discharged bankrupts, just under one-third of respondents reported that this had affected their marriage in a negative way and 60% reported an effect on the rest of the family. In the survey by the British charity NCH (1992), half of the respondents reported that money problems had damaged their relationships and 32% believed it had led to separation or divorce. Likewise, in Edwards’s (2003) survey, 18% reported arguments with their partners, relationship breakdown and disputes within their wider family circle. These pressures are illustrated through a series of qualitative statements, for example:

We have not got any money to do anything. We don’t go out, we just stay in. When the phone rings we panic in case it is a creditor. They are so nasty and do not believe that we cannot pay so we get cross with each other and the kids. (Edwards 2003: 74)

In addition to such stresses, the literature also raises the social stigma attached to being unable to make ends meet and to having bailiffs demanding repayments: “the visibility of bailiffs advertises a family’s situation to those around them in a way that heaps the social disgrace of shame and stigma upon financial distress” (Drakeford and Sachdev 2001: 223). Or, in the words of Edwards (2003: 480):

Many people with debt problems feel ashamed and embarrassed, and they often think that when they seek advice they will be judged. They often feel it is their fault for not being able to manage their money effectively.

Grant (1995, 2000) reports on similar impacts, although her study is concerned only with disabled people.

Living with debt, of course, leaves people with little money to pursue social pleasures; people in debt become excluded from everyday social activities through lack of money ... Friendships, similarly, can be changed by the experiences of debt. Some people sensed that old friends now regarded them primarily and essentially as “a person of debt”. (Grant 1995: 235)

Grant (1995: 239) also discusses how some people “choose to bear the burden of debt alone”, while others experience the stress of having to go to court.

³² See also Nettleton 1998.

Court experiences can have a devastating impact on people's sense of self-worth. People whose debts had resulted in court action invariably felt that they had been treated like "scum", or like "criminals"; that they had been stripped of their citizenship. (Grant 1995: 237)

In New Zealand, a report by the Wellington-based community organisation Kites identified a series of impacts of debt for people experiencing mental illness. These included feelings of shame and guilt, which impacted on self-esteem (Dawson 2003).

Barriers to employment

A fourth possible impact of debt problems relates to the creation of barriers to employment. In the UK, Kempson et al. (2004) report on qualitative evidence that being in arrears impacts on people's decisions on whether to move into work.³³ This can either be because individuals' debts repayments increase when they enter into employment, or else the fear of this acts as a barrier. Kempson et al. summarise four reasons from the qualitative research that explain why people's debt difficulties may increase during the transition to employment:

- creditors, who exercise forbearance when an individual is not working, increase their required repayment rates when they discover that a person has found a job
- people borrow more (especially through credit cards and overdrafts) during the transition to employment
- people fall behind with commitments that had previously been covered by benefit or payment protection insurance payments
- people fail to keep up with existing payment commitments, especially if they are financially worse off being in work than on benefit.

However, quantitative analysis of the UK Families and Children Survey provided no evidence that individuals with arrears, who had not been working in the previous year, were any less likely to move into employment than those with no arrears (Kempson et al. 2004). Indeed, amongst couples those with arrears were slightly more likely to move into paid employment than those without. Nonetheless, there were surprisingly strong links between being in arrears and leaving paid work. Families with children where parents had arrears were twice as likely to have stopped work within the year compared to those who were up-to-date with all their commitments. As such, while having arrears may not prevent people finding a job, being in debt may be a barrier to *sustainable* employment.

In New Zealand, the Ministry of Social Development's (2003b: 48) *Statement of Intent* notes that:

A number of circumstances can make it hard for people to achieve economic independence. This might be because:

- high levels of debt in low income families restrict the ability of people to move out of hardship circumstances; or
- fear of incurring debt when dealing with government agencies inhibits people from choosing to access their full entitlement of available benefits.

³³ See for example Farrell and O'Connor (2003).

The Department of Labour and Ministry of Social Development (2002) evaluation of the 1999 Domestic Purposes Benefit and the Widows Benefit reforms found that debt incurred prior to employment significantly affects whether sole parents financially benefit from entering paid work. In its survey of sole parents who left the benefit for employment, 18% stated that more than a quarter of their income after tax and Department of Work and Income repayments was being used for other debt repayments (such as credit cards and bank loans, but excluding mortgages and child maintenance). Six percent had debt repayments that absorbed more than 50% of their income after tax and Work and Income repayments. Sole parents with a youngest child under 14 years of age had higher median levels of debt than those with a youngest child over 14 years of age.

The impact of debt to Work and Income is also specifically examined in the report by Berkana Consulting Services (2002). This study notes how beneficiaries accumulate a variety of debts while on benefit, and that the move into work may not necessarily make them financially better off due to the costs of employment (such as clothes, transport and childcare).

The Berkana study did not cover the impact of Effective Marginal Tax Rates (EMTRs) and benefit abatements as possible disincentives for returning to paid work. People who enter employment will have reduced benefits and will have to pay income tax, thus limiting the financial gains from working. If such individuals are also pressurised to repay debts once they are working, it can be more profitable, at least in the short term, to remain on the benefit. In the Berkana study, two-thirds of non-current beneficiaries postponed visits to the doctor, two-fifths had put up with feeling cold to save on heating costs, and more than a third went without insurance. Moreover, two-fifths of respondents had fallen behind in repayments for hire purchase, credit cards or store cards three or more times; a similar proportion had borrowed from friends or family three or more times to meet everyday costs; one fifth had fallen behind in payments for electricity or gas; and 29% had been contacted by Baycorp or another debt collection agency three or more times. Only two-fifths believed that their standard of living had improved since leaving the benefit system, while almost a quarter believed it had worsened (see Table 27).

Table 27: Perceptions of standard of living compared to when on benefit for non-current beneficiaries, New Zealand

	Frequency	Percent
Much better	12	16
Better	17	22
About the same	30	39
Worse	11	14
Much worse	6	8
Missing	1	1
Total	77	100

Source: Berkana Consulting Services 2002

Despite these perceptions the report found no evidence that people moved back onto the benefit because of their debts to Work and Income. The research found that debts to Work and Income were typically bottom of the list of respondents' priorities, because

these were not interest bearing, had no penalties attached and there was no threat of the loss of a good or a service if repayments were not made.

Summary

Despite a large quantity of research into household debt problems, empirical evidence on the impacts of these is limited, although there is often an automatic assumption that debt is necessarily “bad”. Another limitation of the literature is that studies tend to assume models of nuclear families living in discrete household economic units. The relevance of these models in the context of New Zealand may be limited. For Māori, kinship networks based on whānau – and to a lesser extent hapū and iwi – may be relevant, with consequent transfers of wealth or other non-financial obligations (eg, in the form of support for marae). For Pacific people, a transfer of wealth in support of churches (in New Zealand and abroad), and the associated impact of this on family standings, is also likely to be important. The relationship between culture/religion and debt is likely to be of significance in New Zealand and is an area requiring further research.

