Dragged down by debt: Millions of low-income households pulled under by arrears while living costs rise

This new research highlights that low-income households, who have borne the financial brunt of the pandemic so far, are also being dragged down by debt as we look to our economic recovery. We find that 3.8 million low-income households across the UK are in arrears, and 4.4 million have had to take on new or increased borrowing through the pandemic. Many of these households weren't in arrears before the pandemic, and have faced income loss and increases in their expenses. We are calling on the Government to do the right thing and release these households from the burden of arrears by reinstating the Universal Credit lifeline, providing grant funding for targeted debt relief, and addressing key drivers of debt through system reform.

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Morgan Bestwick, Policy and Partnerships Officer

Recommendations:

- Reinstating the Universal Credit £20 Lifeline to help prevent low-income households accruing more unmanageable debt.
- Providing grant funding for targeted debt relief: Government should at least double the Household Support Fund to equip local councils and debt support organisations to provide targeted relief to low-income households facing unmanageable and unaffordable debts accrued during the pandemic.
- Addressing the drivers of debt through systemic reforms, through preventing low-income households from accruing debt as soon as they claim Universal Credit and writing off historic tax credit debt.

Executive summary

The pandemic has had dramatically different effects on the position of household balance sheets. While many better-off households built up savings and saw their assets increase in value, low-income households have been more likely to see incomes fall, to run down what little savings they had and fall behind with their bills. The pandemic has left low-income households dragged down by debt, with far-reaching impacts on individual families and the wider economy as we enter the recovery.

This briefing shares findings from a large-scale study of households on low incomes (the bottom 40% of equivalised household income) conducted in September/October 2021. It reveals the extent of arrears on essential bills and additional borrowing families have taken on. During the pandemic the Government took bold action to protect incomes and jobs, but it wasn't enough to prevent an overhang of debt that many will struggle to repay. The Government's decision to proceed with the £20-per-week cut to Universal Credit and Working Tax Credit in October has left many of the same families facing inadequate incomes just as the cost of living is spiralling, piling further pressure on family finances.

Prior to the pandemic, in 2019/20, the Family Resources Survey showed 11% of low-income households were behind on at least one household bill or credit commitment. While our new research is not perfectly comparable, our study found 33% are now in arrears. This stark increase is deeply worrying as we look to our post-pandemic recovery.

We find an estimated 3.8 million low-income households (33%) are in some form of household arrears, and 4.4 million low-income households (38%) have taken on new borrowing or increased their existing borrowing during the pandemic. There is significant overlap between these two groups – over two thirds (69%) of households who have taken on new or increased lending during the pandemic are also in arrears.

A large majority (87%) of low-income households now behind with their bills report they were always or often able to pay all their bills in full and on time before the pandemic, underlining the pandemic's extraordinary hit to household balance sheets.

Essential bills make up the majority of low-income households' arrears. We estimate that arrears currently stand at £5.2 billion across the UK, with £3.4 billion coming from household bills like rent, council tax and utilities, and £1.8 billion from personal borrowing arrears.

Breaking arrears down into four broad categories of housing arrears, utility arrears, state debt arrears and personal borrowing arrears, we find seven in ten low-income households in arrears (2.7 million households) are in more than one type of arrears, and 35% (1.3 million households) are in three or more types. Debts owed to the state feature heavily for those in multiple kinds of debt, with council tax arrears making up half of the estimated £1.5 billion owed to the state. By easing the burden of this debt, the Government would ease the situation for heavily indebted households.

Low-income Universal Credit (UC) recipients are one of the hardest hit groups, with 7 in 10 grappling with arrears even before the cut to UC had taken effect. Despite the Government's talk of shifting to a high wage, high employment economy, our polling found that 50% of Universal Credit recipients said they did not feel confident they could find a job or work more hours. A large minority (40%) was not confident they would be able to pay their bills in full and on time in future, and not confident they will be able to avoid taking on more debt (35%). With around half planning to cut back on essentials like food to manage their budgets, an alarming picture emerges as we head into a winter where inflationary pressures and an energy crisis will be pushing up bills.

With many low-income households still reeling from the financial impacts of COVID, once again extraordinary measures are needed if we are to give families the firm foundations they need to flourish and take part in our economic recovery. We recommend the Government:

- Reinstate the £20 lifeline to Universal Credit and Working Tax Credit – and extend it to people on legacy benefits - to help low-income households pay off pandemic arrears and limit the accrual of further unaffordable debt, especially as cost-of-living pressures increase.

- At least double the recently announced Household Support Fund and give it an explicit focus to enable local councils and debt support organisations to provide targeted relief to low-income households facing unmanageable and unaffordable debts accrued during the pandemic.

- Address the drivers of debt through systemic reforms, through preventing low-income households from accruing debt as soon as they claim Universal Credit, and writing off historic tax credit debt.

Alongside this emergency support, Government must act to prevent damaging cycles of debt in the longer term. These include addressing social security adequacy to help more people avoid getting into debt; redesigning UC deductions with people with experience of them, so they cause less hardship; implementing best practice across state debt collection; and ensuring that when people need it, they have easy access to affordable credit alongside debt and insolvency support

In addition to Government action, personal lenders and utility companies can play a key role through forbearance. Like earlier in the pandemic, the Government should work with companies to enable forbearance around arrears and debt collection.

As we head into the winter, with a looming cost of living crisis on the horizon, our polling paints a deeply concerning picture of low-income households struggling to keep their heads above water, juggling multiple debts and deepening arrears. Now is the time for the Government to take urgent action to support families at risk of being pulled under by debt so they can move into the recovery with a genuinely fresh start.

Introduction

The pandemic has had dramatically different effects on the position of household balance sheets. While in aggregate there have been higher levels of saving and lower levels of debt, the picture looks very different for high- and low-income households. While better off households built up savings and saw their assets increase in value, low-income households have been more likely to see their incomes fall, to run down what little savings they had and fall behind with their bills (Leslie and Shah, 2021).

