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Low Income Households: Casualties of the Boom, Casualties of the Bust?

Grahame Whitfield* and Chris Dearden**

*At the time the research was conducted: Centre for Research in Social Policy, Loughborough University. At the time of publication: Joseph Rowntree Foundation – this article is written in a personal capacity
E-mail: grahame.whitfield@talktalk.net

**Formerly Centre for Research in Social Policy, Loughborough University

This article reflects on research undertaken with low income households over a 12 month period following the 'credit crunch', a period characterised by rapid change to the financial landscape in the UK. It argues that people living on persistent low incomes were casualties of the economic 'boom' as they did not benefit from economic growth and of the 'bust' in that they most keenly felt the impact of the recession and the reaction of financial institutions to the new financial landscape. It concludes by arguing that, reflecting on the complexity of people's lives, addressing indebtedness requires a multi-faceted approach.

Keywords: Poverty, debt, credit, over-indebtedness, unemployment.

Introduction

This article reflects on research undertaken for the Joseph Rowntree Foundation as part of their commitment to improving the circumstances of people living on low incomes (Dearden *et al.*, 2010). Fieldwork was undertaken in 2008–9, a period in which the global economy experienced the most significant financial crisis since the global depression of the early twentieth century. It took place as the 'credit crunch' ended a period of 'boom' (characterized by readily available credit) and triggered a period of 'bust' (in which living costs and unemployment increased and the financial landscape fundamentally changed). This enabled this research to capture first-hand accounts of the effects of the credit crunch and recession on people living on low incomes and provide an indication of the likely impact of the changed political landscape following the May 2010 Westminster election on the circumstances of people living with debt.

Background

There is a great deal of evidence about the level of indebtedness in the general UK population. In mid-2002, a fifth of British families were in arrears with their financial commitments, including unsecured borrowing and arrears on utility and other household bills (Kempson *et al.*, 2004). By July 2004, the stock of personal debt in the UK, both secured and unsecured, had passed one trillion pounds (McKay, 2005) and is currently in the region of £1.44 Trillion. By May 2007, average debt in the UK (excluding mortgages) was estimated to be £8,480 per household (Credit Action, 2011). This situation followed a long period of 'boom' in the economy when low unemployment, low interest rates, high

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consumer confidence and house prices rising at unprecedented levels enabled house owners to release equity from their homes, or borrow on the strength of house prices.

While there is no accepted definition of what constitutes *over-indebtedness*, various measures are often used as an indication. For example: 50 per cent of gross monthly income spent on total borrowing repayments; 25 per cent of gross monthly income spent on unsecured repayments only; having four or more credit commitments; and where household borrowing repayments are 'a heavy burden' (Tudela and Young, 2003; DTI, 2005).

The reasons why people living on low incomes use credit and are particularly prone to becoming and remaining indebted over time have not been fully explored in-depth. However, it is well documented that consumer credit has been widely used in the UK as a means of attempting to smooth consumption over time and manage finances flexibly to avoid financial difficulties (e.g. DTI/DWP, 2004). This pattern of financial management is known to be particularly prevalent amongst people living on low incomes and who are either permanently on out-of-work benefits or who experience work-welfare 'cycling' as a consequence of their being in low-skilled low-paid employment which is particularly likely to be on a unpredictable and short term basis (Kellard *et al.*, 2001; Nolan, 2004). Indeed, many peoples' labour market experience is such that leaving benefit to take up work is likely to see them become unemployed again within three to six months (HM Treasury, 2004; Mansour, 2005) and there is some evidence that as much as 10 per cent of the workforce experience such cycling (Robinson, 2005).