Despite its limitations, the debt research identifies four broad types of impacts: financial hardship; poor health; family stress, stigma and social exclusion; and barriers to employment. Being over-indebted obviously has financial implications in terms of the ability to make ends meet, although it is interesting to note the potential positive effects for debtors of bankruptcy. Over-indebtedness also appears to have negative impacts on (especially mental) health, and may possibly be linked to suicide. For some it is a “dark cloud” that blights their lives and can have a major impact on their family relationships, although others seem to cope with their situations far better. Finally, being indebted can lower the financial advantages of returning to work. In particular, it may be acting as a barrier to sustainable employment.

Part Five: Approaches to Tackling debt

Despite the difficulties of ascertaining the proportion of people who have debt problems (Part Two) and the precise impacts these may have on individuals and their families (Part Four), it is clear that sizeable numbers of predominantly low-income people are suffering negative outcomes. A range of governmental and non-governmental responses are discussed in the literature as offering at least partial solutions. The six main approaches discussed are:

- legislation and/or guidelines to regulate the consumer credit industry
- improving access to affordable credit facilities and the development and support of alternative, community-based lenders such as credit unions
- improved policies for private companies (especially utility and credit card companies)
- education and financial literacy strategies to improve consumer awareness
- money advice services provided by budgeting advisors and other non-governmental agencies (but which may be financially supported by government)
- managing debts to government through changes to court policies, re-examining the role of government as a creditor, and improved co-ordination between different government agencies.

A seventh approach, which is not discussed in the debt literature but may still have relevance, is the role of asset-based welfare. In recent years there have been debates as to whether providing lump-sum payments or subsidies to savings for low-income families will create positive outcomes in terms of encouraging engagement with the savings process and helping people to acquire financial knowledge skills.³⁴ If possessing assets has positive outcomes, then the reverse – having liabilities – would arguably have equally opposite effects. The development of asset-based welfare schemes is thus another possible policy approach that could be adopted by government and/or non-governmental agencies. Because it is not included in the debt literature, it is not discussed further in this study.

An eighth approach, and one that is also barely considered in the international debt literature, is to raise income levels. Given the strong correlations between income and problem debt levels (see Part Three), raising the income levels of low-income people should have significant effects. Income levels for those on the lowest incomes could be increased through higher benefit levels and/or payments to people in low-paid employment. However, there is no analysis of the type or amounts of any increases that would be necessary to have a significant impact on levels of problem debts.

Of the six principal approaches discussed in the literature, the first three – legislation and/or guidelines, improving access to affordable credit, and improved policies in the private sector – are primarily about the *provision* of credit. The fourth and fifth approaches – education and financial literacy, and money advice services – are about the *consumption* of credit. The sixth approach – managing debts to government – principally relates to internal government structures and processes, and is discussed in Part Six.

³⁴ See, for example, Kelly and Lissauer 2000.

Legislation and/or guidelines

The foremost approach to tackling the issue of over-indebtedness discussed in the literature is through legislation and/or official guidelines. In New Zealand the Credit Contracts and Consumer Finance Act has recently been passed. This Bill replaces the Contracts Act 1981 and the Hire Purchase Act 1971. Some of the main changes, as summarised by the Ministry of Consumer Affairs (2003),³⁵ who proposed the bill, are:

- more “clout” against oppressive activities and breaches of the law through a public enforcement agency – the Bill provides for additional funding to the Commerce Commission authority and resources to investigate activities of lenders and take necessary action
- better information for consumers about their credit deal – the aim is to achieve contracts that are clearer, with information that is more useful to consumers: the Act states what information should be provided to borrowers in a credit contract and a performance standard to specify how it should be presented
- increased fairness for consumers – there are now limitations on how lenders can charge interest and limitations on certain types of fees, and the Act provides clear rules for the early repayment of loans.

The new Act also includes provisions to tackle housing buy-back schemes. These schemes have typically involved people entering transactions with unscrupulous lenders, usually to repay debts. Individuals sell their home to financiers but retain the right to stay in their home. Consumers often do not know that they have actually sold their home and that the amounts required to repurchase them are unaffordable. The Act also includes a hardship provision whereby individuals can apply to their creditor – although only before they go into default – to vary the terms of their consumer contract. If creditors refuse to vary the terms, consumers can seek an order from the Disputes Tribunal.

The approach of the Credit Contracts and Consumer Finance Act reflects an attempt to maintain fairness and protect consumers from unscrupulous practices.³⁶ This approach parallels the approach of countries such as the UK, which similarly has a Consumer Credit Act and an Office of Fair Trading (OFT) to ensure that regulations are adhered to. The Director General of Fair Trading issues regular guidelines for lenders and brokers and is able to revoke or refuse consumer credit licences for those that regularly breach regulations. These guidelines are necessary considering the enormous range of breaches and “grey areas” within the law. For example, in relation to the issue of non-status lending, the Director General released the following guidelines in 1997, which refer to a previous 1991 report, *Unjust Credit Transactions*:

The report identified examples of practices which would point towards an unjust credit transaction. These included marketing loans explicitly at those in debt; limited or no enquiries about income; pre-occupation with the value of the security rather than the borrower’s credit worthiness (“equity lending”); brokers’ or other advance fees, often substantial, which were not fully disclosed or

³⁵ See also McBride and Bowie 2001.

³⁶ There are other forms of legislation designed to control some of the specific causes of debt problems. In particular, tighter regulations through the Gambling Act 2003 aim to reduce the prevalence of gambling harm.

explained; very high interest rates; and increasing interest when a loan was in arrears, sometimes in breach of section 93 of the Act. They also included breach of the broker's duty to act in the best interest of the borrower; illegal canvassing of agreements in consumers' homes; irregular documentation including failing to give or misquoting interest rates and APRs; improper tying-in of insurance; falsifying information as to borrowers' income or other aspects of their financial status; misrepresentations as to the form, nature, purpose or long-term implications of loan agreements; and unacceptably high-pressure selling techniques. (Office of Fair Trading 1997: 3)

In Scotland the Bank Arrestments Bill 2000 has recently been passed. This aims to set "fair" and "reasonable" limits on creditors' powers to freeze debtors' bank accounts to enforce debts (McPhee 2000). Bank arrestments were the most common form of diligence in Scotland, and were primarily issued by local authorities trying to recover council tax or community charge debts. The Act is designed to ensure that creditors cannot seize an employee's entire pay.