As the economic recovery is picking up, low-income households are left with a legacy of debt from the pandemic. This has far-reaching effects for individual families and for the wider economy. For individuals, the burden of debt has profoundly negative financial and emotional impacts, as well as long lasting implications for people's access to affordable credit and services. At the most extreme end, the link between problem debt and suicide is well established (Bond and Holkar, 2018).

For a Government relying on a consumer-driven recovery, low-income households dragged down by debt also poses an economic risk. This is especially the case in areas with more people on low incomes, as servicing debt further depresses incomes. On the flipside lower-income households are much more likely than higher-income households to spend any extra income they receive (Earwaker and McDonald, 2020), so easing the debt burden could help fuel the recovery.

During the pandemic the Government took bold action to protect incomes and jobs, but it wasn't enough to prevent an overhang of debt that many will struggle to repay. Proceeding with the £20-per-week cut to Universal Credit and Working Tax Credit leaves many of the same families facing inadequate incomes just as cost of living is spiralling, piling further pressure on family finances. Should an interest rate rise follow, the many households who have borrowed to cover everyday spending will be hit harder still.

This report looks in detail at the debts that low-income households - those in the bottom 40% of 'equivalised' household incomes (see methodology note) - have accrued during the pandemic - how much they are and to whom they are owed. It makes recommendations for urgent action to support families at risk of being pulled under by debt, so people can move into the recovery with a genuinely fresh start.

3.8 million low-income households are in arrears and 4.4 million have taken on new debt as pandemic support ends and living costs rise sharply

Our new analysis finds that an estimated 3.8 million low-income households (33%) are in some form of household arrears, and 4.4 million low-income households (38%) have taken on new borrowing or increased their existing borrowing during the pandemic. There is significant overlap across these two groups. 69% of households who have taken on new or increased lending are also in some form of arrears. These findings come as pandemic support through both the additional £20 to Universal Credit and Working Tax Credit and the furlough scheme comes to an end, and essential living costs are rising sharply. Both the amounts for arrears and borrowing are estimated using self-reported figures from our research commissioned from Savanata ComRes in September and October 2021. The method for calculating these values and others throughout the report can be found at the end of this paper in the notes section.

There are two types of debt we refer to in this paper: arrears and borrowing:

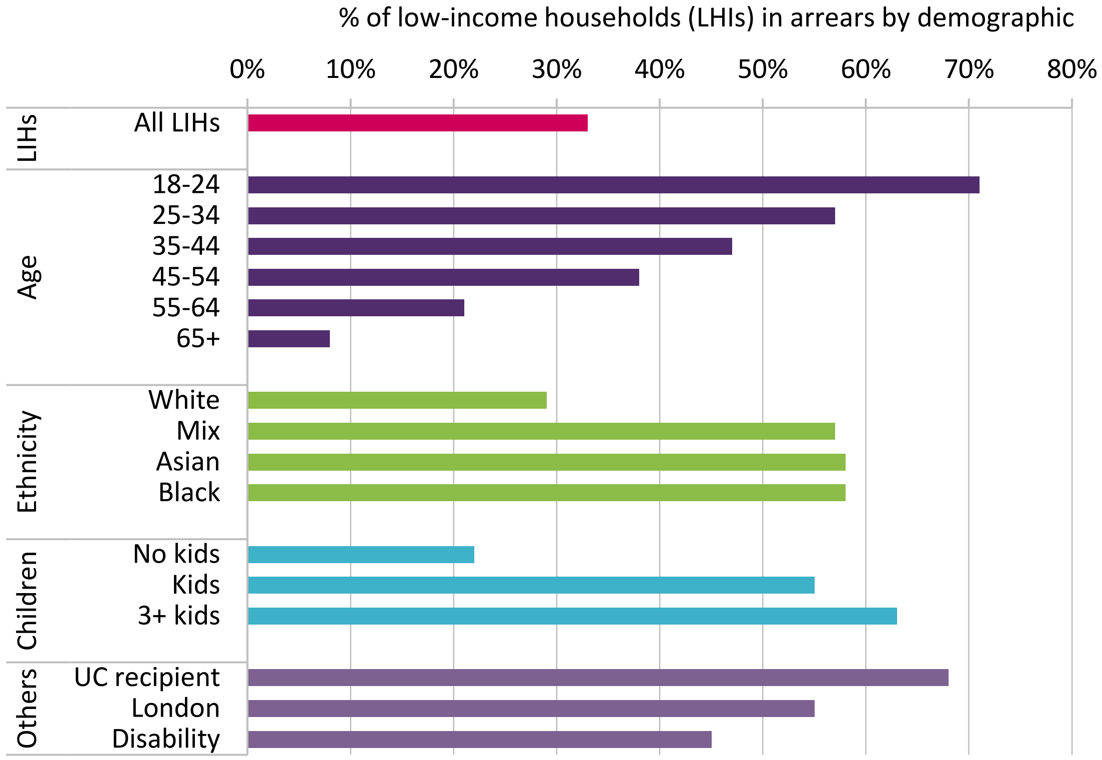
1. **Households that are in arrears** have bills and payments they have fallen behind on. Households may have fallen behind with their household bills like rent or council tax, or fallen behind on making regular borrowing repayments. These arrears signify being in problem debt, and our new research estimates that a third of low-income households (3.8 million) have now fallen behind on paying £5.2 billion worth of bills (see methodology note).
2. **Households who have borrowed** money include those who have borrowed through personal loans, credit cards or from their family and friends. Throughout this paper we refer to this kind of debt as personal borrowing. Personal borrowing is not inherently bad. However, where households end up borrowing at high interest rates (because unsecured lending tends to have high interest costs or penalties attached to it) or relying on family and friends to cover spending on essentials, this indicates that some households are struggling to make ends meet. Our new research estimates that 38% of low-income households (4.4 million) have accrued new or increased lending since the pandemic began. In total, these households have lending amounting to an estimated £9.5 billion.

Low-income households with members who are working-age, BAME, and who have children are more likely to be struggling to pay their bills

As our previous research into arrears has found (Earwaker and Elliott, 2021), some households are disproportionately more likely to have fallen on hard times and are struggling with arrears. As Figure 1 shows, even among low-income households, some are more than twice as likely than others to have fallen into arrears.

