The impact of the Covid-19 pandemic on problem debt in the UK

In association with Ian Moore and Rohan Shah

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PRO BONO ECONOMICS

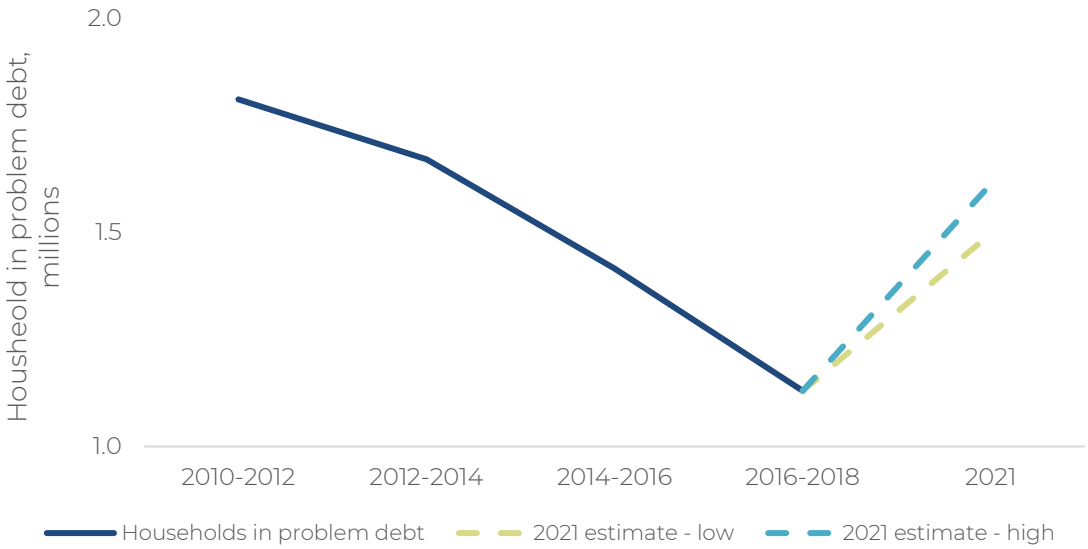
Contents

Pro Bono Economics uses economics to empower the social sector and to increase wellbeing across the UK. We combine project work for individual charities and social enterprises with policy research that can drive systemic change. Working with 400 volunteer economists, we have supported over 500 charities since our inception in 2009.

Summary

The seismic shifts the Covid-19 pandemic has created in the UK economy have dramatically impacted the personal finances of the most vulnerable in society. With around 900,000 fewer jobs and 8.9 million people potentially experiencing cuts in their income through furlough, more people are turning to borrowing to stay afloat and to pay for the basics. In December, Citizens Advice estimated that 7 million adults were behind on at least one household bill, with renters, young people, parents of children under 5, those on zero-hour contracts and those from BAME backgrounds all particularly vulnerable to this financial stress.

This evidence of more people borrowing and struggling financially is likely to foreshadow a significant growth in "problem debt" – when someone becomes unable to pay their debts or household bills. Our analysis, commissioned by Citizens Advice, finds that there could be at least 1.5 million households at risk of problem debt by mid-2021 as a result of the economic fallout from the Covid-19 crisis - an increase of 370,000 – 480,000 households compared to pre-crisis levels. Around 150,000 – 270,000 of this increase is down to expected job losses, while a further 140,000 working households are at risk due to reduced incomes after being furloughed or having hours reduced.



This rise is a serious concern. The stresses and strains of unmanageable debt are closely related to wider problems in people's lives such as financial exclusion, family breakdown and poor physical and mental health. It is also a concern for wider society, as it has significant resultant costs to public services. Indeed, we estimate that current problem debt is likely to cost the government in the region of £0.35 billion per year as a result of increased demands for mental health support and statutory housing provision, with a total cost to society of around £1.25 billion per year once the costs of lost employment are included. This is an increase in costs to society from problem debt of around £350 million per year as a result of the Covid-19 crisis.

Our modelling suggests nearly half of this impact could be concentrated in the 16-24 age bracket, reinforcing fears that the financial burden of the crisis is falling disproportionately about the shoulders of the young.

These estimates add to the growing evidence about the impact of the crisis on the personal finances of the most vulnerable in society. It highlights the need for government to consider what measures could be introduced to support those struggling with problem debt and help the UK to "build back better". Citizens Advice are calling on the government to provide financial support for people who have built up debt because of the pandemic. They believe financial support should be prioritised for people with rent and council tax arrears, where the consequences of having arrears can be most severe.

At least

1.5 million

Households at risk of problem debt by mid-2021

Additional households likely to be struggling with problem debt as a result of job losses during the Covid-19 crisis

150k - 270k

140k

additional working households at risk of problem debt due to reduced incomes

Total cost to society from problem debt

£1.25 bn

due to knock-on consequences of increased health service costs, demands on statutory housing services and lost employment

Introduction

The Covid-19 pandemic has had an unprecedented impact on the social and economic fabric of the UK. Measures introduced to control the spread of the virus have had dramatic effects on large swathes of the economy, leading to a reduction in the number of jobs between September 2019 and September 2020 of around 900,000[1], in addition to the 8.9 million people potentially facing reduced income as a result of being furloughed through the Coronavirus Job Retention Scheme[2].

A number of organisations have been quick to highlight the impact that these shocks to the economy are having on the financial resilience of households across the UK[3] – an effect exacerbated by the disproportionate impact of the crisis on younger age-groups and low-income households[4].

In May 2020, Citizens Advice published a report examining the range of consumer protection measures put in place during lockdown, and also provided some initial survey evidence of the impact on the incidence of households falling behind on bill payments, build up of debt and indebtedness.[5] This was followed by further survey evidence published in December reporting 7.3 million adults had fallen behind on at least one household bill since the start of the pandemic.[6] Meanwhile, the ONS' latest data indicates that 19% of adults reporting their household finances are being affected by Covid[7] and that 9 million people had to borrow more money because of the coronavirus pandemic in the latter half of 2020[8].

But problem debt is more serious than regular borrowing, where most will be repaid. Those in problem debt are unable to make repayments on what is owed, and the longer the economic crisis goes on, the greater the concern about those in this situation.

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[1] Source: HMRC PAYE Real Time Information, from ONS Labour Market Statistics December 2020

[2] Peak numbers on CJRS in May 2020. Source: CJRS Statsitics accessed at https://www.gov.uk/government/publications/coronavirus-job-retention-scheme-statistics-december-2020

[3] For example, StepChange estimated in May 2020 that 28% of adults, or 14 million people, had experienced a direct negative effect on their income. See StepChange (2020a) *"Coronavirus and personal debt: a financial recovery strategy for households"*, June.