The financial consequences of this instability are well documented in terms of personal and family consequences (Magadi and Middleton, 2005; Smith and Middleton, 2007) and in terms of the underlying psychological impact on people trying to deal with their current circumstances and the consequences of repeated attempts to improve them (Malenfant *et al.*, 2007). Reflecting this, it has been the aim of successive governments to encourage people to take up and stay in work and 'make work pay'. In addition to 'activation' strategies in the JobSeeker's Allowance regime, initiatives, such asHousing Benefit and Council Tax 'run-ons' (where recipients can receive benefits for the first four weeks in work), JobGrants (for those taking up work after six months unemployment) and the 'linking rules' (to enable people to return to their previous benefit package if they lose a job), have been intended to incentivise job-seeking, soften the impact of taking up work and form the financial underpinning for the in-work support that is intended to help sustain people in work, but which has been noted as having had limited effect (Kellard, 2002).

The changing economic landscape between 2007 and 2009 had far-reaching consequences for the global economy, the UK labour market and, in turn, the circumstances of people living on low incomes – in particular, those reliant on access to credit on an ongoing basis to meet their day-to-day needs. These changes have been augmented by the changing political landscape since the May 2010 Westminster election.

Both the US and UK economies began experiencing economic difficulties in 2007. In the UK, the 'totemic' event was a run on Northern Rock bank in September 2007 that ultimately resulted in it being nationalised in 2008 and intensive state involvement in the UK banking sector – including taking a stake in Bradford & Bingley, Alliance & Leicester, RBS (amongst others) and having to mak4 provision in the region of up to £500 billion under the Asset Protection, Special Liquidity and Credit Guarantee schemes (NAO, 2010).

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During this period, governments and central banks across the world adopted a policy of quantitative easing to try and stimulate bank lending and consumer spending. While this was partially successful, financial institutions continued to lend (and people to borrow) far less than they had before the crisis and, as a result, the housing market slowed, house prices and both business and consumer confidence fell. Indeed, in the UK, the combination of increased fiscal control of government spending and the tightening of lending criteria during 2010–11 led to calls by many city analysts that urgent government action was needed to avoid a 'double-dip' recession, something Chancellor George Osborne denied as likely to occur due to the programme set out in his 2010 budget (HM Treasury, 2010).

In recent months, there has been marked concern about the ability of a number of counties, notably Greece, Spain, Portugal and Ireland, being able to respond to their economic circumstances. While concerns were less pronounced about the UK, the government has vowed to eradicate the structural financial deficit over a three-year period to ensure financial certainty for the future. The full impact of the actions they propose is as yet unknown, but it is widely predicted (e.g. Office for Budget Responsibility, 2010) to result in increased unemployment in the medium-term. Taking this into account alongside the projected rate of inflation in the medium term (at the time of writing, CPI (Consumer Price Index) 4.5 per cent, RPI (Retail Price Index) 5.2 per cent (National Statistics, 2011)) and the move to tie benefits to CPI, this is likely to have a particular impact on the circumstances of people already living on low incomes and who experience unstable low-paid employment. While it is difficult to disentangle restrictions on lending from reluctance to borrow, figures released by the Finance and Leasing Association in 2010–11 (who represent a significant proportion of formal lenders) led them to comment on the ongoing fall in the level of borrowing during this period and to argue that some lenders could be driven from the market if further regulations (such as rate caps and cooling off periods) were imposed on them, thus further reducing access to credit for those that use these forms of borrowing (FLA, 2010).

A number of initiatives were in place or were planned prior to the 2010 election which were intended to contribute to the financial stability of people living on low incomes. These included the *Child Trust Fund* (to encourage families to contribute to savings for their children), the *Saving Gateway* (to encourage people in receipt of benefits or on low incomes to save) (DirectGov, 2011) and continuation of personal finance education in schools and above school age (RBS, 2009; FSA/HMT, 2009; DCSF, January 2010). Not all of these initiatives were taken forward and announcements about the type of provision that will be supported continue to be made (e.g. the ending of the Financial Inclusion Fund (Hoban, 2011)) and other provision expanded (e.g. the Money Advice Service).

The research methodology and aims

The aims of this research were to investigate: the factors that make households vulnerable to debt, what 'triggers' debt, the impact of debt, how over-indebted people manage their debts and how they get out of debt. It aimed to gain an understanding over time in order to gain a historical context of previous experiences and of events and changing circumstances over a twelve month period.

