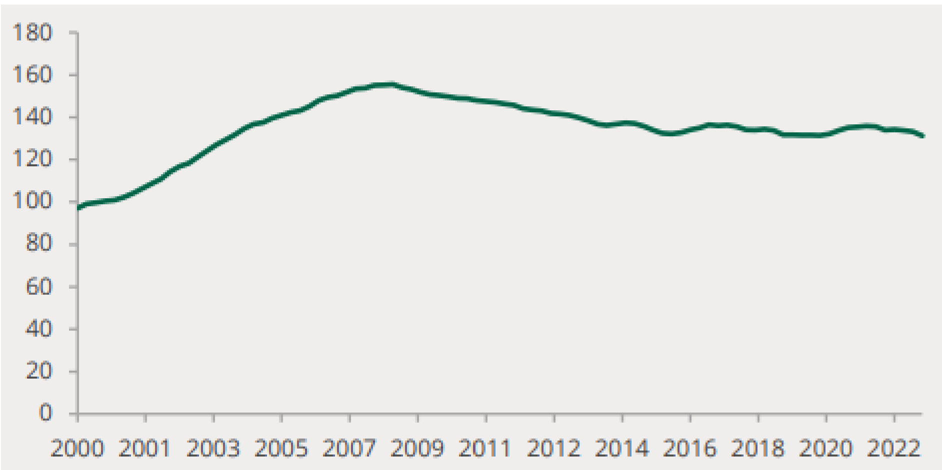
Household Borrowing: Rising debt and economic growth

Under the Conservatives from 1979 to 1997 and also New Labour from 1997 to 2010 the top 10% of earners and especially the top 1% gained most from economic growth. The bottom 10% and especially the bottom 5% did badly, "*though the vast majority of the population have also lost out significantly.*" [1] The most recent figures for UK wage growth show that in January 2024 average real wages grew by 1.6%. Since the beginning of the pandemic around April 2020 however there have been 23 months of negative growth. Before that there were 81 months of negative growth in the 10 years or so following the financial crisis in 2008. [2] As a result average weekly earnings are about £205 per week or £10,700 per year lower than they would have been had previous growth rates continued.[3]

Households have compensated for the lack of growth of their incomes by becoming increasingly reliant on borrowing. Household debt such as spending on credit cards, personal loans and mortgages was around 50 percent of total household disposable income in 1980. The chart [4] shows that this had risen to around 97% by 2000. It then rose to its highest point of 156.4% in 2008 at the time of the financial crisis. Household debt then declined to 134.6% by early 2016 and from then it has remained fairly steady. At the end of September 2023 it was 126%. [5] UK levels have been much higher than the European average and above those of the United States.[6]

Household debt as a % of aggregate household disposable income



Financial debt, that is consumer debt excluding mortgages on property, typically involves one or more of the following: credit cards, car finance, personal loans, overdrafts, non-vehicle hire purchase agreements, store cards and pay-day loans. The total amount of financial debt decreased following the financial crash in 2008 due in part to the introduction of restrictions on how much banks could lend. From about 2015 there was a sharp rise in borrowing because of a larger share of cars being bought on finance, although total financial debt was still a good bit lower before the pandemic, than it had been before the financial crisis. Financial debt fell from £313 billion in July 2008 to £270 billion in December 2019. However, despite the fact that the total level of financial debt fell during this period, the debts of low-income families increased. Between 2009 and 2019, borrowing by the bottom 20% of households rose by 13 percentage points. This compares with the top 20% of households whose borrowing rose only by 2 percentage points.[7] Financial debt is expected to increase over the next five years, from

29.1% of disposable income in 2022 to 38.6% by 2028. This rise in family debt amounts to an increase of £154 billion or an average of £5,445 per household.[8]

Rising debt and consumer spending have played a major role in Britain's economic growth over the last 40 years. Household expenditure was 55% of GDP in the mid-1970s. By 2000 this had risen to 67% and it has remained between 64% and 69% ever since. This is high by international standards – household expenditure in Germany for example has actually fallen from 58% in 1980 to about 52% in 2022. The result is that in the UK "*the economy is no longer stimulated by wage growth or government spending and public debt but by individuals borrowing money to maintain income in times of stagnant wages and waning welfare*." [9] However when economic growth comes mostly from consumer borrowing and spending, demand for goods and services in the future is likely to be reduced. This is because households need to devote more and more of their income to paying off their debt. "*While factors such as credit growth and rising house prices can boost consumption in the short run, the incidence of consumption-led growth and rising debt………. significantly dampen growth in the medium to long run*". [10]

According to the economic historian Avner Offer the rise of household debt is one of the most significant economic and social changes in Britain since the 1970s, and a key aspect of what he calls the 'market turn' - the change from social democracy with its emphasis on public investment and full employment, to market liberalism with its emphasis on cutting taxes and deregulating credit, "*which permitted large increases in household borrowing.*". [11] Robert Skidelsky argues that the rise in debt and the ease with which credit can be accessed is an essential element of market liberalism, which contrasts markedly with the previous model of social democracy. During the 1950s, 60s and 70s there existed a balance between the rewards from capital and the rewards from labour. Strong trade unions were able to push up wages in line with productivity. The government's policy to do everything they could to maintain full employment created a favourable climate for business investment, and government investment in capital projects and infrastructure in turn contributed to full employment and increases in productivity. Consumer credit was restricted.[12]

References

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Notes

For more on low pay and wages see our previous articles:

Low Pay in Britain: Where are we now? 27 December 2023
https://www.economiclifeinbritain.co.uk/_files/ugd/728b7f_1c7d6e1be85649db94ed6c5db02689ae.pdf
Wage Growth: What's happened to wages in Britain? 27 December 2023
https://www.economiclifeinbritain.co.uk/_files/ugd/728b7f_8f0e17e529a34237aef984574b5ef784.pdf

The rapid growth of car finance from 2015 is likely to have been influenced by the use of discretionary commission arrangements. These allowed the dealers from whom people were buying their cars to adjust the interest rates being offered by finance companies. Usually the higher the interest rate, the higher the commission the dealer received. This practice was banned by the Financial Conduct Authority (FCA) in January 2021. Discretionary Commission Arrangements, Volkswagen Financial Services https://customer.vwfs.co.uk/discretionary-commission.html?traci_s=CP:VW:ORG:VWFS:Website:2024-02:DiscretionaryCommission&traci_ie=myvwfinance.vwfs.co.uk:Content:Button:Landing

The Office for National Statistics (ONS) distinguishes between property debt (mortgages and equity release) and financial debt (credit cards, car finance, personal loans, overdrafts, non-vehicle hire purchase agreements, store cards, pay-day loans as well as student loans from the Students Loans Company).