[4] in July 2020, take up rate of furlough among 18-24 year olds was 23%, nearly two-thirds higher than the 14% rate among 45-54 year olds. Source: CJRS Statistics as above.

[5] Citizens Advice (2020a): *Near the cliff-edge; how to protect households facing debt during COVID-19*

[6] Citizens Advice (2020b): *Debt at the close of 2020*, Citizens Advice.

[7] ONS, Coronavirus and the social impacts on Great Britain, February 2021

[8] ONS, Personal and economic well-being in Great Britain: January 2021

Scope of this study

Our report supplements this early evidence, setting out an initial analysis of the potential impact of the current Covid-19 crisis on problem debt in the UK focused on two key questions:

- How is the Covid-19 crisis likely to affect the incidence of problem debt in the UK?
- What are the potential wider societal costs from this increase in problem debt?

We focus on how the dramatic changes in the labour market related to employment, unemployment and inactivity, and also earnings could translate through to changes in the incidence of problem debt. We then explore what these changes may mean in terms of wider costs to society.

This analysis provides an early assessment of the potential scale of the impacts that the ongoing crisis could have on problem debt. However, as the pandemic continues to progress, there remains significant uncertainty about the economic situation. Nevertheless, as all indicators are that incidence of problem debt is growing, it is vital that policymakers debate how to limit the serious negative consequences of problem debt for both individuals and society.

Background

What is problem debt?

Problem debt has been defined by the National Audit Office as follows:

> "Over-indebtedness, or problem debt, is when someone becomes unable to pay their debts or other household bills" [9]

Problem debt occurs in both the financial sector (unsecured or secured borrowing such as credit cards and mortgages respectively) but also in respect of household bills. The largest sources of household bill indebtedness are: from essential services provision (water, electricity, phone), in respect of housing (rent arrears to either private or social landlords) and from debts to government (council tax arrears, or overpayments of tax credits and other benefits).[10]

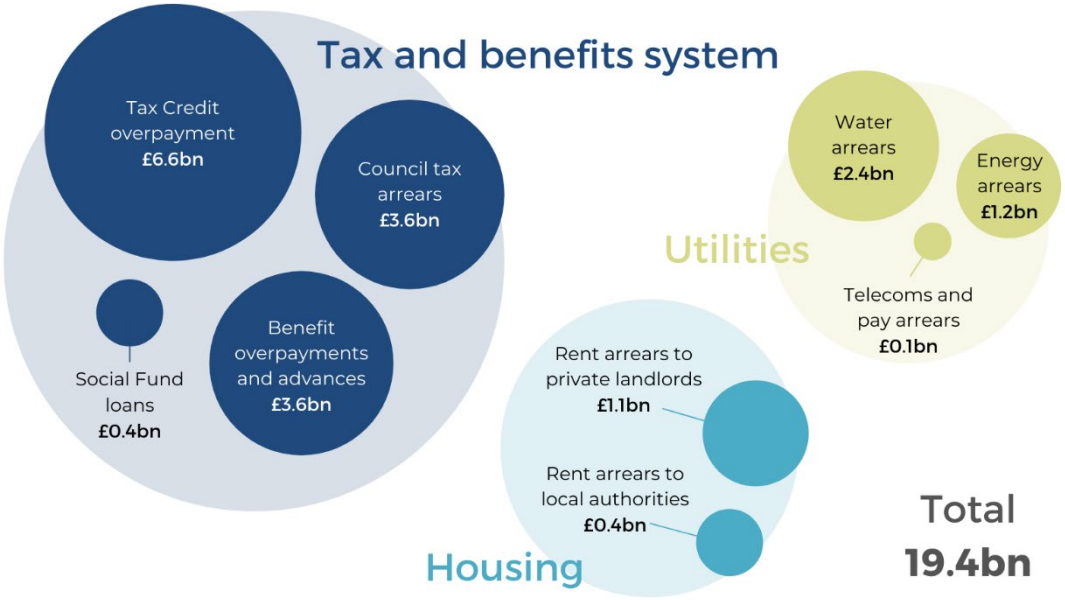
The scale of problem debt in the UK before the crisis

A number of studies have estimated the scale and incidence of problem debt in the UK prior to the pandemic.

The NAO has estimated that the level of problem debt stands at £18 billion, of which debts to government were £13.7 billion and debts in respect of utilities and rent were £4.4 billion – see Figure 1. The dates of the individual data components and their reporting vary somewhat, but with the majority of datapoints either March 2017, December 2017 or March 2018, as a rough approximation we take this to be "end-2017". This estimate is broadly in line with that produced by Citizen's Advice for broadly the same time period, which suggested problem debt stood at £18.9 billion.[11]

[9] NAO (2018): *Tackling problem debt,* HC1499 Session 2017-2019, page 12, para 1.1
[10] NAO (2018) and Citizens Advice (2018) *"Hidden debts: the growing problem of being behind on bills and in debt to the government"*.
[11] Citizens Advice (2018), Citizens Advice also included an amount of £610 million in respect of court fines, fixed penalties and compensation orders.

Figure 1. Pro Bono Economics' estimates of the value of problem debt in 2019



We estimate that the monetary value of problem debt in the UK at the end of 2019 stood at £19.4 billion – around 7.5% higher than at the end of 2017.[12] Growth is widespread across all broad categories, with particularly rapid growth in debt from housing.[13]

This growth in the monetary value of problem debt is a continuation of the broad trend over a longer period highlighted by Citizens Advice who estimate that total household bill debt increased 34% over the six years from £14.1 billion in 2010/11 to £18.9 billon in 2016/17.[14] It is particularly striking that this growth in problem debt in the last 2 years appears to have occurred at a time when economic circumstances were generally favourable, in particular unemployment has fallen from 4.6% of the labour force to 3.8% over the same period, and average weekly wages have risen from £510 (Q42017) to £543 (Q42019)[15].