In the USA the 1977 Community Reinvestment Act was designed to stop banks closing down branches in low-income neighbourhoods (Campen 1998, Drakeford and Sachdev 2001). The Act followed an exposure of "red lining", whereby banks effectively cut off credit from poorer neighbourhoods, especially those populated by minority ethnic communities. Banks' applications for new branches, relocations, mergers, consolidations or other corporate activities are dependent on the ratings they receive in relation to how they have served their local communities. Drakeford and Sachdev discuss how the UK backed away from such an approach because of fears about compliance costs. However, they quote Alan Greenspan (Chairman of the US Federal Reserve Board), who stated that the Act has "very significantly increased the amount of credit that is available in the communities and if one looks at the detailed statistics, some of the changes have really been quite profound" (in Drakeford and Sachdev 2001: 217).

It should be noted that the current approach of countries such as New Zealand and the UK reflects a gradual move over the course of the last century away from thinking of consumer debt as a crime. While the emphasis in legislation is on fairness, market efficiency and consumer protection, historically consumer debt was punishable by imprisonment. Indeed, in the UK as late as 1969 the Payne report argued that the system of debt recovery was coercive and inhumane, and the report led to the abolition of imprisonment for most types of debt. Nonetheless, according to Berthoud (1989), imprisonment in the UK is still available as a last resort against non-payment of income tax, council rates and maintenance payments. Moreover, debt advocacy organisations such as the Citizens Advice Bureaux in the UK argue that the law is still regressive. For example, NACAB (2000b) argues that the use of bailiffs to seize possessions as a method for collecting debts is an "archaic" procedure that dates back centuries. To illustrate their case they give an example of clients who received a visit from a bailiff seeking to enforce council tax arrears.

The clients offered to make a monthly payment, but this was refused. The clients reported that the bailiff threatened to have them arrested if they did not pay the arrears; that he then offered to obtain a loan for them so that they could repay the arrears; and that, despite the fact that it was pouring with rain, he attended the house in a short sleeved shirt, bearing a tattoo on his arm with the words "pay or die" emblazoned on it. (NACAB 2000b: 3)

NACAB argue that other forms of debt enforcement, such as attachment of earnings or direct deductions from benefits, are far more humane. Moreover, they are highly critical that for enforcement work there are no restrictions on who can become a bailiff.

At present, the public tolerate a system which allows someone to turn up at the door, sometimes late into the evening, demanding entrance, without any proper form of identification being required. (NACAB 2000b: 7–8)

Similarly, Berthoud (1989) argues that enforcement action, through warrants for the possessions of goods, is often ineffective in reimbursing monies owed to creditors.

It is said that the execution of a warrant is more effective in causing anxiety to the debtor than in recouping money for the creditor. This is especially true in Scotland, where the “warrant sale” seems designed simply to inflict public humiliation on defaulters. (Berthoud 1989: 34)

Despite the raft of legislation worldwide, it is worth noting Parker’s (1990) and Whyley’s (2002) warnings that if legislation is too restrictive in allowing lending, then the result may be more illegal activities or else low-income families struggling under unnecessary hardship.

It is extremely important to note, however, that simply curtailing the activities of [non-status] lenders will not, in isolation, fully resolve the problem of exclusion from mainstream credit. The demand for credit among poor and vulnerable people makes it unlikely that they will cease to borrow simply because the sources of credit that they normally use are no longer available. Consequently, any strategies aimed at relieving the difficulties faced by people on low incomes who need to borrow money must be combined with wider initiatives, such as improved consumer information and education, and the development of other, lower-cost sources of credit, such as credit unions. Otherwise, already vulnerable, low-income consumers may be forced to go without essential goods and services, such as food and fuel, because they cannot borrow the relatively small amounts of money they need to make ends meet. (Whyley 2002: 160)

Improving access to affordable credit

A second approach to tackling household debt problems relates to improving access to affordable credit for low-income families. This is particularly relevant given that because of their often poor credit worthiness, low-income families often have to pay more for money than those that are better off (see Part Four). As such, a number of often locally based alternative lending schemes have been developed in different countries. These schemes lend out money with low or no interest charges and are typically more flexible about repayment schedules than mainstream high-street credit lenders (such as major banks and credit card companies). For example, credit unions are financial co-operatives that, at least for smaller schemes, are based on low-income neighbourhoods, are owned and controlled by local residents, and aim to provide savings and low-cost credit facilities to their members (see also Part Two).

McArthur et al. (1993) argue that credit unions allow more low-income families to purchase goods and services than would otherwise be the case, and that they have a

role to play in tackling poverty at the neighbourhood level. Nevertheless, they acknowledge that better-off groups using credit unions tend to save and borrow more than those on low incomes.

If the membership were dominated by highly disadvantaged people, the members would have little to contribute in savings, thus restricting what the credit union can offer in loans and limiting the scope to earn an income through interest. Yet, faced with large-scale and multiple debt, these are the sort of people who are most in need of urgent help. This “Catch 22” situation appears to place a major constraint on what credit unions can do for the poor. (McArthur et al. 1993: 409)

Given these constraints, McArthur et al. argue that:

Credit unions are making useful but marginal contributions to the credit and debt problems of low-income families. They could probably achieve more with additional resources, but any intervention by external agencies should be sensitive and avoid damaging the strong mutual aid foundations upon which credit unions are based. (McArthur et al. 1993: 399)

Despite this somewhat negative assessment, McArthur et al. do offer a series of practical ways that public and voluntary agencies could assist credit unions.

Credit unions require premises in which to meet and run their activities; volunteers who manage the organisation require training and guidance to operate effectively and satisfy the demands imposed by the Registrar of Friendly Societies for financial information; and new members would be attracted with the right sort of advertising and publicity ... A more ambitious step would be to explore channelling externally-provided resources through credit unions as a way of extending low-interest credit to low-income households. Where a credit union exists and is well managed, it offers a potentially very attractive vehicle through which anti-poverty agencies could reach relatively large numbers of poor families. (McArthur et al. 1993: 414)

From his study of low-income credit providers in Liverpool, England, Jones (2001)³⁷ argues that credit unions require strategic financial and technical assistance. He argues the case for a central services organisation that could fulfil such a role. Jones also acknowledges that while many low-income families do not see banks as a solution to their needs, these institutions could provide far more positive assistance than they currently do. In the USA a similar approach is taken by Syron (1993: 280), who argues that “traditional lenders must play a larger role in lending in low- and moderate-income neighbourhoods.” However, Syron also argues that there is also a place for non-traditional lenders to provide credit to individuals who would not qualify for this at mainstream banks, although these should be licensed to avoid unscrupulous lending.

In New Zealand, the recently opened Kiwibank, run by the state-owned postal service, is designed to provide more affordable banking services and facilities that are accessible to low-income families. By utilising the large network of already established post offices and seeking to charge lower fees than rival commercially based banks, Kiwibank is

³⁷ See also Berthoud and Hinton 1989, Pearson 1998.

designed to appeal to individuals who may not have otherwise used banking facilities. Kiwibank is also participating in an initiative to make home ownership easier for low-income families. Prospective owners will not require a deposit for loans less than \$100,000 and the Government will pay some of the costs of mortgage insurance premiums.