The study developed the approach used in 'poverty dynamics' research (e.g. Smith and Middleton, 2007) and used a longitudinal qualitative approach to explore household

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Table 1 Participants' employment and household composition

	Long-term unemployed benefit recipient	Long-term low waged	'Churn' between low income and benefit
Households with dependent children	11	9	8
Households without dependent children	11	9	9

experiences and characteristics over time (see Kempson *et al.,* 2004). This method was selected as it was felt that the cross-sectional and 'static' approach of much existing qualitative research in this area had not substantially added to the understanding of how people living on low incomes use credit and live with debt or of their perceptions of credit and debt itself. Visiting respondents for over a year enabled the research to identify the consequences of events such as family birthdays, religious festivals, school holidays and a particularly cold winter. In addition, it was able to investigate the impact of rising food and utility prices, the tightening of lending criteria and the impact of increasing unemployment as the recession deepened.

The research involved interviews with 57 people of working age from low income households drawn from areas with indices of low income and deprivation within three cities in the UK Midlands (Derby, Leicester and Nottingham). Participants were recruited on the doorstep, using a detailed screening pro-forma which aimed to identify potential participants according to a number of key criteria (Table 1). Defining 'long-term' as three or more years, participants fell into three groups: the long-term unemployed, the long-term low waged and those who moved between work and benefits. They also included both single people and couples with and without children. All participants had a household income below £20,000: the majority below £15,000 and almost half less that £10,000. All participants either had debts at the time of the research or had been in debt in the past. In terms of demographic characteristics, the sample consisted of 33 women and 24 men (although some partners participated) in the age range 20 to 60 years.

Following analysis of the initial interview, 12 participants were chosen to be case studies based on the likelihood of their situation changing (i.e. there was an indication that significant change might occur – such as expectation of employment or threatened eviction) and were interviewed face-to-face every two months over the year. The remaining 45 were interviewed by telephone every two months, with provision for conducting face-to-face interviews if their circumstances changed or appeared likely to do so. At the end of the fieldwork period, 50 participants had a final face-to-face interview and three discussion groups were held with participants to discuss the emerging findings.

At the heart of policy concerns for this research was the issue of 'structure' versus 'agency'. As the research was intended to offer policy makers, financial institutions and those providing support and advice with a steer on what kind of responses might make a difference to people living with debt, it was focussed on finding out to what extent the circumstances people lived in were a result of their own actions and to what extent wider factors placed them at such disadvantage that their lives were characterised by persistent low income and (increasing) indebtedness.

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The next section provides an overview of the general findings of the research and then focusses on the impact of the financial situation.

A brief overview of the general findings

Participants' experience of credit and debt was complex. It was dominated by the need to meet day-to-day living expenses in the context of living with incomes that were inadequate, rather than being related to 'consumerism'.

For some, the debts they had taken on at a young age had remained with them due to their inability to clear them given their persistent low incomes and demands on their finances. For others, the costs associated with setting up home, divorce, the arrival of a baby, changing or losing work had significant and long-term impact. However, it was rare that 'material consumption' made a significant contribution to the level of debt people held or, indeed, to them being over-indebted in the first place.

Participants reported having a range of debts, including arrears in rent and utilities, catalogues and other instalment arrangements at such as 'Brighthouse' stores, store and credit cards, bank loans, overdrafts, loans from doorstep lenders and family or friends, student and social fund loans. Although many participants reported prioritising payment of utility bills second only to rent or mortgage payments, more than half were in arrears with these.

Most were using more than one kind of credit or had more than one type of debt. Many of those with multiple forms of credit/debt reported 'juggling' their repayments rather than regularly servicing all of them, for example by taking out loans to service credit card debts or using credit cards to make mortgage payments (Shelter, 2010). This regular re-prioritisation was widespread, with participants commonly reporting servicing one debt at the expense of others.