[12] Full details of our sources for updating these figures are available in Annex A.
[13] Where individual line items are declining in Annex A, there are very specific explanations (eg Social Fund arrears) or weaknesses in the methodology (eg private sector rent arrears) where we would otherwise be expecting increases. Further, some line items are increasing despite underlying factors which would otherwise be driving a decrease (eg housing association rents falling 1% pa).
[14] Citizens Advice (2018) provides estimates from 2010/11 to 2016/17.
[15] Source: Labour Force statistics, per data tables released alongisde the Office for National Statistics (2020) *"Labour market review, UK: December 2020"*, published 15 December 2020

Figure 2. Summary of updated NAO estimate of problem debt

£m	NAO "end 2017"	PBE "end 2019"	Change
Debt from utilities	3,400	3,683	8.3%
Debt from housing	1,310	1,549	18%[16]
Debt from tax and benefits system	13,346	14,179	6.2%
Total problem debt	**18,056**	**19,411**	**7.5%**

There is some evidence to suggest this phenomenon may be linked to a growing value of problem debt being concentrated in an increasingly small group of households prior to the pandemic. The ONS Wealth and Assets Survey estimates that the prevalence of problem debt across households may have been falling prior to the crisis, from around 1.4 million households in 2015-2016 to around 1.1 million households 2016-2018.[17] The gradual reduction is in line with what we would expect given the broader macroeconomic picture at that time and paints a concerning picture for the households in which problem debt was likely concentrated within prior to the crisis.[18]

The impacts of problem debt

Problem debt is not just a private problem but has societal costs as well. There is quite an extensive literature highlighting the impact of problem debt on (worse) physical and mental health, with consequent impacts in terms of demand on the health service and other facets of publicly funded

[16] We have used an alternative source of data for Housing Association arrears which suggests a higher absolute level of debt. On a like-for-like comparison Debt from Housing has grown by around 9%.

[17] The WAS definition of problem debt is "having liquidity problems, solvency problems or both". Where "liquidity problems" is defined as "falling behind with bills or credit commitments and (in two or more consecutive months) arrears on bills or credit commitments, or household debt repayment to net monthly income ratio >25%, and "solvency problems" is defined as "feel debt is a heavy burden and debt to net annual income ratio > 20%". See "Methods Note" in the household debt tables downloaded from https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/householddebtwealthingreatbritain

[18] As there is not a good historical relationship between the monetary value of problem debt and the WAS data for number of households, we are unable to use this to update the baseline for number of households. A more up-to-date figure for pre-Covid position will become available when the WAS Wave 7 data (covering 2018-2020) is published.

support services[19]. One report highlighted that "almost half (46%) of people in problem debt also have a mental health problem, compared to just one in six (17%) of people who are free of problem debt"[20]. The RSPH has produced a report that drew together various academic literature, noting that debt "has been linked to poorer self-rated physical health, disability, chronic fatigue and obesity"[21].

One study, NAO 2018, has modelled the costs of these wider societal externalities. In its work, said by the NAO to be the first estimate of the cost of problem debt to the public purse, the NAO used national survey data (Wealth and Assets Survey and UK Household Longitudinal Survey) to estimate the effect of being in problem debt on an individual's likelihood to become unemployed, increase their benefit uptake, suffer from anxiety or depression, or be in state-subsidised housing. These outcomes were then translated into costs using previous research, for example, the average cost of treatments for common mental health disorders.[22] They estimate that the direct cost to taxpayers as a result of these problems caused by problem debt was around £248 million per year, with the wider societal costs, including the costs of lost employment, reaching £900 million per year. This highlights the scale of the potential costs to society from this issue.

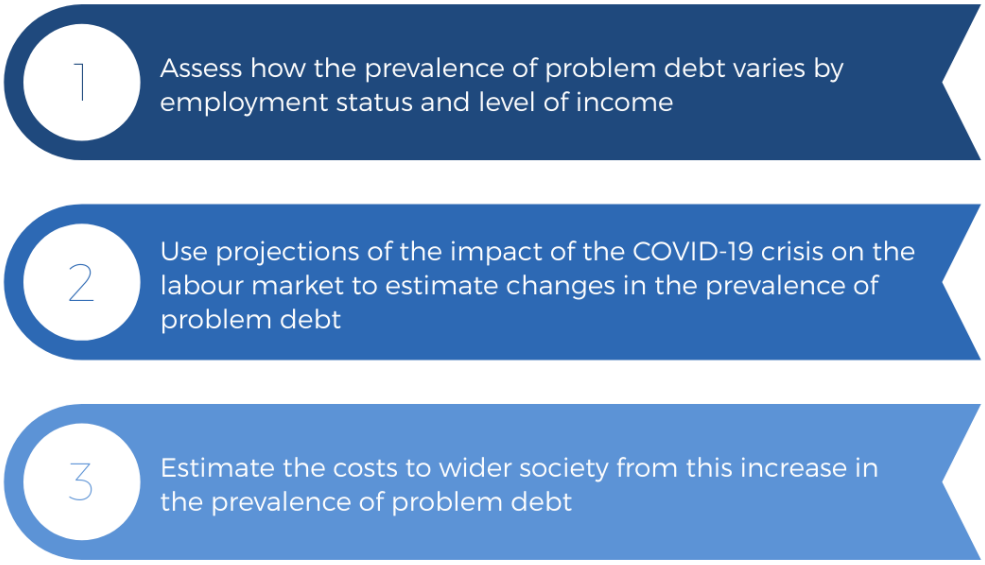
[19] For example: Royal Society for Public Health (2018) *"Life on Debt Row"*; Gathergood J. (2012) *"Debt and Depression: Causal Links and Social Norm Effects"*, The Economic Journal, Vol. 122 Issue 563, September 2012, pp. 1094-1114; Money & Mental Health (2019), "*Debt and mental health: a statistical update*", Policy Note no. 15, March. See also PBE's 2020 review of the literature for Fair4All Finance.
[20] Money & Mental Health (2019), p3
[21] Royal Society for Public Health (2018), p6
[22] See NAO (2018) p.45 for further details and Pro Bono Economics (2020): *Externalities arising from use of high cost credit in the UK*.

Our approach

To assess how the number of households experiencing problem debt is likely to have changed as a result of the current crisis and the potential costs of this for wider society, we undertake a three step process:

1. **Assess how the prevalence of problem debt varies by employment status:** we use data from the latest wave of the ONS Wealth and Assets Survey to assess the difference in problem debt prevalence by age and whether an individual is employed, unemployed or economically inactive.
2. **Use projections of the impact of the Covid-19 crisis on the labour market to estimate the change in prevalence of problem debt:** we use latest ONS labour market data to estimate the potential change in the prevalence of problem debt from: increased unemployment, increased economic inactivity and reductions in income for the those still in employment.
3. **Estimate the costs to wider society from this increase in the prevalence of problem debt:** we draw on existing evidence on the wider societal costs of problem debt to estimate the potential impact that an increase in problem debt prevalence will have on costs to wider society.