At the end of September 2021, almost seven in ten (68%) low-income, Universal Credit (UC) recipients were grappling with arrears. In addition, more than half of each of the following low-income households are facing arrears with at least one bill: households with children, those in London, those with a respondent under 35, and BAME households. They have also had their balance sheets hit hard during the pandemic, with the majority seeing a rise in expenses, and many seeing a fall in income.

Figure 1: Households are disproportionately more likely to be in arrears if they are young, BAME, have children in their household, live in London and are a UC recipient



Source: JRF research commissioned by Savanata ComRes 24 September to 5 October 2021

While a third of all low-income households are in arrears, this figure is 11 percentage points higher for working-age households, 44% of whom have arrears. Given that pension incomes haven't been negatively impacted by the pandemic, working-age, low-income households (who either receive benefits or are in work) are most likely to be hit by a loss in income, and therefore face difficult trade-offs on their spending and bills. This has been particularly stark for households where an adult between 18-24 answered our survey, where almost three quarters (71%) of those households are in arrears.

Low-income households were struggling with household finances pre-pandemic, but COVID has made a bad situation worse

Pre-pandemic, there were warning signs about low-income households' financial resilience

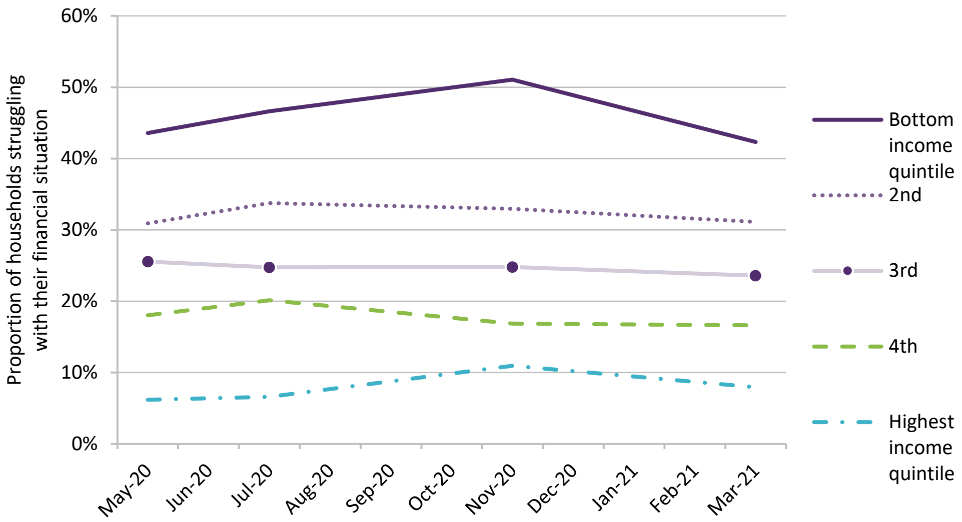
In February 2020, the Financial Conduct Authority (FCA) found that 43% of those on very low incomes (less than £15,000 per year), along with unemployed adults, renters and Black adults were more likely to have low financial resilience (FCA, 2020) than others. Low financial resilience includes factors like over indebtedness and having been unable to pay your bills or credit commitments for three out of the previous six months.

During the pandemic, low-income households' financial situations have suffered far more than those on high incomes

In March 2021, working-age households in the bottom 20% of incomes were almost twice as likely to have seen a fall in earnings during the pandemic than those in the highest income quintile (27% of households compared to 14%) (JRF analysis of USoc, 2021). And in September 2021, when the Universal Credit uplift was still in place, a third of low-income (those in the bottom two income quintiles), working-age households had still not recovered that lost income during the pandemic, suggesting recovery could be very slow for these families.

Looking across the pandemic in Figure 2, households in the lowest income quintile (in the bottom 20% of incomes) are around five times as likely to be struggling with their financial situation as those in the top income quintile (in the top 20% of incomes), and this has been consistent throughout the pandemic (42% compared to 8%). On a similar trend, we also found that those in the lowest income quintile were twelve times as likely to be behind with their bills than those in the top income quintile in March 2021, as pandemic restrictions began to ease (JRF analysis of Understanding Society Covid Waves, 2020 and 2021). In stark contrast, the Bank of England and the Resolution Foundation (2021) finds that wealthier households have tended to accumulate savings and may have been able to pay down debt should they have wished to.

Figure 2: Low-income households were more likely to be struggling with their financial situation throughout the pandemic than higher-income households



Source: JRF analysis of Understanding Society Covid waves 2020 and 2021

Note: Struggling with their financial situation is defined as those who have said they are finding their financial situation quite difficult, very difficult, or just about getting by.

Almost half of the estimated 3.8 million low-income households in arrears now were not in arrears pre-pandemic

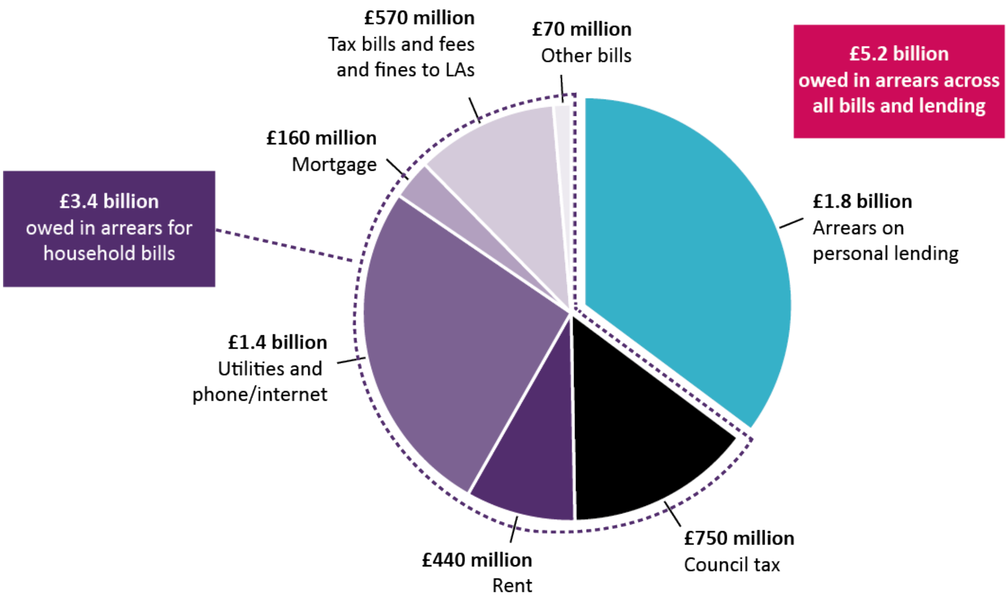
For those in arrears now (September 2021), our new analysis finds many households weren't having to grapple with arrears pre-pandemic. Almost half (47%) of low-income households in arrears now say that they were always able to pay their bills in-full and on-time pre-pandemic, and a further 40% say that they could often pay their bills in full and on time.