Improved private sector policies

A third approach relates to the policies that private sector firms adopt when seeking to recover monies owed to them. This literature has mostly looked at policies by British utility companies in the 1980s and early 1990s towards individuals in arrears. However, there is some literature on approaches adopted by credit card companies relating to credit-related insurance.

As discussed in Part Two, trends in utility disconnections are one possible way to measure levels of over-indebtedness. However, the reason they are an unreliable indicator – that trends are often caused by policy changes rather than variations in levels of over-indebtedness – shows how utility companies' policies can affect the debt levels and experiences of their clients. In the UK, Herbert and Kempson (1995)³⁸ discuss how different approaches by British water companies considerably altered the number of households whose water supply was cut off due to failure to pay their bills. Between 1989 and 1994 there was a ninefold increase in the number of households who had fallen into arrears (to almost two million households). Nonetheless, there was considerable variation in the proportion in arrears between the 10 water and sewage companies operating in Britain. While part of these differences related to the socio-economic profile of clients living in the different geographical areas, Herbert and Kempson note the importance of other factors such as the differing cost of water bills and whether companies offer flexible repayment options. They note that while most companies had started to develop more customer-friendly approaches to debt recovery, there were still considerable variations: some companies adopted a "relaxed" approach with low summoning and disconnection rates, others subscribed to a "short, sharp shock" method with high rates of summoning and disconnection. As such, customers in similar circumstances were far more likely to have their water cut off in some parts of the country than in others.

In the UK, utility companies are overseen by independent watchdogs. For the water industry, OFWAT (Office of Water Services) provides this role, issuing guidelines and ensuring that companies follow them. In 1992 they published guidance for water companies in their recovery of debts and are in the process of renewing this (OFWAT 2002). The new guidelines follow the Water Industry Act 1999, which made it illegal for any water company in England and Wales to disconnect for non-payment of charges any dwelling that is occupied by individuals as their only or principal home. By removing this sanction, companies had to develop different approaches to debt collection. OFWAT (2002: 3-11) sets out a series of principles they believe water companies should adopt in how they seek to recover debt.

- *Principle 1:* companies should be proactive in attempting to contact customers who fall into debt before proceeding to court action.

³⁸ For a similar discussion in relation to gas debts, see Rowlingson and Kempson 1993.

- *Principle 2:* companies should provide a reasonable range of payment frequencies and methods for all customers. The entire range of options should be properly and widely advertised to ensure that customers can select the arrangement that best suits their circumstances.
- *Principle 3:* literature and letters or notices sent to customers should be written in a non-threatening style, but should clearly set out the action the water company will take if the customer fails to make payment or contact the company.
- *Principle 4:* when agreeing payment arrangements with customers in debt, the customer's ability to pay should be taken into account.
- *Principle 5:* customers whose accounts are managed by debt recovery agents should receive a similar level of service and care to those whose accounts remain with the water company.

In New Zealand there are no sector-specific regulators. The Commerce Commission performs an overarching role, with its primary purpose being to promote market efficiency through fostering healthy competition between businesses, informed choice by consumers and sound economic regulation. The Commerce Commission enforces regulation in the gas and electricity industries (as well as at airports and in the dairy industry). The water industry, at least in metropolitan areas, is not privatised and comes under the domain of regional and district councils. Without standard guidelines or policies, then geographical unevenness in how low-income families are dealt with if they have debt repayment difficulties – as was the case in the UK prior to the introduction of the sector regulators – is likely.

It is also worth noting how credit card companies' policies can have impacts on levels of over-indebtedness. As noted in Part Two, credit companies are developing increasingly sophisticated systems for scoring clients' credit worthiness (KPMG 2002). Such schemes may limit the number of people who take out loans that they cannot reasonably be able to repay, although they will have little impact on people who had a good credit rating but who suffer adverse life shocks and consequently fall into difficulties, or end up using the non-status market.

Another option relating to private companies is changes to (or enforcement of) credit-related insurance. According to the Ministry of Consumer Affairs (2000), the most common types of credit-related insurance are goods insurance (whereby goods are insured against risks such as fire, theft, damage or loss); consumer credit insurance (which ensures that repayments are met if the borrower dies, becomes ill or loses their job); life insurance (this is often required by home-finance lenders to ensure that in the event of the death of the borrower any monies owed can be repaid); and lender's mortgage insurance (this protects the lender and may insure them against any shortfall from a mortgagee sale, or against overdue payments). The advantage of credit-related insurance is that it can protect both borrowers and lenders from adverse financial and other shocks. Despite this, the Ministry of Consumer Affairs highlights a number of potential disadvantages, such as consumers paying excessive premiums for insurance, policies not being fully disclosed, and inappropriate and duplicate insurance cover being offered. They argue that the market typically does not function efficiently because lenders sell only one type of insurance, from which they earn commission. Currently, a lender or supplier has a right to require any type of insurance, and the Ministry of Consumer Affairs has raised questions about whether or not this is appropriate.

Education and financial literacy strategies

Instead of seeking to regulate or change the provision of credit or services (and thus the consequent recovery of monies owed), an alternative approach is to improve the education of consumers. This is particularly relevant given often very low levels of financial literacy (see Part Three).

In the UK the need for financial literacy strategies has been argued by several authors. In their research on financial exclusion, Kempson and Whyley (1999b) argue that knowledge of financial products was often remarkably low, and this rendered people especially vulnerable to mis-selling, and deterred them from taking up financial products in the first place. Collard et al. (2001) argue that a lack of financial skills leaves people feeling gullible in their dealings with financial service providers. They suggest that while financial literacy skills should be taught in schools, their interviewees thought that the years immediately following formal education were the crucial time for this type of learning. Similarly, Citizens Advice Bureaux in the UK argue that better informed clients would avoid some of the more extortionate credit schemes that abound.

Those people seeking advice from CABx are generally not well-informed on credit and money management. Well-informed confident consumers would be clear about their options and aware of the relative cost of alternative credit agreements. Well-informed consumers would naturally steer clear of the most expensive and extortionate agreements. (NACAB 2000a: 36)

In the UK the government has called for improvements in financial literacy. The UK Department of Trade and Industry Task Force on Tackling Overindebtedness (2003: 14) established by the notes the need for “better financial education both for young people in schools and adults to provide them with the understanding and tools necessary to manage their finances effectively.” In a speech on over-indebtedness, Melanie Johnson (2002), (then) UK Minister for Competition, Consumer and Markets, argued that schoolchildren are already learning about personal finance.