Figure 3. Summary of our approach

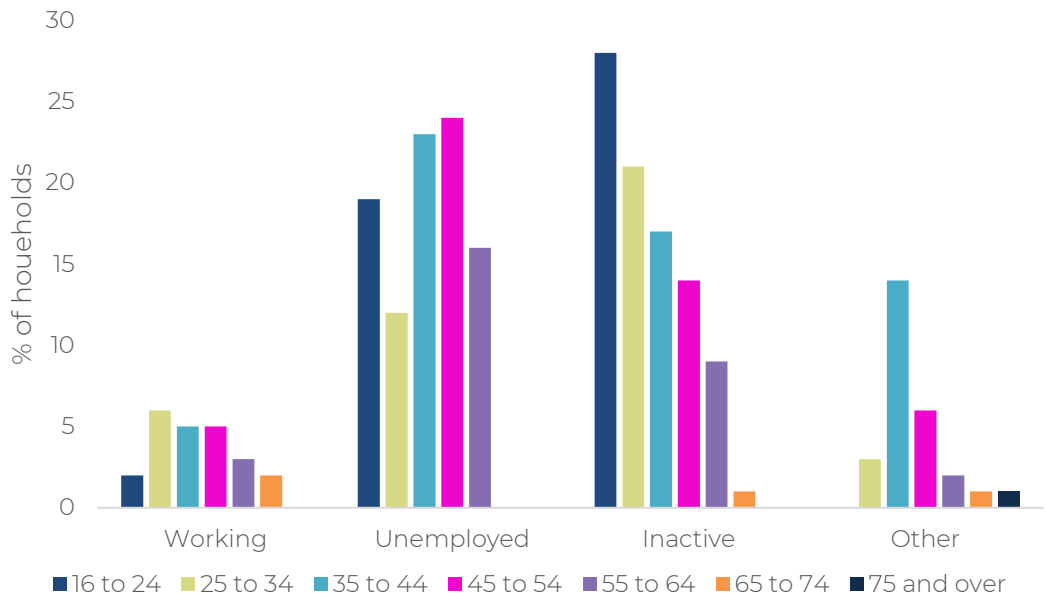


Step 1: Assessing how the prevalence of problem debt varies by employment status and level of income

Data from the WAS shows that the prevalence of problem debt prior to the pandemic varies significantly depending on employment status. Unemployed households have a 4x higher prevalence of problem debt

compared to the employed, with similar levels for those that are inactive. As Figure 4 shows, there are further marked differences in prevalence of problem debt depending on both economic status (employed, unemployed, inactive) and by age band.

Figure 4. Prevalence of problem debt by age and economic status, 2016-2018



Source: Wealth and Assets Survey, Wave 6

Although on average the prevalence of problem debt is low amongst those that are in work, the ONS have published evidence demonstrating that there are many working households in a very precarious position where a reduction in income could have a significant impact on their financial resilience.[23] Their analysis shows that it is the poorest households with least financial resilience. In the bottom fifth of households, 40% of households had insufficient financial reserves to withstand a 25% drop in income for 3 months (vs 90% with sufficient reserves for the top quintile). For these households, a significant decrease in income is likely to put them at high risk of entering problem debt.

Step 2: Projecting the impact of the Covid-19 crisis on prevalence of problem debt

The second stage of our evidence pathway is to project forwards the level and prevalence of problem debt to a point when the post-Covid economic

[23] ONS (2020a): *Financial resilience of households; the extent to which financial assets can cover an income shock*, Office of National Statistics

cycle has reached its nadir. Broadly, we consider this to be "mid-2021" for central scenario economic forecasts, later in the case of a downside scenario.

We combine evidence on the higher prevalence of problem debt amongst those that are unemployed and inactive, as well as evidence from the ONS study on the financial resilience of those on low incomes, to estimate how projected changes in the labour market as a result of the Covid-19 crisis are likely to affect levels of problem debt.

We separate our analysis into two parts:

1. The change in problem debt for those no longer in employment
2. The change in problem debt for those in employment but facing a reduction in income

The change in problem debt for those no longer in employment

2020 has seen a dramatic rise in the level of unemployment and inactivity in the UK economy, with around 900,000 fewer jobs in September 2020 compared to September 2019.[24] Further, these changes have been concentrated in particular sectors (retail, hospitality) and – initially at least - among younger age groups. For example, 48% of the drop in employment[25] has been accounted for by the 18-24 age group (which only accounts for 11% of the workforce), with the balance accounted for by modest absolute numbers, but very small percentage change movements, in numbers of people employed in the 25-34, 35-49 and 50-64 age groups.

These dramatic changes over a short period of time, combined with difficulties in reconciling different datasets, add to the uncertainty in understanding labour market impacts since the start of 2020 and how it might evolve into 2021. However, the Office of Budget Responsibility (OBR) provides a range of projections for how the labour market may evolve in 2021, these are summarised in Figure 5.[26]

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[24] ONS (2020b): JOBS05: *Workforce jobs by region and industry,* Office of National Statistics

[25] PBE calculations based on data tables released alongside the Office for National Statistics (2020) *"Labour market review, UK: December 2020"*, published 15 December 2020.

[26] The degree of uncertainty around this is illustrated in the changes in the OBR's forecasts between July 2020 (when furlough was expected to end in October 2020) and November 2020 (when it had been extended to end March 2021; subsequent announcements in December now put the end date at April 2021). Originally, the OBR was expecting a high proportion of furloughed jobs to move to redundancy. Now, the OBR sees reduced hours as a major absorption factor in firm-level economic adjustments, together with an expectation that the extension of the

We choose to focus on the central and downside scenarios for our analysis as the upside scenario appears significantly less likely at present. This is on the basis that since these projections were published there has been further evidence of high rates of actual redundancies, 370,000 in the August to October period, and a continuing high rate of future or planned redundancies (c.30% of all firms, per CIPD survey) or outright uncertainty (17% of businesses "could not give an opinion as to whether they would make redundancies in the following three months"[27]). Further, recent developments in December / January (such as the Tier 3 and then Tier 4 restrictions in London, subsequently followed by the third national lockdown) are exacerbating the downside risks, particularly in sectors such as hospitality or entertainment, which have already seen concentrations of both furlough and job losses.