JRF analysis of pre-pandemic data from the Family Resources Survey shows that 11% of low-income households were behind on at least one household bill or credit commitment. While our new research is not perfectly comparable, when a similar question was asked in September 2021, it showed that 33% of low-income households are now in some form of arrears, a stark increase.

As we start to emerge from the pandemic, a third of low-income households face the burden of arrears, totalling over £5 billion in unpaid bills

Essential bills make up the majority of low-income households' arrears
As Figure 3 shows, we estimate that low-income households' arrears across the UK totalled £5.2 billion when this research was conducted at the end of September, with £3.4 billion coming from household bills like rent, council tax and utilities, and £1.8 billion from personal borrowing arrears (for example where households have fallen behind on regular repayments to their credit cards or personal loans – see methodology note). These come from household estimates made before the £20 Universal Credit cut came into effect and as households now face higher energy costs and rising overall inflation.

Figure 3: Personal lending, utilities and council tax arrears make up the majority of low-income households' arrears

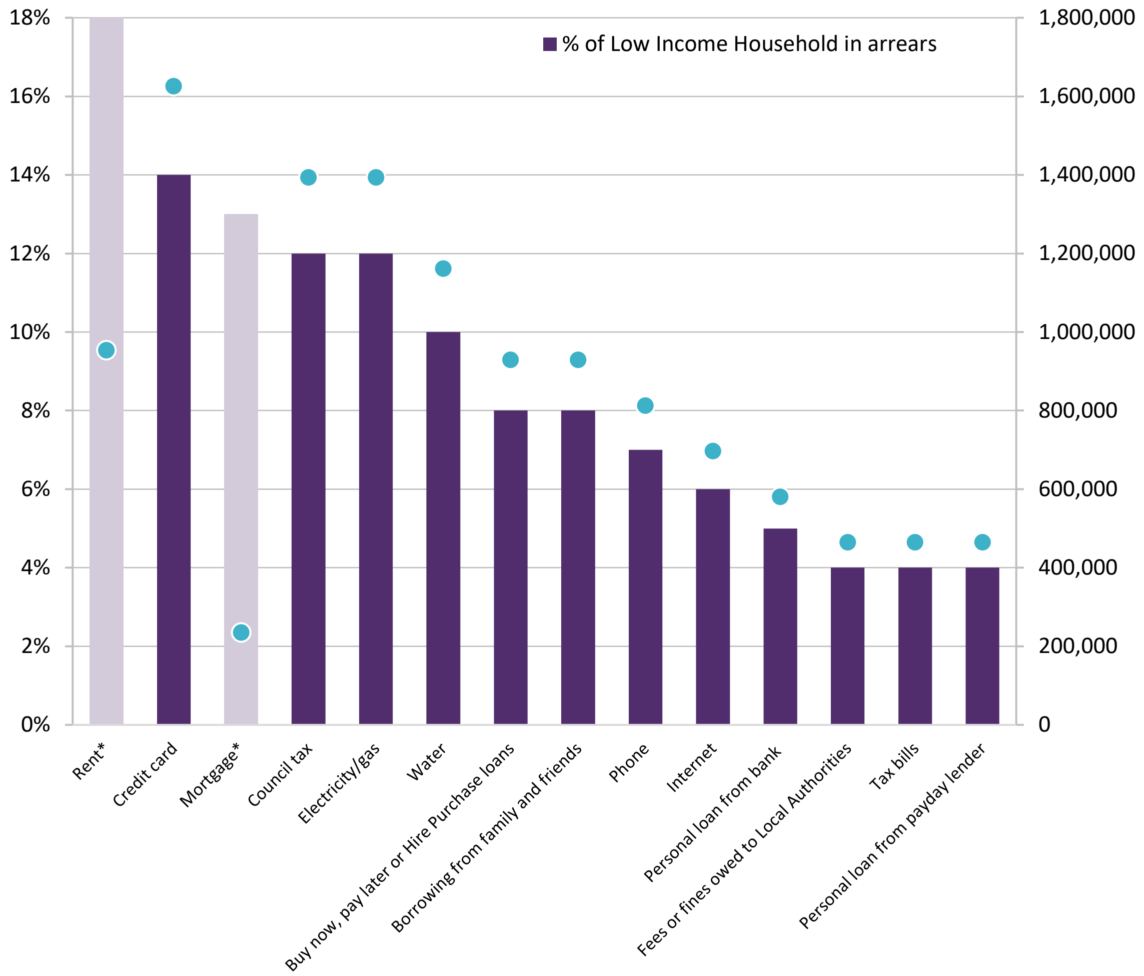


Source: JRF research commissioned by Savanata ComRes 24 September to 5 October 2021

Note: personal lending arrears includes arrears where households are behind on their scheduled lending repayments in arears such as personal loans, overdrafts, credit cards, and borrowing from friends and family. Utility arrears covers falling behind on payments including electricity/gas, water, internet and phone. Tax bills includes outstanding tax due to under or overpayments (including tax credit repayments).