Paying for goods by instalment was common and usually used for larger household items, such as furniture and white goods. People were aware that they were paying an inflated price, but could not 'shop around' like cash buyers. For many, the affordability of the weekly/monthly payments was more important than the total amount paid or the interest rate. This was also true among people who used doorstep lenders – even though they were aware of the high charges.

Bank loans and overdrafts were problematic for some participants, who reported what they perceived as disproportionate charges for unpaid items or unarranged overdrafts. Often it was direct debits going out of bank accounts (sometimes before benefits or wages were credited) that led to unauthorised overdrafts — this then attracting additional charges.

Borrowing from family was common and was sometimes a reciprocal arrangement, with both borrowing and lending between family members. In some cases, this avoided people using formal credit and avoided interest charges and fixed repayment arrangements. In others, it included borrowing from older parents who were themselves living on low fixed incomes.

Many credit card debts were long-standing and for items bought when participants had been in work and believed they would be able to meet the repayments. In some cases, changes in circumstances (e.g. losing a job, reduction in income) resulted in participants being unable to borrow or re-negotiate existing credit, but continuing to incur interest while small (sometimes minimum) payments were made monthly. In some cases, late or

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missed payments added further to people's debt due to penalty charges and a lack of willingness to admit difficulties to lenders.

Non-payment of some debts resulted in participants incurring additional costs or sanctions, the ultimate one being eviction for non-payment of mortgages or rent. In addition, some social housing tenants were unable to move to other accommodation (for family and work reasons) until they had cleared previous rent arrears.

Some participants managed their credit use effectively and a very small number had no ongoing debts at the time of the research. The factors associated with participants managing their debts included: them being in regular paid employment; having family and friends who helped out during a crisis, either by offering loans or gifts; having budgeting and other skills such as home cooking; and being averse to using credit or moving into debt – sometimes as a result of their upbringing/culture, sometimes because of previous bad experiences.

Very few participants were in a position to save apart from in a short-term, instrumental way. For those that could, it represented a useful means of responding to unexpected costs. However, most could not afford to put money 'out of reach' even for short periods and thus this was not something they could realistically undertake to do. Doorstep loans or social fund loans were often the only option available when they had unexpected costs or at expensive times of the year, such as Christmas or holidays. Those who managed to save often had to use them in the case of unexpected expenses or changes in their circumstances.

Although rare, some participants had used the services of professional debt advice services and had a repayment plan in action. However, use of private services (as opposed to CAB) resulted in them incurring charges that added to their overall level of debt and meant payments were not reducing their debt as fast as they had thought. Overall, there was little evidence of particular triggers into indebtedness. For those participants who were over-indebted, their lives were characterised by an ongoing (and often relentless) series of struggles and crises where unanticipated expenses (such as unexpectedly high utility bill, the breakdown of a household item such as a cooker or boiler) or delays in benefit payments were problematic and often the only thing they could economise on was food and other basics as they had such little financial flexibility.

The impact of the financial situation

In the years preceding the economic downturn, the use of credit had become commonplace, and the UK population as a whole was considered as living in – and benefitting from – a culture of easily available credit. For many higher income households, rising property prices enabled them to release equity in their homes and first time buyers were offered loans equal to several multiples of their annual incomes to 'get a foot on the property ladder'. This period of 'boom' was characterised by low interest rates, low unemployment, economic growth and stability and rising standards of living.

However, participants in this research had few such advantages. Only a very small number were owner-occupiers and their homes, in areas of deprivation, had not increased in value to the same extent. Nevertheless, in many cases, they too had been encouraged to take out credit even if it was evident that they had limited means of repayment or had insecure employment. For some, the temptation of using credit to solve financial crises was almost 'irresistible' when living on persistent low incomes, albeit the reprieve was

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often short lived. Some participants spoke about being actively encouraged to borrow more than they had asked for:

> I got £1,500 (loan) and then the credit card, it's the one I've still got now. I was 20 and they told me the minimum amount I could have was £1,250. [Nadia, 24]
> Yes I found credit really easy to get. When I was 18 I got myself in a bit of debt. I went to the bank and they said, 'Look you can have a loan'. I was working, and they said 'You can afford it comfortably'. And I got a £6,000 loan and the same day they offered me a credit card with a level of £2,500. So I was like, that is easy. So I got myself in debt and it has took me four years. I mean I am 23 now, I have only just got rid of my debts and that has taken about four years to pay it off. [Darren, 23]

When asked about the 'credit crunch', very few participants felt that they had been particularly affected by it. For those with a poor credit rating, formal credit was often already unavailable to them and many were already struggling to manage their existing debts and thus had not sought to take on further borrowing. Many felt the 'crunch' had hit the more wealthy members of society with formal loans or mortgages, although they were aware that doorstep lenders continued to offer loans to those excluded from mainstream finance:

> The people who don't work have to get street loans and they pay, say you borrow £100, you could be paying £40 back on that. When it goes down some they'll give you another one to top it up. So you end up in a lot of debt. To me they're like armchair pimps do you know what I mean? [Carrie, 53]

One of the initial concerns when access to credit dried up for the small number who held mortgages (taken when in better financial circumstances) was that interest rates would rise and mortgage repayments could rise. In reality, the Bank of England lowered interest rates to their lowest ever during this period and participants with mortgages were able to reduce their payments and use the funds to meet other costs. However, the vast majority of participants were in the rented sector and thus did not benefit from the low interest rates and did not experience reductions in rent during this period.

The main complaint from participants in the early days of the credit crunch was the rising cost of food and fuel. The cost of basic foodstuffs was rising as the research was conducted and many participants cut back on basics and bought stores' economy ranges as this was one of the few ways in which they could economise. The few who were car owners noticed the rise in petrol costs and many expressed fears about paying the costs of gas and electricity over the winter period. Many paid for their fuel via card meters, the most expensive method of payment. This was a particular cause of hardship and the benefits of paying by monthly direct debit were unavailable to many – this sometimes a result of their having missed payments previously. This resulted in many participants having to find additional funds to pay their fuel bills during the winter period and this often had a considerable impact on their ability to meet their day-to-day living costs and other financial obligations.

Although few participants felt directly affected by the credit crunch, they commonly felt they had been affected when the economy moved into recession. For example, two participants working in the building trade were made redundant early in the research. For

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one of these households, this 'shock' pushed them into debt for the first time as they had previously been very debt averse. The combination of the sudden reduction in income and their attempt to repay their debt resulted in them going into arrears on rent and utilities. In order to make ends meet, they cut back on all but the necessities and found meeting their obligations extremely challenging.

As the research progressed, more people lost jobs or reported having considerable uncertainty about their future. Two participants applied for positions with local authorities: one was offered a job only to have the offer rescinded due to financial cutbacks, whilst another was taken on a self-employed basis as the council would not commit to the post long-term. One participant who worked for a care agency was made redundant for a second time, on both occasions missing out on redundancy pay as she had not been in her post for sufficient time. Those who were actively seeking work found few vacancies available. Indeed, one reported the closure of local employment agencies due to the lack of locally available jobs.

Many participants were unskilled or had few qualifications. Their finding sustainable 'well-paid' work had been difficult in a buoyant labour market, thus the level of churning between employment and benefit receipt in the preceding three years. However, when the impact of the recession began to bite, opportunities for them to gain work were much reduced. The experience of participants in this study supports the findings of research over many years that people with a long history of low-paid and precarious employment are often the first casualties of a recession. Inevitably, the loss of employment – or the impact of reduced hours – meant managing financial commitment (including debt) became even more difficult. However, for some the certainty of relatively stable (even if low) income was preferable to fluctuating incomes and 'cycling' between work and benefits. As such, participants were often reluctant to take up work that they were unsure would last and thus provide at least some degree of certainty, even if this meant they were worse off in the short term.