Figure 5. Summary of expected labour market impacts from COVID-19 crisis

	Employment	Unemployment	Inactivity
Baseline			
2020Q1	32.9 million	1.3 million	19.2 million
Central scenario – peak unemployment in 2021Q2			
2021Q2	31.7 million	2.6 million	19.5 million
Change	-1.3	+1.3	+0.3
Downside scenario – peak unemployment in 2022Q1			
2022Q1	2021Q2	2021Q2	2021Q2
Change	-2.3	+2.5	+0.4

For our analysis we break these changes down by age bands using year-to-date actual labour market changes – full details of this process are available in Annex B.

furlough scheme "makes it more likely that businesses will hold on to staff even if demand is still depressed in the spring". It is therefore projecting much less impact from the ending of the furlough scheme.

[27] Source: ONS (2020b).

We take the differences in problem debt prevalence by age and employment status from WAS and apply these to the changes expected in the to the projected changes in employment from the OBR to estimate the change in the number of households with problem debt in the UK. So, for example, using the OBR central scenario:

- Taking the 16-24 age band
    - of all households where the head of household is working, the incidence of problem debt is 2%.
    - for those unemployed it rises to 19% (ie +17pp)
    - for those inactive it rises to 28% (+26pp).
- Of the 1.3 million total additional unemployed, 26% or 333k are in this age bracket, resulting in
    - 56k additional persons with problem debt from unemployment
- Of the 300k total additional inactive status, 65% or 188k are in this age bracket, resulting in
    - 49k additional persons with problem debt from inactivity

We repeat this for each age bracket, and aggregate for the whole 16-64 age range. We then convert the total for additional persons to number of households using the WAS average (for all age groups) of 1.5 working age adults per household[28]. Our analysis is summarised in Figure 6, below:

Figure 6. Results for increase in problem debt

000s	Labour market changes		New problem debt: # of persons			New problem debt: # of households
	Change in unemploy-ment	Change in inactivity	Due to unemploy-ment	Due to inactivity	Total	Total
Central	1,300	300	169	56	225	150
Downside	2,500	400	330	69	399	266

The change in problem debt for those in employment but facing a reduction in income

There is good evidence to suggest that the 2020 economic cycle has seen dramatic impacts on household budgets even where people remain in

[28] ONS estimate that there were 41.7 million working age adults in the UK and 27.8 million households, giving an average of 1.5 adults per household. For simplicity we do not adjust this for differences in the size of households by age or socio-demographic group.

employment. Higher income groups have seen big increases in savings, as some household bills have fallen (eg commuting costs) while income has been largely is unaffected. However, in lower income groups, savings are more likely to decrease as income falls due to reductions in hours worked and the furlough scheme.[29]

Taking furlough specifically, although technically counted as "employed" many such workers have experienced a cut in wages under the terms of the scheme. Whilst the government has paid 80% of wages there will be some variation around this figure; some individuals have experienced less of a reduction where employers have topped it up to 100% wages, whilst others have experienced more of a drop where, for example, sector specific rules meant a bigger drop in take-home pay (for example, the exclusion of tronc from the definition of basic wages used for furlough payments for employees in hospitality sector).

However, the potential impact of a 20% cut in income on triggering new problem debt could well be very significant, particularly for the poorest households. We demonstrate the potential scale of this impact by combining the ONS's evidence on the impact of a 25% reduction in income on financial resilience for the poorest households (as a proxy for reduction in income under furlough) with an estimate of the number of individuals from this group that have been furloughed:[30]

- If 40% of the lowest fifth of households by income have no financial resilience (ie cannot withstand 25% cut in wages), and 30% of the workforce has been furloughed, then, for just this one group, an additional 12% could be facing serious financial distress.[31]
- This is double the ratio of existing problem debt in this quintile based on the wealth and assets survey, so this alone could add

[29] Bank of England (2020): *How has Covid affected household savings?,* Bank of England
[30] ONS (2020a)
[31] 40% with low financial resilience * 30% furloughed = 12%. Note that this conservatively assumes that the likelihood of being furloughed is no higher amongst those in the lowest income groups than for other groups. The sectoral data shows much higher take-up in sectors traditionally associated with part-time work and lower than average pay, such as accommodation and food services (50% take-up rate at July 2020) and arts, entertainment and recreation (52%), compared with sectors associated with full-time work and higher than average pay, for example information and communication (12%) or finance and insurance (4%). This suggests that furlough could be disproportionately concentrated in the lower income groups. Source: CJRS Statistics December 2020, Table 9.

344,000 people to the total problem debt across all persons in employment, the equivalent of 1.2% of the total workforce.[32]

- This additional risk group of 344k persons compares to our existing estimate of 225-399k persons (see Figure 6 above), and amounts to a further 140k of households at risk of problem debt.

This provides an indication of the potential scale of the increase in the prevalence of problem debt for those remaining in work.

Step 3: Estimating the costs to wider society from this increase in the prevalence of problem debt

In its 2018 report, the NAO used panel data on households in the UK to estimate the impact that problem debt might have on two areas of public service demand: mental health and need for subsidised housing. They estimate that the direct cost to taxpayers as a result of these problems caused by problem debt was around £248 million per year. In addition to this, they estimate the costs to wider society as a result of lost productivity due to the impacts that these issues have on the likelihood of an individual maintaining employment. This brings the total costs to society up to £900 million per year.

We assume that these wider societal costs of problem debt will increase in proportion to the number of households suffering from problem debt.

Key assumptions and limitations behind our analysis

Our analysis has inevitably relied on some important assumptions in the data and relationships.

Firstly, we rely heavily on WAS data from Wave 6 on the prevalence of problem debt by age group and employment status. This survey data was collected over April 2016 - March 2018, some 2 years before the onset of the Covid-19 pandemic. Reliance on the WAS Wave 6 data means we are effectively assuming that the number of households in problem debt had not changes significantly during 2019 and that the relative prevalence of problem debt for employed, unemployed or inactive groups will be the same in 2020 and 2021 as reported for 2016-18. We do not know whether this is likely to result in an over- or under-estimate of the potential impact of the current crisis on problem debt - it is possible that those now entering the unemployed or inactive groups will have greater savings than those that were in the groups in 2016-18 but it is equally plausible that they will have higher outgoing costs and have already run-down their financial reserves during the extended crisis period.

[32] 20% of workforce * (12% - 6%) = 1.2%

Secondly, we are reliant on the accuracy of the Labour Force Survey reporting during 2020, in particular for the age-group impacts. The scale of changes in the labour market, combined with methodological changes at the ONS to cope with the lockdown, has resulted in difficulties in reconciling different datasets to date[33] and suggest that the full picture is only likely to emerge as various revisions are published in the future. Whilst the Labour Force Survey remains the primary source of employment data in the UK, this is likely to add additional uncertainty to our estimates.