Many of the 3.8 million households who hold the estimated £5.2 billion in arrears are behind on multiple types of bills - but even just looking at individual types of arrears, worrying proportions of households are behind on their bills. As Figure 4 below shows, 18% (950,000) of low-income renting households are in rent arrears totalling £440 million. Looking to other kinds of household bills, around 12% of low-income households are in arrears with their council tax (1.4 million) and a further 12% with their electricity and gas (1.4 million) bills. These figures are striking on their own, but particularly so when we know that the cost of energy is about to shoot up by hundreds of pounds next year (BBC, 2021) and inflation is on the rise (ONS, 2021).

Figure 4: Millions of low-income households are in arrears with their borrowing and household bills



Source: JRF research commissioned by Savanata ComRes 24 September to 5 October 2021

Note: Rent and mortgage arrears are not a percentage of all low income households – they are a percentage of all low income renters, or low income mortgage holders. Note that shared ownership is not included due to small sample size.

The majority of low-income households in arrears are behind on multiple types of bills, piling up pressure on millions of households

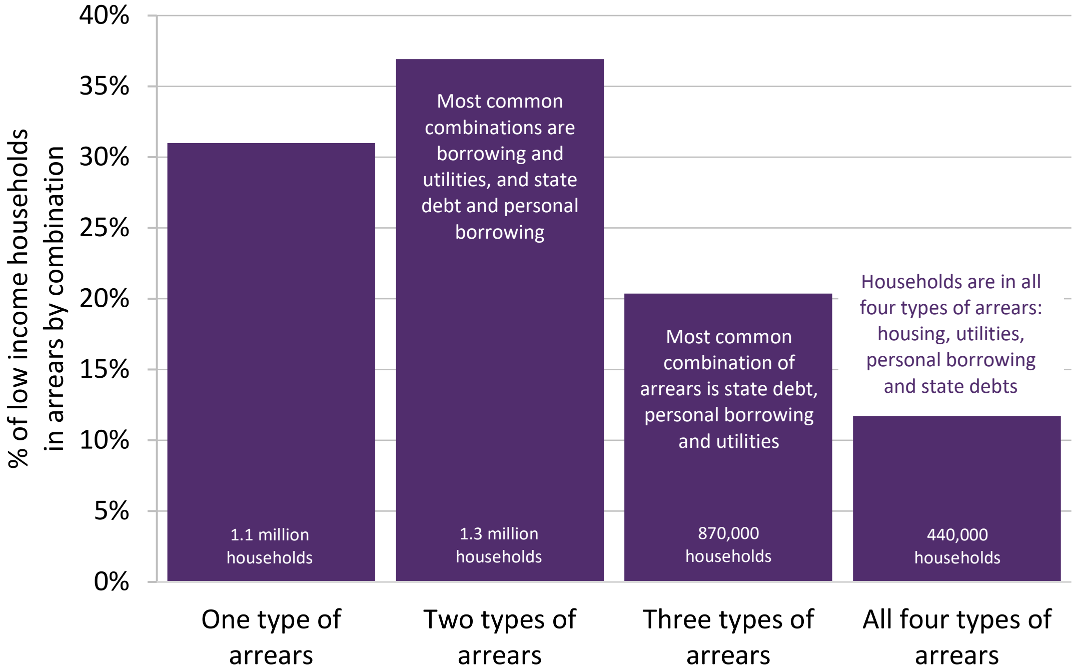
Most households in arrears are behind on more than one bill. To look at different combinations of debts, we've separated arrears into the following four categories:

- **Housing arrears:** rent or mortgage
- **Utility arrears:** electricity, gas, water, phone and internet
- **State debt arrears:** council tax, fees and fines to local authorities and tax bills
- **Personal borrowing arrears:** where households are behind on scheduled repayments for personal loans, credit cards, overdrafts, lending from family and friends, or buy-now-pay-later purchases.

As shown in Figure 5, across the four categories, seven in ten low-income households in arrears (2.7 million households) are in more than one type of arrears, and 35% of those in arrears (1.3 million households) are in three or more types. The most common combinations of types of debt are personal borrowing and utility arrears (see definitions above). We also found that around 460,000 low-income households in arrears (12%) are wrestling with all four types of arrears, and as such are having to deal with arrears owed to their landlord or bank, their local authority or central government, their bank or lender and their utility provider.

The most common combinations of arrears tended to include utilities, personal borrowing, and debts to the state, suggesting that households are trying to prioritise their housing bills - as this is where a lot of risk is attached if you miss repayments. Households owing multiple forms of arrears this winter may face an overwhelming challenge of managing or prioritising between significant multiple repayments. Where these debts are owed to the state (one of the most common types of arrears), Government is in prime position to alleviate some of this debt burden and subsequent anxiety, as we outline later in this briefing.

Figure 5: The proportion of low-income households in multiple types of arrears across housing payments, utility bills, borrowing payments and debts to the state.

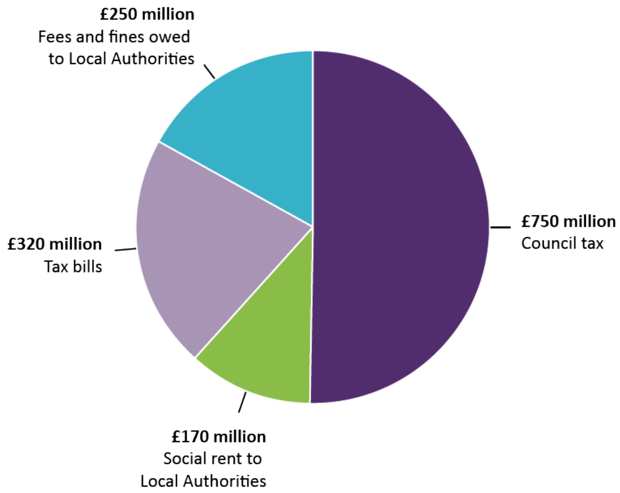


Source: JRF research commissioned by Savanata ComRes 24 September to 5 October 2021

Debts to local and central government make up a large proportion of household arrears and lending

As shown in the combination of debts section above, debts owed to the state by low-income households feature heavily for those in multiple kinds of debt. When we looked at a combination of arrears owed to the local and central government through council tax, tax repayments, fees and fines, and rent to local authorities, we found that low-income households owe an estimated almost £1.5 billion to the state. This amount is very largely owed to local councils. As shown in Figure 6, around half of this is made up of council tax arrears. The Government is uniquely placed to do something about this debt, and in doing so could ease the situation for heavily indebted households.