Many participants were very negative about banking practices that they felt had encouraged them to use credit and then offered no support when their circumstances changed and they were unable to manage. Indeed, some expressed anger that banks and financial institutions could treat them in this manner when they saw them as being responsible for the credit crunch and recession and the resultant impact at both a macro level and at a level which saw their daily lives so adversely affected (in terms of prices and job opportunities) and where avenues to re-negotiate credit arrangements were suddenly closed to them. Although the people who used doorstep lenders appeared to have better relationships with their creditors, they were also critical of the methods they sometimes used.

Conclusions

This research did not find a picture of widespread profligate use of credit to acquire a high materialistic standard of living amongst people on persistent low incomes. What it did find was that the use of credit and the acquisition of debt was a function of persistent low levels of income, both benefit and earnings-derived, and exacerbated by often-repeated experiences of 'churning' between work and welfare dependency. It found that people living on persistent low incomes were, in many ways, casualties of the economic boom as they were unable to benefit from the economic growth – in particular increased equity

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and salary levels – and, indeed, found that their indebtedness increased during this period. Further, it found that they were also casualties of the economic bust in that they most keenly felt the impact of the recession and the reaction of financial institutions to the new financial landscape.

To respond effectively to these findings, policy makers, financial organisations and those providing support and advice to people living on persistent low incomes and who are (or who are at risk of becoming) over-indebted, need to recognise that addressing particular issues in isolation is unlikely to improve peoples' circumstances or prospects for the longer term. In particular, arguing that people should avoid getting into debt in the first place does not take into account the reality of peoples' experiences. Many peoples' current indebtedness was rooted in events that occurred or choices made several years previously or which were the result of recent financial shocks. It was also exacerbated by inability, despite often considerable effort, to find a way to escape the 'debt trap' in which they live.

The research supports the message that 'making work pay for those who can' is the key means by which people can be helped to avoid both the poverty trap and the debt trap. Recognising that the use of credit for most people is a necessity and a constant burden, it is clear that the most significant contribution to improving peoples' circumstances is *sustainable* work. It also supports existing evidence that raising minimum income levels to a 'living wage' (e.g. Davis, *et al*., 2010) would be a key factor. If this is not done, it would appear likely to be the case that even people who are able to move into work will remain limited in their ability to meet their financial commitments, the level of problematic debt will increase and incentives to take up work/training will be adversely affected.

The research points to a real need for there to be a concerted and ongoing programme of work to improve financial literacy – for all. While there are currently initiatives being trialled for young people, it is clear that there is a need for these to be extended for young adults (especially those becoming financially independent) and for people on low incomes during difficult periods, such as when being made unemployed, having children, moving house, getting divorced or changing jobs. The Money Advice Service is providing information on these latter issues, but the real question is as to whether this is reaching those most in need.

There is also a clear role for the financial sector as a whole, including its regulators. While a large proportion of the population are reducing their use of credit, those on low incomes for whom credit is a necessity require ongoing access to affordable credit, protection from excessive charges and solutions which result in the premium they pay for the 'insurance' that their use of credit provides being reduced. Addressing this during the current economic climate will be challenging, but exploring how affordable credit solutions can be made available to people on persistent low incomes (particularly those who are vulnerable to employment 'cycling') could make a positive impact on their employability and wider circumstances. In addition, further attention being paid to the costs of utility bills for people on low incomes, issues around direct debit payments, enabling people to exit (mobile or pay television) contracts due to them no longer being able to afford to pay and making provision that supports flexible saving would also help support people trying to meet their obligations and escape debt.

In conclusion, it is uncertain how the changes being put in place by the government and financial sector will impact on people living on persistent low incomes in the long term. However, it would be counterproductive if efforts to deal with the 'borrowing

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culture' in the general population prior to the credit crunch and efforts to eradicate the structural financial deficit through radical welfare reform and restructuring of the public sector had its greatest detrimental impact on those who generally use credit to make ends meet due to their otherwise inadequate incomes, which, no matter how hard they try, cannot meet their day-to-day needs.

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