Thirdly, the analysis depends on the future evolution of the labour market, which the OBR and others (eg Resolution Foundation) have noted is particularly uncertain at the present time. An indication of the scale of this uncertainty is given by comparing the OBR forecasts from July 2020 (when furlough was expected to end in October 2020) and November 2020 (when it had been extended to March 2021). Further, neither sets of OBR forecasts included a third lockdown, as has since happened, and which will be causing further shockwaves through the labour market.

Given this uncertainty, our range of estimates are best treated as an initial indication of the broad scale of impacts on problem debt that could be expected from the current crisis and we discuss them in the context of analysis and evidence from other sources.

[33] For example, the LFS statistics show a 400k reduction in employment, of which employees has risen 160k and self-employment has fallen 530k. This rise in employees contrasts with HMRC real time figures for payroll which shows a drop of 800k since Dec19. Other commentators have explored the inconsistencies in the LFS statistics, see for example M. O'Connor and J. Portes (2021), "*Estimating the UK population during the pandemic*", January, accessible at https://www.escoe.ac.uk/estimating-the-uk-population-during-the-pandemic/

Results

How is the Covid-19 crisis likely to affect the incidence of problem in the UK?

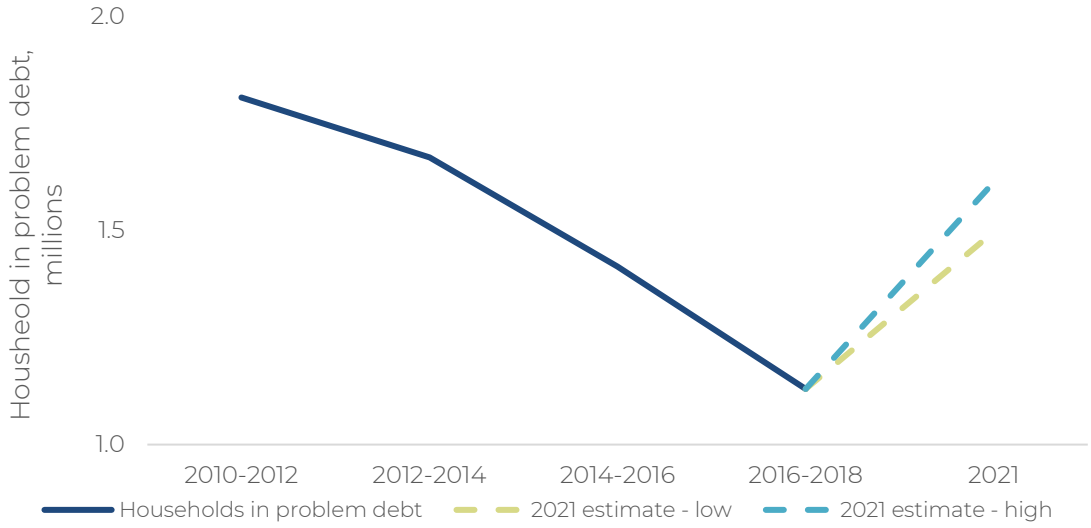
Our analysis has updated existing studies of the prevalence of problem debt in the UK and taken projected changes in the labour market, combined with historical evidence on the prevalence of problem debt amongst households with different employment statuses, to estimate the impact that the Covid-19 crisis will have on levels of problem debt in the UK.

We estimate that problem debt will have increased from 1.1 million households during the period 2016-2018 to 1.5-1.6 million households by mid-2021 (time of peak unemployment post-Covid). This is an increase of 150,000 – 270,000 households as a result of job losses, and a further 140,000 households still in work that are at risk of problem debt as a result of reductions in income. These increases would undo much of the reduction in the number of households in problem debt seen over the last decade.

Figure 7. Summary of changes in problem debt

	Households with problem debt
2016-2018 baseline	1.13 million
Impact of changes in employment status	
Low	1.36 million
High	1.47 million
Plus Impact of reduced wages	
Low	1.50 million
High	1.61 million
Total increase in problem debt from crisis	**270 – 480k 33%-43%**

Figure 8. Number of households facing problem debt, Great Britain



These impacts are likely to be concentrated towards younger age groups - nearly half of the increase in problem debt estimated to result from changes in employment status is experienced by those aged 16-24.[34]

Figure 9. Breakdown of impacts by age groups

Age Group	Share of increase in problem debt due to changes in employment status, %
16-24	47%
25-34	9%
35-49	20%
50-64	24%
Total	**100%**

Our results appear plausible but conservative when compared to evidence from surveys. Other studies, such as those undertaken by the FCA and Shelter, suggest a similar scale of impacts on household debt of around 20-40%.[35] However, other indicators point to even higher numbers of people/households falling behind on one or more bills. For example, Citizens Advice suggest that 7.3 million adults were behind on their bills in

[34] We are unable to provide a breakdown by age for those still in work but at risk of problem debt due to reduced income due to insufficient data availability.
[35] Financial Conduct Authority (2020): *FCA Vulnerability and Harms survey,* October 2020 and Shelter (2020): *Landlords, letting agents and charities urge the government to help renters clear Coronavirus (COVID-19) rent debts and stay in their homes,* Shelter.

December 2020, StepChange estimated that 5.6 million people have fallen into arrears or had to borrow to make ends meet during the pandemic and Resolution Foundation have estimated that the prevalence of households falling behind on housing rent has doubled since the crisis started.[36] The difference compared to these higher estimates is likely to be largely down to differences in definitions of indebtedness used across studies – the definition of problem debt used in our study sets a higher threshold based on a combination of the following criteria: the scale of debt payments relative to income, at least two months of arrears and perceptions of debt.

The outsized effect of the crisis on younger age groups (18-24 in our case, 25-34 in many others) is also supported by other research. For example the Legatum Institute which suggests "those hardest hit have been young workers, those in relatively low-paying employment and those working in sectors such as hospitality and retail"[37]and StepChange who suggest 25-34 year olds are most at risk of both falling behind on essential bills and borrowing to make ends meet[38].

Similarly, the Resolution Foundation[39] found the greatest impacts of labour market changes to be concentrated in younger age groups, be it unemployment, furlough, reduction in income or difficulties in finding new work. They conclude: "As is the case with most aspects of the labour market shock, the youngest workers seem to struggled most, with only 33 per cent of 18-24-year-olds whose job ended being back in work by September, compared to 57 per cent of 35-44-year-olds, a difference that comes on top of younger workers' increased likelihood of losing work in the first place".

What are the potential wider societal costs from this increase in problem debt?