Figure 6: Arrears and loans owed to the state by low-income households amount to £1.5 billion



Source: JRF research commissioned by Savanata ComRes 24 September to 5 October 2021

Note: Tax bills includes outstanding tax due to under or overpayments (including tax credit repayments).

Cutting Universal Credit is not just leaving households struggling with day-to-day costs, it leaves them trapped with unmanageable debt

One of the groups most likely to be in arrears and struggling with household finances are Universal Credit recipients. This group has been hard hit through the pandemic, and over two thirds are currently in arrears. This research was carried out just as Universal Credit was being cut and the Government was talking about a shift to a high wage, high employment economy as the solution to the income loss. However, our polling found that 50% of Universal Credit recipients said they did not feel confident they could find a job or work more hours.

This group also aren't confident they will be able to pay their bills and avoid further debt: 40% are not confident they will be able to pay their bills in full and on time, while 35% aren't confident they will be able to avoid taking on more debt. More than half of these families (53%) don't think they will be able to build up any savings at all before the end of the year. Instead, around half are planning to cut back on essentials like food – but they will be facing inflationary pressures at the same time, alongside an energy crisis, which will be pushing up bills.

Government must act on pandemic arrears and debt among low-income households

The once in a lifetime occurrence of a global pandemic has hit low-income households hard financially. At the start of the pandemic Government's bold support package for households and businesses acknowledged that extraordinary times really do call for extraordinary measures. With many low-income households still reeling from the financial impacts of COVID, this is no less true. We are currently heading into a recovery with households facing enormously unequal financial hangovers from the pandemic - and with a shocking 3.8 million low-income households currently in arrears.

Without Government action now, low-income households will struggle to benefit from or contribute to the economic recovery – with over indebtedness causing enormous personal anxiety, restricting people's ability to thrive, and potentially undermining a consumer spending-driven recovery. The Government's economic forecasts in early 2021 showed a strong reliance on a recovery led by consumer spending, and it should be wary of actions that don't support this (Innes and Schmuecker, 2021). As we face a winter cost of living crisis, Government must finish the job it started in the first lockdown and introduce bold measures to urgently address low-income households' balance sheets, enabling people to get back on their feet.

Recommendation 1: the Government should reinstate the £20 lifeline to Universal Credit and Working Tax Credit – and extend it to people on legacy benefits - to help low-income households pay off pandemic arrears and limit the piling up of further unaffordable debt, especially as cost-of-living pressures increase.

Government's October 2021 cut of £20 per week to Universal Credit brought the main rate of out-of-work support down to its lowest level in real terms since around 1990, and its lowest ever level as a proportion of average earnings.

This cut has fundamentally undermined the adequacy of our social security system at precisely the moment when families are facing considerable increases in the cost of living – with rising energy bills, consumer prices and a looming National Insurance increase planned for April 2022. This policy decision is one which disproportionately affects families with children, Black, Asian, or minority ethnic ('BAME') families, and families containing someone who is disabled – many of the same families that our polling shows are more likely to have got into debt.

While some households may be facing the winter with increased housing wealth and boosted savings, the striking number of households our polling reveals are behind on paying bills and considering reducing spending in the coming months means many will likely be feeling profound worry about taking on more debt to cover essentials like keeping the lights and heating on - particularly at a time when prices are rising. A clear first step from Government should be to acknowledge the scale of the challenge facing families and reinstate the £20 increase to prevent a build-up of debt this winter.

The analysis in this paper highlights that the case for reinstating the £20 UC increase is not only its vital role in supporting low-income households to meet their day-to-day costs; it is also crucial in preventing them from accruing even greater debts and giving them a fighting chance to pay off those they already have.

Recommendation 2: the Government should at least double the recently announced Household Support Fund and give this additional funding an explicit focus to enable local councils and debt support organisations to provide targeted relief to low-income households facing unmanageable and unaffordable priority debts accrued during the pandemic.

JRF polling indicates a deeply concerning build-up across a range of arrears, including council tax, rent, utilities, and credit card debt. As we move into the recovery, Government must act to help low-income households address unmanageable and unaffordable debt accrued during the pandemic, to give them a fresh start and a genuine chance to participate in the economic recovery.

In some cases, low-income households will be able to cope with the arrears and borrowing highlighted in this report. Some will see their income rise through employment and be able to get their finances back onto something of an even keel. However, for many this will not be possible, and the arrears and debt accrued during the pandemic will continue to weigh down households – and in some cases will get worse, as Universal Credit is cut and cost of living increases.

Therefore, Government should provide one-off funding to enable households to deal with pandemic-related arrears and pay-off priority debts. This would best be done by local councils, working in partnership with debt support agencies, who have relationships with local people struggling financially and are able to identify people whose arrears and debts are unmanageable and unaffordable.

A straightforward mechanism for channelling such one-off funding would be via the recently announced £500 million Household Support Fund (which currently has a very limited remit to address problem debt). Given this funding is already established, this may be simpler and more effective than other funding routes; JRF's previous work on rent arrears (Baxter et al, 2020) highlights some of the limitation of Discretionary Housing Payments (DHPs) in addressing rent arrears for all low-income households.

As a start, the Government should at least double the size of this fund and give this additional funding an explicit focus to deal with arrears and debt that households are not going to be able to manage or repay. This extra funding should be seen as a first instalment, to give local councils and debt support agencies a fighting chance to work with households at significant risk of going under financially ahead of Christmas. Government should commit to tracking arrears and debt levels as we head into the winter and stand ready to respond with further funding if needed in the New Year.