The UK Basic Skills Agency (funded by the Department for Education and Skills: DfES) is developing a programme of support for adults for financial literacy and basic skills. The DfES is also funding a pilot Community Finance and Learning Initiative to support existing local community-based organisations, such as credit unions and Citizens Advice Bureaux, to work in partnership to deliver literacy and numeracy support, access to mainstream financial services, and access to micro-finance. Despite these initiatives, strong calls to improve financial literacy programmes remain. According to Edwards (2003), too many initiatives are one-offs or short-term projects. She also argues that government needs to take into account the often low levels of financial literacy when designing the delivery of financial services such as welfare benefits and tax credits.

We continue to see a need for a comprehensive national strategy for improving financial literacy over the next ten years. Such a strategy needs clear and strong leadership and [to] be able to engage the public, private and voluntary sectors in ensuring that consumers: can easily obtain information that allows them to choose between and manage their choice of financial products; can get access to high quality impartial advice on a range of financial issues; have the skills and confidence to make informed choices, including underpinning literacy

and numeracy skills; are protected from abusive market practices. (Edwards 2003: 85)

In New Zealand, the Ministry of Consumer Affairs (2000: 6) acknowledge that consumer credit legislation has only a limited role in preventing over-indebtedness.

Social policy considerations relating to credit are largely outside the scope of the Consumer Credit Law Review. The Ministry believes that broad goals such as reducing personal indebtedness (including bankruptcy filings) and dealing with poverty are more appropriately dealt with by wider policy instruments. (Ministry of Consumer Affairs 2000: 11)

In relation to such policy instruments, the Ministry of Consumer Affairs suggests that consumer education and budgeting advice could receive more prominence in the school curriculum. The New Zealand government has already initiated a numeracy and literacy strategy for children, and the Office of the Retirement Commissioner has developed a Financial Literacy Programme to teach senior secondary school students about personal money management skills. Alternatively, consumer education could be targeted at beneficiaries and low-income earners, given the greater propensity among these groups to become over-indebted. The government has invested in an Adult Literacy Strategy (see Office of the Minister of Education 2001), which includes the development of numeracy skills but not financial literacy skills directly. The New Zealand Council of Christian Social Services has also called for a national strategy to improve financial literacy (Williams and O'Brien 2003).

Money advice services

A fifth approach to tackling debt problems relates to the support of money advice services. In New Zealand, organisations such as the New Zealand Federation of Family Budgeting Services, Citizens Advice Bureaux and church organisations fulfil this role. These organisations provide advice about rights and responsibilities and assistance in dealing with debt issues. Berthoud (1989)³⁹ explains how debtors are often confused about their rights and responsibilities, and about the most appropriate methods for negotiating with creditors.

Their instinct was to conceal the extent of their commitments. They tended to offer the whole of their available income in response to each demand ... Creditors understandably got the impression that the debtors were dishonest, and ready to evade their obligations ... Money advisers' technique is to reverse this whole process. Far from concealing the extent of their client's debts, advisers' first action is to inform all creditors about all debts, so that they can stop asking for money which is not there. Advisers then see if they can increase the client's income, especially from social security benefits. They help him or her to sort out a statement of income and expenditure, to see how much can be made available for debt repayments. The third stage is to make arrangements with those creditors (such as landlords, building societies or fuel boards) who have to take priority over others because of the seriousness of the sanctions at their disposal. Finally, the adviser negotiates with the remaining creditors, asking each to accept a regular payment ... (Berthoud 1989: 35)

³⁹ See also Wilson et al. 1995, Wilson et al. 1997.

Budgeting advisory services are generally voluntary organisations, although they often receive indirect state funding (eg, through block grants or lottery grants). In terms of developing and supporting these services, the Ministry of Consumer Affairs (2000) suggests there could be a greater role for lenders to give more support for these services; for example, through a body such as the Consumer Credit Counselling Services established in the UK in 1993. Johnson (2002) highlights how the UK government has recently launched a pilot project for a national debt telephone helpline. Part-funded by both the government and the private sector, the aim is to determine the best way to provide debt advice to consumers in need of advice. In New Zealand, the Retirement Commission has established a website (www.sorted.org.nz), which provides generic advice on managing debt.

Summary

Within the literature six broad approaches to tackling household debt problems are discussed: legislation and/or guidelines, improving access to affordable credit, improved policies for private companies, education and financial literacy strategies, money advice services, and managing debt owed to government. Managing government debt is discussed in the following section. A seventh approach, the role of asset-based welfare, was not discussed, but remains a potentially innovative way of tackling issues of over-indebtedness and financial exclusion over the long term. An eighth approach, given the strong correlations between low income and debt problems, might be to raise income levels. However, there is no analysis of the potential benefits of, for example, increasing benefit levels and/or payments to those in low-paid work instead of (or in addition to) other potential policy solutions.

Given the realities of a market-oriented society, debt problems will inevitably feature for at least some households. As Part One emphasised, indebtedness is not the same as over-indebtedness, and from a policy perspective there is a fine balance between protecting individuals from undue distress and unscrupulous lending, and stifling competition and the ability of individuals to borrow money. If, for example, legislation on lending is too strict, then low-income families who are denied credit from legitimate sources may seek out lenders whose lending practices are less desirable.

From a government perspective, a direct policy response is to regulate the consumer credit industry. In New Zealand, the Credit Contracts and Consumer Finance Act has recently been passed, although as the Ministry of Consumer Affairs acknowledges, it is not designed to prevent over-indebtedness. Moreover, this Bill will not be the final word in legislative approaches, with potentially innovative approaches from other countries requiring further attention. Other avenues include increased support for money advice services, which provide the bulk of counselling and assistance for over-indebted individuals. Alternative lenders such as credit unions also have a significant role in providing affordable credit to low-income families. There is very little information on these providers in New Zealand, but there may be a role for government to assist in the support and co-ordination of resources and information for such groups. There are also questions about the role of commercial non-status lenders, which are often located in low-income areas and charge far higher interest rates than mainstream lenders. The actions of this sector of the market require investigation. There may also be potential for developing and improving adult financial literacy skills – especially given often low

numeracy skills – although evidence that these are effective would need to be demonstrated.

In addition, there could be a role for media strategies to raise awareness about the dangers of borrowing too much money and the risks this entails. Government could also look at the debt collection policies and practices of utility companies, given the likelihood of geographical unevenness in how they enforce the repayment of monies owed to them. Finally, there is a need for high-quality research. Given the strong inter-relationships between low income and debt, broader policies to tackle societal inequalities require a firm understanding of how over-indebtedness contributes to these issues if they are to maximise their chances of success.

Part Six: Managing Debts to Government

In Part Five potential approaches to tackling debt problems were discussed. These approaches were either directly related to the activities of government (eg, consumer credit legislation or guidelines) or else indirectly related, such as through support for money advice services or alternative lenders. Nonetheless, a few studies have specifically raised as an issue the role of government as a major credit provider and debt collector. Within the debt literature three broad areas of government reform in this area are discussed:

- changes to the Court system
- reform of government loans to low-income families
- the co-ordination of government debt establishment and collection policies.