The National Audit Office estimated that problem debt prior to the crisis was costing the public sector around £248 million per year due to increased demand for mental health services and statutory housing services. In addition to this, they estimated the costs to wider society as a result of lost productivity due to the impacts that these issues have on the

[36] Citizens Advice (2020), StepChange (2020): *Tackling the coronavirus personal debt crisis* and Resolution Foundation (2021): *Getting ahead on falling behind.*
[37] Legatum Institute (2020): *Poverty During the Covid-19 Crisis,*pg 2.
[38] StepChange (2020)
[39] M Brewer, N Cominetti, K Henehan, C McCurdy, R Sehmi & H Slaughter, *"Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the UK labour market"*, Resolution Foundation, October 202, pg11

likelihood of an individual maintaining employment. This brought the total costs to society up to £900 million per year.

If we assume that these costs increase in line with our suggested 33-43% increase in the scale of problem debt, then these costs would now reach around £0.35 billion per year of direct fiscal effects from the government providing mental health support and statutory provision of housing and as much as £1.2-1.3 billion per year if we include the lost productivity due to the increased likelihood of these individuals remaining unemployed. This represents an additional cost to society of around £300-400 million per year as a result of the increase in problem debt caused by the Covid-19 crisis.

Conclusions

Our analysis has drawn on existing evidence, latest publicly available information and projections from the Office of Budget Responsibility to estimate the change in problem debt resulting from the Covid-19 crisis. We find that:

- There could be as many as 1.5 million households at risk of problem debt by mid-2021 as a result of the economic fallout from the Covid-19 crisis - an increase of 370,000 – 480,000 households compared to pre-crisis levels.
- Around 150,000 – 270,000 of this increase is down to expected job losses, whilst a further 140,000 working households are at risk due to reduced incomes after being furloughed or having hours reduced.
- Our modelling suggests nearly half of this impact is concentrated in the 16-24 age bracket, consistent with findings from other studies of the impact of Covid-19 on different demographic groups.
- Overall, we estimate that this problem debt is likely to cost the government in the region of £0.35 billion per year as a result of increased demands for mental health support and statutory housing provision, with a total cost to society of around £1.25 billion per year once the costs of lost employment are included.
- This is an increase in costs to society from problem debt of around £350 million per year as a result of the Covid-19 crisis.

These estimates suggest that the Covid-19 crisis is likely to have significantly exacerbated the pre-existing trend towards higher levels of problem debt in the UK. This highlights the need for urgent consideration of the measures that could be taken by government, private and social sectors to support those struggling with problem debt and limit the wider costs this has for society.

Annex A – Additional details for update to NAO estimate of problem debt

Our updates to the NAO estimates of the monetary value of problem debt in the UK suggest that at the end of 2019 it stood at £19.4 billion – around 7.5% higher than at the end of 2017. Growth is widespread across all broad categories, with particularly rapid growth in debt from housing.[40]

Here we provide further details of our approach to updating the NAO estimate of the monetary value of problem debt, separated in three categories:

1. Utilities
2. Housing
3. Tax and benefits system

Utilities

Our research finds that the sub-total for utilities arrears has risen from £3.4 billion (NAO, "end 2017") to £3.7 billion (PBE, "end 2019"), an increase of 8%.

[40] Where individual line items are declining in Annex A, there are very specific explanations (eg Social Fund arrears) or weaknesses in the methodology (eg private sector rent arrears) where we would otherwise be expecting increases. Further, some line items are increasing despite underlying factors which would otherwise be driving a decrease (eg housing association rents falling 1% pa).

Figure 10. Updated baseline for utility debts

£m	NAO "end 2017"	PBE "end 2019"	Change	Source
Energy (electricity + gas)	1,065	1,163	9%	Ofgem (2018) reports: "The overall number of customers in debt4 increased by 4.2% in electricity and 4.8% in gas in 2018 (p5). This combined rate of 4.5% pa is assumed to repeat for one further year.
Water	2,200	2,379	8%	Enquiries were made direct to Ofwat seeking an update on their 2014-15 figures, but these statistics have not been published. We have therefore applied the CPI growth rates for water supply and sewerage, code D7GS in the CPI tables.
Telecoms	135	142	5%	No published sources could be found providing more recent data than the data from the Citizens Advice (2018) report. We have therefore applied the CPI growth rates for telephone services, code D7IY in the CPI tables.
Subtotal - utilities	**3,400**	**3,683**	**8%**	

The estimates for utilities arrears have largely been estimated based on price inflation in each sector since the original source data. Neither Ofgem nor Ofwat systematically publish arrears data, and the estimate for the water sector (the largest component here) continues to rely on the oldest original data (2014-15 figures) as ultimate source.

Housing

Our research finds that the sub-total for housing arrears has risen from £1.3 billion at end 2017 to £1.5 billion at end 2019, an increase of 9%.

Figure 11. Updated baseline for housing debts

£m	NAO "end 2017"	PBE "end 2019"	Change	Source
Rent arrears – private sector	508	493	-3%	The English Housing Survey (EHS) has not published any information on private sector arrears since the 2016-17 report. Enquiries were made direct to the MHCLG who confirmed that such data had been collected and would be published for EHS 2019-20. We have therefore adjusted for inflation using the MHCLG Table 704 data (reductions of 1.3%, 1.1% and 0.9% respectively for the last three years).[41]
Rent arrears – housing associations	466	643	9%^	Data for "gross arrears excluding former tenants" was taken from the Regulator of Social Housing's "Global Accounts of Registered Providers" for each year. This replaces the NAO source which was based on EHS.[42]
Rent arrears – local authorities	336	413	23%	This data is updated using MHCLG local authority housing statistics live data returns, downloaded spreadsheet tab "H – rents and arrears"[43]
Subtotal – housing	**1,310**	**1,549**	**9%**	

[41] Accessible at: https://www.gov.uk/government/statistical-data-sets/live-tables-on-rents-lettings-and-tenancies

[42] The RSH data is accessible at: https://www.gov.uk/government/collections/global-accounts-of-housing-providers

[43] Accessible at: https://www.gov.uk/government/statistical-data-sets/local-authority-housing-statistics-data-returns-for-2018-to-2019

^ Change in housing association arrears calculated on like-for-like basis from same RSH source.

The increase in rent arrears in housing associations and local authorities, compared to an estimated decline in the private sector, hints at a stratification of the problem debt issues, ie it is lower income households (and hence tenants in these sectors) which are seeing worsening position. The increase in housing association arrears is particularly striking as over this period HAs were required by the government to reduce nominal rents at the rate of 1% pa.