It is important that this is flexible funding to allow local authorities to identify and respond to the situation of households in their local area – as the circumstances of households facing arrears and debts will vary greatly. To assist, Government should provide guidance on the types of problem debt to address, with a focus on rent and council tax arrears, and with the flexibility to cover other priority debts where these are unaffordable for households. This should be underpinned by some simple reporting metrics, to track how much of the funding has been spent, how many households have been helped, and any reason for underspend.

To ensure this support gets to the households who need it fast, Government should allow councils to use a small proportion of the funding for administration, including to underpin partnerships with debt specialists and advice organisations. This would build on learning from the Scottish Welfare Fund scheme (Poverty and Inequality Commission, 2020). The Government should also commit to raising awareness of the grant scheme nationally, including through a targeted campaign. This should include communicating through trusted intermediaries like GPs and community organisations.

Recommendation 3: the Government should address the drivers of debt through systemic reforms, through preventing low-income households from accruing debt as soon as they claim Universal Credit, and writing off historic tax credit debt.

Reforming the start of the Universal Credit claim process

Our polling shows six in ten UC recipients have taken out a UC advance/loan; this mirrors the 2020 figure cited by DWP of around 60% of new claims typically taking an advance payment (Schofield, 2020).

People turning to the social security system for essential support should not have to choose between hardship now or debt later on, but this is precisely what the design of the start of the UC claims process drives. The system, based on monthly payments in arrears, forces households to take on debt if they need immediate financial support when they begin their claim. Evidence shows that in practice many people do delay making a UC claim until the point that they really need it, coping until then on their own resources, only to find they have to take out a repayable advance when they do seek support (Summers et al, 2021).

One key consequence of this systemic debt driver is that households are having to get by, in practice, on levels of support even lower than the inadequate rates of social security support. Typically, deductions can take up to 25% of your monthly Standard Allowance, and advance repayments make up around half of the money deducted from UC claimants in aggregate (Quince and Stephens, 2020 and 2021) - meaning many households are not only facing a £20 cut in their Standard Allowance, but that this cut is coming on top of a potential deduction of up to a quarter of their Standard Allowance. For example, for a couple, a 20% deduction equates to losing around £102 per month from their UC claim.

The current policy of only offering a repayable advance when people first claim is systematically driving low-income households into debt, and then lowering their actual income over a period as that debt is recouped through deductions.

The Government response to this structural problem has been to say that it is inherent in the design of UC, which is based on monthly payment in arrears. But with advance payment debts taken out by the majority of claimants, they are demonstrably an institutionalised and widespread part of the system - and it is no longer credible to say this cannot be addressed. There are clearly technical and financial issues to work through, but we suggest three potential options for tackling this issue here.

First, people submitting a claim could receive a full payment for that initial month upfront, based on an estimated award, subject to their identity being verified. Unlike the current advance, this would be non-repayable. For anyone whose claim is refused, this initial payment could be treated as an overpayment from the state, to be paid back. There is no technical barrier to this, as the Government is currently operating a system that calculates and pays that first monthly claim (as an 'advance'). This is therefore the simplest answer - though also the most costly. Correspondence from DWP suggests that changing the policy to introduce this initial payment could cost somewhere around £2 billion per year whilst UC completes its rollout (DWP, 2020) – although the assumptions underpinning this estimate are unknown and likely subject to a range of variables.

Second, the DWP could make this initial advance payment non-refundable for those who can demonstrate they have no other source of income or face other particularly high risks of hardship. This would be a more complex solution, requiring an assessment of affordability - but also cheaper. Or thirdly, the Government could only require repayment of advances once a household earns enough to no longer receive Universal Credit. It would mean less of the funding for advances is recouped by the Government, but it would focus the repayment burden on those with somewhat higher incomes.

Upon addressing this problem of UC advances, Government should consider how to ensure fairness between current claimants repaying existing advance debts, and future claimants; this could involve writing-off all existing UC advance debt still within the system.

Writing-off tax credit debts for households on low incomes

Tax credit debt should be a second key area for Government to consider in relieving some of the debt burden weighing on households within the social security system. Evidence shows deductions from UC for tax credit overpayments are causing significant hardship (StepChange, 2021), and many people are not even aware they have historic tax credit debts (APPG on Universal Credit, 2019) - until they transfer to UC and deductions begin.

The Government estimates some £5.4 billion of tax credit overpayment debt either has or is due to be transferred to DWP from HMRC to be collected as people move onto UC

(House of Lords, 2021). Much of this debt is historical: data from 2019 shows that 68% of the debt is from before 2016, 16% from before 2011 (APPG on Universal Credit, 2019). The overall debt owed is likely to grow further: as of April 2021, 1.9 million families were still claiming working or child tax credits (HMRC, 2021).

There are two significant policy design issues with the tax credit system which have given rise to these overpayment debts. The first is the inherent risk of overpayment or underpayment in an annual system which calculates payments based on an estimated income for the coming year, then reconciles payments at the end of the year once actual earnings are reported. The second is the active choice to decrease the generosity of the income disregard threshold – the amount your income can vary by before your award is recalculated – which was reduced by the Coalition Government from £25,000 in 2010 to £2,500 in 2016. This reduction removed much of the 'smoothing' power of the more generous buffer amount. Analysis shows tax credit overpayment debt increased sharply in response (Royston, S. 2017).

The ongoing agreement to transfer tax credit overpayment debts from HMRC to DWP for collection can mean a historic tax credit debt – potentially one which HMRC has neither chased nor notified you of – suddenly crystallising in the form of unaffordable debt deductions from the minute people start their UC claim. This can add to an already unmanageable debt burden for many, with historical debts which may have gone unpursued suddenly being automatically deducted from your UC claim.

Government should fully write off tax credit debt for people transferring to UC, putting an end to new UC claimants being hit with historic debt repayments. This would be the simplest approach to addressing the ongoing burden of historic tax credit debt, though would involve the state foregoing potential income if that debt were re-claimed from low-income households via deductions to their UC entitlement. However, while this involves an upfront cost in terms of forgoing potential income, the alternative is for Government to fail to act on this and continue to try to collect over £5 billion from households on the lowest incomes.