In addition, there is some literature on the role of student loans, and there will also be specialist literature on housing policy and on the role of taxation policies. These latter areas are beyond the scope of this study and require specialist attention that can build on the broader analysis of debt discussed here. The collection of these debts is also related to the income levels or financial circumstances of debtors, which is not usually the case for debts to private companies (except in the situation of bankruptcy or where there are Summary Instalment Orders). Legislation surrounding the recovery of debt to state agencies typically prevents collection where this would involve hardship or would breach the Protected Earnings Rate (the proportion of weekly earnings – typically 60% – that a person must be left with after the state has recovered monies owed).

Courts

As discussed in Part Three, fines appear to be a relatively small but still significant component of the monies owed by people who have debt problems. In some ways fines differ from other types of debt because they are not related to credit and are not voluntarily entered into. However, other types of debt – such as non-payment of child support to the Inland Revenue Department – are sanctions imposed both to punish offenders and to encourage compliance with the law. From an individual's perspective these types of debts are still monies owed and are therefore included in this study.

In New Zealand Courts, fines are the most widely imposed penalty for offenders: in 2001 33% of all charges resulting in a conviction (56,786 out of 173,485) had a fine imposed as one of the sentences (Searle 2003). Searle found that district judges considered fines a useful sanction for first-time and minor offenders and that they were particularly appropriate for traffic offences. However, judges expressed concern about the number of people coming before the Courts who could not afford to pay. A key contributor to this has been the rapid increase in the number of infringements, which are “instant fines” associated with traffic matters, parking offences, under-age drinking, dog-control and bio-security offences. These infringements are usually imposed by prosecuting authorities such as the Police or local councils. According to Wilson (2001), between 1993 and 2001 the number of unpaid infringements that reached the Courts increased by more than 300% to more than 650,000 (see Table 28). This figure excludes the far larger number of infringement penalties that are paid within the due date and thus are not referred on to Courts.

Table 28: Fines imposed in New Zealand, 1993–2001

Year	No. Infringements	No. Court-imposed fines
1993	210,681	84,411
1994	240,259	88,028
1995	345,122	90,691
1996	413,336	90,630
1997	481,040	81,702
1998	568,954	77,557
1999	626,482	78,543
2000	587,316	73,710
2001	654,970	75,797

Source: Wilson 2001

Infringement fees vary from a few dollars for some parking offences, to \$2,000 for certain overloading offences, although a large proportion of fines are around \$200. As a method of punishment they are relatively quick and cheap to administer. However, they do not discriminate on the basis of ability to pay, and the penalties imposed on individuals can mount up extremely quickly. Wilson gives the example of a person who is stopped for not wearing a seatbelt (\$150 fee) and is found to have an unregistered vehicle (\$200 fee) and no warrant of fitness (\$200 fee). Very quickly a series of minor infringements can land an individual with a large debt. Such fees are not adjusted to suit the means of the offender (although offenders can go to Court to seek the imposition of a lower fee), so those on low incomes are fined to the same extent as those who are financially better-off. Wilson cites research undertaken for the Department of Courts (now part of the Ministry of Justice) showing that a significant number of low-income people have difficulty paying infringement penalties. There are cases of individuals who have accumulated massive debts from infringement penalties, running into tens of thousands of dollars.

In Searle's (2003) survey, some judges expressed frustration that the increasing use of infringements was impairing their ability to set fines, and was bringing the system into disrespect. In the words of one judge:

... the disrespect for the system, and for non-payment of fines stems from the ease with which fines can be imposed for infringement fees ... it's a huge irony that we are restricted to not imposing fines that can't be collected within a reasonable period of time and are within the means of those before us and yet the infringement fees for speeding as well as for the stationary vehicle offenders are fixed and in no way related to the means of the owner ... until that dichotomy is solved I think that the fines system as a first penalty will always lack integrity and will fall into disrespect. (in Searle 2003: 41)

In June 2002 the Sentencing Act and the Parole Act came into force. This Act includes a stronger presumption in favour of fines as a first resort than has previously been the case. Courts also take into account the financial circumstances of offenders in setting fine levels. However, the rapid rise in unpaid infringement penalties may threaten this if offenders amass debts that are so high that they are unable to pay further monetary penalties.

Another issue raised by Searle (2003) is that those who are fined are, in addition to the monetary penalties imposed on them, also highly likely to be made liable for court fees, which can be a further burden to those on low incomes. In Australia, Ives (2001)⁴⁰ notes that the cost of civil debt recovery weighs much more heavily on low-income earners. Costs relating to legal enforcement are set at a flat rate, so the smaller the debt, the higher the relative cost. Moreover, if individuals do not pay these fees, penalty interest is charged. Ives raises the possibility of cost-capping and a fixed cost for litigation.

Finally, in New Zealand the Ministry of Economic Development (2003a) is currently reviewing insolvency law.⁴¹ This review argues that for an effective personal insolvency regime there must be a clarification of the current confusion as to when bankruptcy administration begins. Debtors and creditors require education about the options available to them and the obligations of pursuing these. The regime also needs to match better the nature of debtors. This is related to the changing nature of debtors, who increasingly are becoming bankrupt due to consumer credit-related issues, rather than because they are sole traders whose businesses have failed. The review argues the case for early intervention, financial counselling for debtors and improving formal alternatives to bankruptcy.

Government emergency and hardship loans

According to Parker (1990: 2–3), governments, at least in the UK, have traditionally preferred to leave credit provision to the private sector.

... the state has always been reluctant to intervene in the relationship between customer and seller (creditor). When it has done so it has usually been because abuses have become so widespread or so injurious to customers that to have done nothing would have been interpreted as carelessness. The state's major involvement with individual, rather than corporate, indebtedness has thus been with default and insolvency rather than the process by which the individual becomes indebted. Concern with the *social* impact of credit use has consequently waxed and waned. As early as the sixteenth century concern about the cost of credit to the poor led to the suggestion that state-financed pawnshops, charging no more than six percent on money lent, should be established. (Parker 1990: 2–3)

While the idea of state-financed pawnbrokers was not taken up, from the late 1980s administrations in New Zealand and elsewhere have developed systems for providing loans for people on low incomes. They may be provided for purposes such as equipment for a new baby, furniture when setting up a home, the cost of replacing damaged household items, or for meeting funeral costs. In principle, such systems provide cheap credit to individuals who would otherwise have had to do without essential items, or which they may have purchased from expensive non-status lenders. Nonetheless, such schemes have faced widespread criticism. In the UK Drakeford and Sachdev (2001: 211) describe the "hated Social Fund", which was introduced in 1988. In an article entitled "The Social Fund: Unlucky for most", Craig (2001) argues that the Social Fund discriminates against unpopular claimants (unemployed young people, lone parents and minority ethnic groups), it has an overwhelming emphasis on loans rather than non-

⁴⁰ See also Kliger 2001.