Tax and benefits system

Our research finds that the sub-total for tax and benefits system arrears has risen from £13.3 billion at end 2017 to £14.1 billion at end 2019, an increase of 6%.

Figure 12. Updated baseline for tax and benefits system debts

£m	NAO "end 2017"	PBE "end 2019"	Change	Source
Benefit overpayments	2,589	3,571	38%	DWP Annual Report & Accounts, Table 13.
Tax credit overpayments	7,158	6,618	-8%	This data is updated using DWP Annual Report & Accounts Table 13 and HMRC Annual Report & Accounts, Note 4.1.2 (2019/20 Accounts). Note that the debt is transferring from HMRC to DWP in stages since April 2016 as customers move onto Universal Credit.
Social fund arrears	577	413	-28%	DWP Annual Report & Accounts, Table 13.
Council tax arrears	3,022	3,577	18%	This data is updated using MHCLG Council Tax Live Tables, Table 7[44]
Subtotal - utilities	**13,346**	**14,179**	**6%**	

[44] Accessible at https://www.gov.uk/government/statistics/collection-rates-for-council-tax-and-non-domestic-rates-in-england-2019-to-2020

The individual figures for benefit overpayments and tax credit overpayments reflect the gradual roll-out of Universal Credit in this period. New arrears on the new UC benefits accumulate on the line for benefit overpayments, while the old tax credit overpayments system is gradually running down. Taken together, the two lines show a 5% increase from end 2017 to end 2019.

The Social Fund was replaced in April 2013 and hence no new advances to beneficiaries have been made since that date. Arrears are gradually reducing as new repayments are received.

Commentary on sources

Six of the ten lines of data, accounting for 78% by value, come from readily identifiable public sources, and can be systematically updated on an annual basis. This gives a high sense of robustness as to the trends over time.

The weakest data is for the utilities sub-group. In particular, it is disappointing that there have not been any figures published by Ofwat since a 2014-15 report, even though arrears (and write-offs) form part of their regulatory data returns and are also part of the process of setting the periodic price cap regimes.

In the housing sector, the (negative) price inflation applied to private sector rent arrears and hence estimated reduction in problem debt is counter-intuitive. Commentary from both landlord and tenant groups (eg Shelter) over recent years points to a rise in arrears (and evictions), which was halted in 2020 by the temporary relief measures introduced by the government. A better update may be possible when EHS 2019-2020 is published.

Annex B: Changes in employment by age band

This annex describes the process taken to breakdown OBR projections for unemployment and inactivity by age band.

OBR forecasts

The high level figures for change in unemployment from December 2020 to peak rate are taken from the two OBR reports, combining the commentary, charts (including downloaded chart data) and the Supplementary Tables published with the November EFO.

	Change, millions	
	Unemployment	Inactive
OBR Nov central	1.28	0.29
OBR Nov downside	2.49	0.36

LFS data on labour market changes: December 2019 to October 2020

Unless otherwise stated, all UK Labour Force statistics are taken from ONS release of 15 December 2020[45].

[45] Accessible at: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/summaryoflabourmarketstatistics

Employed				
	Dec-19	Latest	Diff	%
16-17	339	250	-89	-26.3%
18-24	3,482	3,264	-218	-6.3%
25-34	7,615	7,595	-20	-0.3%
35-49	10,896	10,846	-50	-0.5%
50-64	9,307	9,227	-80	-0.9%
All (16-64)	31,369	31,182	-457	-1.4%

Unemployment				
	Dec-19	Latest	Diff	%
16-17	96	99	3	3.1%
18-24	410	498	88	21.5%
25-34	258	345	87	33.7%
35-49	276	342	66	23.9%
50-64	271	378	107	39.5%
All (16-64)	1,311	1,662	351	26.8%

Inactivity				
	Dec-19	Latest	Diff	%
16-17	975	1,090	115	11.8%
18-24	1,1583	1,654	71	4.5%
25-34	1,084	1,005	-79	-7.3%
35-49	1,551	1,524	-27	-1.7%
50-64	3,238	3,329	91	2.8%
All (16-64)	8,431	8,602	171	2%

U/E rate		
	Dec-19	Latest
16-17	22%	28%
18-24	11%	13%
25-34	3%	4%
35-49	2%	3%
50-64	3%	4%
All (16-64)	4%	5.1%

Combining the data

We take the OBR projections for changes in unemployment and inactivity, stratify them into age bands using year-to-date actual labour market changes, and then apply the WAS data for change in problem debt prevalence for each category.

For unemployment driven changes, we have used shares as calculated from LFS actual data. However, for inactivity, this is not possible.

As above, the LFS data shows that inactivity has reduced during 2020 for the 25-34 and 35-49 age bands. This appears to be associated with relatively stable total employment in these bands, and may also be reflecting displacement such as previously non-economically active members of a household taking up jobs or registering unemployed, if others in the household have become unemployed or furloughed.

However, recognising that the year-to-date experience is only the first part of a much larger rise in unemployment and inactivity, we expect the impacts to eventually reach all age bands, and so have assumed a minimal 2.5% share for these two groups, and spread the balance across the other three age bands roughly proportionate to current experience.

	Share of change in unemployment		Share of change in inactivity		Change in problem debt prevalence per WAS	
	Per LFS Dec 19 – Oct 20	As used	Per LFS Dec 19 – Oct 20	As used	Unemp-loyed	Inactive
16-17	1%	1%	67%	35%	17%	26%
18-24	25%	25%	42%	30%	17%	26%
25-34	25%	25%	-46%	2.5%	6%	11%
35-49	19%	19%	-16%	2.5%	18%	9%
50-64	30%	30%	53%	30%	13%	6%

Comparison to non-stratified data

For sensitivity analysis, we have compared our results based on age-band stratification to simpler modelling of the whole labour force as one.

For unemployment driven changes, the differences are not material. For example, in the OBR November downside scenario, unemployment driven changes are 330k when stratified and 338k taken as a whole.

For inactivity driven changes, however, the stratified modelling produces results just over 2x higher than the simpler method. For example, taking the OBR November downside scenario again, our stratified results are 69k vs 30k when taking the labour force as whole.

This difference highlights the benefit of using the more detailed data in WAS. It also emphasises the importance of considering the whole labour market, ie inactivity as well as employment/unemployment.

Other technical notes

The age bands used in WAS and LFS do not align perfectly. For simplicity we have used the following mapping:

LFS 16-17 and 18-24	⇔	WAS 16-24
LFS 25-34	⇔	WAS 25-34
LFS 35-49	⇔	WAS 35-44
LFS 50-64	⇔	WAS 55-64

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