This would also target debt write-off at people on the lowest incomes and who are claiming means tested benefits. In combination with this, to prevent further debts from accruing while the transition from Tax Credits to UC completes, the Government should significantly increase the generosity of the income disregard again, to ensure current Tax Credit claimants are less likely to accrue debt. For existing Tax Credit claimants, Government should also write off historic tax credit debts which have not been pursued for six years, in line with the general limitation period applying to other debts, and fully write off debts created as a result of administrative error on behalf of DWP or HMRC.

Preventing future debt

Alongside emergency support, Government should take additional measures to prevent damaging cycles of debt in the longer term. These include addressing social security adequacy to help more people avoid getting into debt; implementing best practice across state debt collection; and ensuring that when people need it, they have easy access to affordable credit alongside debt and insolvency support.

Social security adequacy and affordability

Our social security system should protect families from harm, keeping their heads above water, but JRF analysis shows a consistent picture of an inadequate system that is failing to protect families, or give them the stability needed to escape poverty (JRF, 2021). This highlights the need for Government to design essential services in an inclusive way, ensuring they understand and respond to the pressures facing low-income households. Beyond reinstating the £20 lifeline, Government should review the broader adequacy of the social security system to ensure it provides a genuine safety net, alongside embedding affordability assessments in debt deductions. Government should also work in partnership with people with direct experience of the debt deductions system to redesign it to ensure it works properly for people on low incomes.

With our data on housing arrears painting a worrying picture for renters, Government must take further action around housing support in particular. The freeze in cash terms to Local Housing Allowance (LHA) rates from April 2021 puts additional pressure on low-income households. To address the growing shortfall for low-income renters, Government should at least ensure that LHA rates rise in line with local rents each year, to help protect people from falling into debt covering essential housing costs.

Ensuring state debt collection practices don’t increase hardship

When households do accrue arrears owed to the state, Government should ensure state debt collection processes model best practice around fairness and affordability.

Government’s recent publication of new best practice guidance on council tax enforcement is a welcome step in improving enforcement practices across local authorities (DLUHC, 2021), but further action is needed. Research shows people receiving partial Council Tax Support are more likely to be in arrears on certain other bills and credit commitments than people receiving full support (Money Advice Trust, 2021). Government should increase funding to ensure full local council tax support for people on the lowest incomes, and amend regulations to improve council tax collection processes, including preventing missed council tax bills from escalating so quickly.

Government has made recent welcome moves around debt management, including through the Debt Respite Scheme – which includes Breathing Space and the Statutory Debt Repayment Plan - publication of the Debt Management Vulnerability Toolkit, and Cabinet Office’s ongoing review into fairness in Government debt management. It now has further key opportunities to make meaningful reforms to state debt collection, including through responding to sector-wide and cross-party calls for a Debt Management Bill. Now is the right time to implement ambitious reforms to state debt collection to ensure it is fit for the future and demonstrates the highest standards of ethical debt collection.

Ensuring people can access affordable credit, advice, and support

If and when things do go wrong, people must be able to access affordable credit, good quality debt advice and support, and accessible and effective insolvency measures which offer a genuinely fresh start. Government's commitment to funding the pilot no interest loans scheme is a welcome step in expanding much-needed access to affordable credit. Government's promised review of the Insolvency Service must be a key opportunity to ensure insolvency measures work for people on low incomes.

Conclusion

As we head into the winter, with a looming cost of living crisis on the horizon, our polling paints a deeply concerning picture of many low-income households struggling to keep their heads above water, juggling multiple debts and deepening arrears.

Now is the time for Government to take urgent action to support families at risk of being pulled under by debt. Through a combination of emergency debt relief grants to households and a lifting of the state debt burden for many people on low incomes, Government can help guarantee low-income households move into the recovery with a genuinely fresh start.

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Methodology notes

Savanta ComRes surveyed 4,193 UK adults aged 18+ in households in the lowest 40% of equivalised household income between 24 September and 5 October 2021. 4,093 were surveyed online and 100 with very low digital skills were surveyed by telephone. Data were weighted to be representative by age, gender, region, ethnicity and housing tenure. Data tables can be found at comresglobal.com/our-work/poll-archive/. Out of the 4,193 respondents polled, 2,934 were working-age (18-64), which is representative of low-income households in the UK. The age breakdowns of the respondent numbers are as follows:

- 18-24: 356
- 25-34: 534
- 35-44: 657
- 45-54: 688
- 55-64: 699
- 65+: 1,259

The sample is representative of low-income households across the UK, and our low-income threshold is based on figures from the Households Below Average Income Survey (HBAI) 2019/20.

Our definition of low-income households for this paper is households in the bottom 40% of incomes across the UK, using a Before Housing Costs (BHC) equivalised household income. This income definition includes earnings and benefits, as well as other income sources. Households had to have a BHC equivalised household income of under £24,752 to participate in the survey.

Where we have scaled up the survey findings to population level, this has been done by JRF, and uses population numbers based on the HBAI 2019/20 survey.

Where we have estimated the amount of arrears held by type of bill, the amount of lending by type of borrowing, or the amount of savings held by a household, we have taken the following approach:

- Respondents were asked to choose a band that reflected the amount of arrears/lending/savings held, for example £700-749.
- We have then used the midpoint of these bands (for example, £724.50) and multiplied it by the number of people in each band, taken the total for each type of arrears/lending and divided it by the number of people in arrears. This provided us with the average amount of arrears using the mean, and then we have multiplied this by the number of households in arrears and scaled up to population level using HBAI household figures.
- For the highest band, we have taken its lower bound – this is a conservative estimate.
- Further tables can be provided on request.

About the Joseph Rowntree Foundation

The Joseph Rowntree Foundation is an independent social change organisation working to solve UK poverty. Through research, policy, collaboration and practical solutions, we aim to inspire action and change that will create a prosperous UK without poverty.

We are working with private, public and voluntary sectors, and people with lived experience of poverty, to build on the recommendations in our comprehensive strategy - We can solve poverty in the UK - and loosen poverty's grip on people who are struggling to get by. It contains analysis and recommendations aimed at the four UK governments.

All research published by JRF is available to download from www.jrf.org.uk

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