⁴¹ For a discussion of similar issues from a UK perspective see Department of Constitutional Affairs 2004.

recoverable grants, and the presence of annual expenditure caps drives demand “underground”.

In its report on the UK government's use of loans, Prime Minister Tony Blair argues that:

Loans have a valuable role to play. They allow public money to go further ... They are particularly important for those people who do not have access to other forms of support and have difficulty getting finance from existing financial institutions. (in Performance and Innovation Unit 2002: 3)

The Performance and Innovation Unit report (2002: 23) argues that loans are an appropriate intervention if the following criteria are met.

- They provide an effective way to deliver government objectives: they deliver objectives at the lowest cost to government, directly address identified market failures and minimise barriers to take-up, so achieving the desired result in the target group.
- They provide an efficient way to target government resources: they minimise “deadweight” losses by targeting loans on those who could not borrow in private markets, and the costs of administering the loan do not outweigh the benefits of repayment.
- There is a reasonable expectation that the recipient of the loan will be able to repay.
- The use of loans promotes positive incentives (eg, people seek value for money in the goods or services purchased).

The Performance and Innovation Unit report concludes that government loan schemes such as the Social Fund generally score well against these criteria.⁴²

In New Zealand, Simmers and McGurk (1999: v) argue that the Department of Work and Income has become a major money lender through recoverable Special Needs Grants, advance payments of benefit and recoverable assistance programme payments: “a significant amount of its supplementary assistance is not a grant but a loan. People receive help by becoming debtors.” Simmers and McGurk argue that, as with any type of loan, there are limits on the amounts that can be borrowed so that those who are in most need of assistance are denied help. To counter these issues, the report makes a series of recommendations, including increasing core benefits, increasing non-recoverable supplementary assistance, developing a consistent policy for debt recovery, greater use of statutory authority powers to write off debt caused by departmental error, and suspension of debt recovery for people in temporary hardship situations.

Berkana Consulting Services (2002: 13–14) note a series of initiatives that were announced in the 2002 Budget that have significance for benefit debt and supporting movement into work. These include a “pathways payment” payable to Work and Income clients who notify the department they are returning to work, have received a main benefit continuously for 12 months or more and have dependent children included in their main benefit; “debt repayment suspension”, whereby sole parents who leave the benefit for paid employment can have their debt repayments held at the same rate for 90 days; “enhanced case management”, which may help sole parents avoid added debt

⁴² Although see Edwards 2003, Jones 2001.

when they move from benefit to work; and a simplified abatement regime that will affect sole parents in part-time work with a youngest child aged over 14 years, allowing them to keep more of their earned income. Berkana also suggests other factors that could facilitate debt recovery, including ensuring that all beneficiaries actually understand the longer-term implications for themselves when accessing recoverable assistance; keeping them informed when their debt grows while on benefit; and developing processes to minimise errors, especially processing errors.

The Ministry of Social Development has also commissioned research on one of the principal causes of debt to the department, the “innocent overpayment” of benefits, especially to people who are in the transition from benefit to paid employment. Innocent overpayment can occur through an error by a Work and Income office, late processing of changes in circumstances, and the late notification by beneficiaries of the movement into a non-entitlement situation such as paid employment (see Heynes 2001).

In addition to emergency and hardship schemes, other government loans schemes exist. In the UK these include career development loans, housing loans and deferred payments for residential care (Performance and Innovation Unit 2002). In the USA, some of the largest federally managed credit schemes are the Department of Housing and Urban Development’s Federal Housing Administration Single Family and Multifamily Loan Programs (which insures mortgages on projects such as housing for older people, hospitals and nursing homes); the Department of Veterans Affairs Guarantee and Vendee Loan Programs (for current and ex-service personnel to purchase, construct or repair homes); and the Department of Agriculture’s Rural Housing Service Single Family and Multifamily Housing Direct Loan Programs (for low and moderate income families to purchase or repair homes in rural areas) (United States General Accounting Office 1997). In addition, the Department of Education has a Federal Family Education Loan Program, which provides for post-secondary education for eligible students.

In the UK and New Zealand, student loans were introduced in the early 1990s. By June 2002 in New Zealand the net total of all outstanding loans was \$4.75 billion, and in the academic year of 2001, 148,174 students borrowed \$908.9 million (Ministry of Education et al. 2002).

Co-ordination of government debt establishment and collection policies

A final area under the domain of managing debts to government relates to how different state agencies co-ordinate debt establishment and collection. Within the USA, a report by the General Accounting Office (1997) discussed the need for enhancements in how the state collects monies that it is owed. It argued that with outstanding loan balances approaching US\$1 trillion – with between US\$31 billion and US\$38 billion in reported bad debts – the federal government is the nation’s largest credit manager. The report raised serious concerns about inadequacies in how delinquent debt is reported and in agency collection performance as required by the 1996 Debt Collection Improvement Act. Four enhancements to current procedures were discussed in the report:

- (1) Developing a reporting framework to identify and assess the status of agency efforts to collect delinquent balances, (2) providing more information on how actively, successfully and cost-effectively agencies are using individual collection tools, (3) reporting actual delinquent amounts that agencies are trying

to collect and showing how those figures relate to amounts reported on agency financial statements, and (4) improving the reliability and consistency of reporting on delinquencies and credit receivables. (United States General Accounting Office 1997: 2)

Although this report raises the need for government to be aware of its overall debt portfolio and the extent to which individuals are repaying monies loaned, it does not engage with the more complex issue of whether or not different state agencies should better co-ordinate or link their activities. The only discussion of this in the literature is in the UK, with the publication of the Performance and Innovation Unit (2002) report, *Lending Support: Modernising the Government's use of Loans*. This report argues that loans as a government policy tool have developed in an *ad hoc* way, resulting in an unco-ordinated development of administrative arrangements for delivering loans policy products. This means that:

... in addition to any existing shortcomings in the administrative arrangements of individual schemes, there may be additional inefficiencies because of a lack of consistency and failure to exploit economies of scale arising from common functions. Most of the key steps in the loans promotion, assessment, payment and recovery process involve the same types of tasks. It therefore makes sense to see if improvements can be made through considering a more joined-up approach. (Performance and Innovation Unit 2002: 14)

The report identifies seven steps required for making and recovering loans, with weaknesses in the current system identified in each of these areas:

- 1) publicity, with often no clear information of who the point of contact should be for the customer
- 2) application – most loan schemes do not have the option of electronic application (with data having to be manually entered), and for some (such as student loans) the application process has to be repeated to test for eligibility and then to arrange payment
- 3) assessment, which is often not well supported by information technology
- 4) payment, with not all loans delivered by automated credit transfer
- 5) the management of accounts
- 6) the collection of repayments, with schemes differing in their efficiency
- 7) the recovery of bad debts, with only some schemes having high recovery rates, and little general guidance about the efforts that should be made to recover debt.

To address the current problems, the report suggests several ways in which loans administration could be improved. One approach is to provide the facility of online application. This has been available to higher education students, although they still have to print off the form and send it to their local education authority.⁴³ The Department for Education and Skills is considering whether to upgrade the facility by linking it to other departments such as Inland Revenue, thus removing the need to send in validating documents detailing information already known by other parts of government. Such an

⁴³ In New Zealand, students can apply online for their Student Allowance, Student Loan and Bursary payments.

approach fits with the UK government's e-strategy, which is supposed to put citizens at the centre of service delivery.⁴⁴

Following on from this, another approach is to improve data sharing between government departments. In addition to the student loan scheme, better links between the Social Fund system and the Income Support system would speed up processing time. The report suggests that a far-reaching approach would be to co-ordinate centrally the administration of account management and loan recovery functions for different loan schemes. This could be achieved either "virtually" through the establishment of electronic links between different administrative systems, or "institutionally" through a single organisation. The report suggests that such an approach would not bring about significant gains given that the different loan schemes involve very different client groups. However, if the number of government loan schemes increased, this could become more realistic. Moreover:

... it is possible to envisage greater gains if recovery of all types of debts to government held by citizens is considered. This would include, for example, recovery of unpaid fines or taxes, or overpaid benefits as well as loan repayments. The scale of these total debts to government is clearly much larger than simply unpaid loan repayments, and the potential gains from improving the systems of recovery are therefore proportionately higher. (Performance and Innovation Unit 2002: 99)

The report further suggests that in the longer term there could be gains from integrating the administration of all financial transactions between government and citizens, including taxes and benefits, as well as loans. This would be a single citizen's account, which could have the effect of improving efficiency, allowing more coherent information to individuals, and more sophisticated control and tracking of payment accounts. Of course, such an approach would raise many debates about the role of government and civil liberties.

Overall, the report suggests that a feasibility study should be set up to determine whether there would be gains from joining up and centralising the administration of financial transactions between government and citizen. In the first instance this should look at the costs, benefits and risks from the management and recovery of all debts to government administered by a single organisation. It should also look at the feasibility of establishing a single citizen's account. Such a study should also consider the following issues: the priority of government debt as opposed to other debts, how far departments should go in recovering debt, lessons that can be learnt in how commercial organisations manage customers' debt, the opportunities offered by the central administration of financial transactions for future policy development and delivery, and the policy and practical challenges of bringing together financial and other information about individuals in one place. If the study concluded that centralisation would be beneficial, the following issues would then need to be considered:

- a central organisation's role in terms of responsibility and accountability (eg, whether it would be a completely new organisation or an arm of an existing department such as Inland Revenue, Treasury or the Department of Work and Pensions)

⁴⁴ In New Zealand the "e-government" strategy fulfils a similar function.

- the boundaries of responsibility and accountability between relevant government departments and any new organisation
- the statutory basis of any data-sharing proposals
- how processes should ensure fair treatment
- how processes should take account of an individual's overall indebtedness and ability to pay, including work on how to prioritise different debts
- identification of the functions that would be core to a central organisation and those that would be performed by other parties
- defining what any central organisation would look like in terms of staffing, IT systems and structure
- developing an implementation strategy.

The report notes how developing a system for integrating the recovery of government debt, and particularly the creation of a single citizen's account, would take many years. It argues that the experience of other major projects highlights the problems there would be in trying to change systems too quickly.

Summary

Published literature detailing the changes or reforms that government could make in relation to its position as both major creditor and debt collector is limited. The areas that have been highlighted in this work relate to the reform of Court practices, the role of government in the provision of loans to low-income families, and whether or not there are possibilities for co-ordinating the collection of debt to different government agencies.

In regard to the Courts, in New Zealand the 2002 Sentencing Act and the 2002 Parole Act have put a greater emphasis on fines as a first resort. There has also been a considerable increase in the number of infringements that are unpaid and are thus lodged in the Court system. The rise in infringements has implications for both the ability of judges to pass sentences that involve fines, as well as on overall levels of over-indebtedness.

In terms of government loan schemes, these face a series of pressures. On the one hand they can be seen in a positive manner as providing cheap credit to individuals who would otherwise have gone without essential items or who would have borrowed money at very high interest rates from non-status lenders. They also recycle government money because loans are repaid and can thus be lent again to other low-income families. On the other hand, they may be seen as detrimental to poor families if loans simply replace non-recoverable grants. The administration of these schemes has also been criticised. In any case, policies relating to recoverable loans to low-income families require regular attention.

Finally, the possibility of co-ordinating the debt establishment and collection policies of government departments has been raised by the Performance and Innovation Unit of the UK government. The creation of a central organisation to collect and manage debt has the potential to improve efficiency and make it easier for individuals to access government services. However, this would require very careful planning and a much broader analysis of the strengths and weaknesses of such an approach.

Part Seven: Information Gaps

Personal debt problems – as opposed to issues relating to national debt and business debt, which are beyond the scope of this study – have received relatively little coverage in New Zealand. There have been no direct, representative surveys of people with debt problems, with consequently little information of the impacts this may be having on households. This has hindered public policy solutions: it is hard to tackle a problem when there is only tangential information on how big an issue it is and what impacts it is having.

Despite the lack of direct surveys in this country, analysis of current information sources – especially the 2001 Household Savings Survey (HSS), the 2000 Living Standards Survey and data from the New Zealand Federation of Family Budgeting Services – and from international studies allows some conclusions to be drawn. However, these figures are tentative at best. To gain a more reliable and robust picture requires further research. Ideally, dedicated research on debt issues in New Zealand would be carried out. Failing this, further research could usefully begin with quantitative data mining of the HSS and the Household Economic Survey. In particular, unit analysis of the HSS would provide further information on those people who have negative net worth and who also have low levels of human capital. Further information from the 2004 Living Standards Survey and the Survey of Family, Income and Employment should also be extremely useful.

There is also a need for qualitative data to find out more about the impact that problem debts are having on (in particular) low-income families and the reasons why a significant proportion of New Zealanders are finding themselves in this situation. Such research could involve interviews with those who are most engaged with these issues, such as budgeting advice organisations, Work and Income staff, and debtors themselves. There is need for specialist research on the apparent growth of the non-status credit industry and the reasons why this industry seems to be developing so quickly. Similarly, there is very little information on alternative, not-for-profit lenders, and thus the potential support these groups may require. Finally, there is little information on the debt establishment and collection policies and practices of utility companies, and the impacts these may be having on, in particular, low-income families.

Overall, over-indebtedness and financial exclusion appear to affect a significant proportion of New Zealand households and to be important causes and effects of low income and poverty. Further research is required to fill in the blanks in the knowledge base about this issue and thus help develop appropriate policy solutions.

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