Behind the balance sheet:

the financial health of low earning households

Resolution Foundation

SUMMARY

This report summarises current statistical data relating to the financial health of low earning households, and complements this with new qualitative data to give a fuller and more accurate picture of financial health.

Our objective was to get behind the figures documenting financial inclusion and financial capability in low earning households – in other words, those households living on below median income who remain broadly independent of state support. For the 14 million low earning adults living in 7.2 million households in the UK, these figures show that:

- Housing, fuel and power, and food account for around 26 per cent of the disposable income of low earning households, compared to 15 per cent for higher earners
- Over a quarter of low earners say that they usually run out of money each month and over a half of low earners report problems with bills and credit commitments. A fifth of low earners say their debt burden is 'heavy'
- 35 per cent of low earners had no reported savings in 2007/8, and a further 21 per cent have less than £1,500 in the bank
- 53 per cent of low earners join superannuation pension schemes where they are available, and while 83 per cent of higher earners have these schemes offered to them, just 60 per cent of low earners do
- Low earners are less likely to have the safety net of insurance to fall back on: 39 per cent of low earners, compared to 58 per cent of higher earners, take out life insurance. This pattern is mirrored in use of contents, critical illness and income protection insurance

These figures highlight the financially vulnerable state of many low earning households. However what they do not tell us is how low earning households juggle their limited weekly and monthly incomes. They do not elaborate on the factors that drove financial decisions in these households, therefore influencing the overall financial health of low earners. To produce this report we have therefore used qualitative research to focus on the factors that influence financial health that can get lost in a more quantitative analysis.

Chapter 1 sets out the context for this work. It includes a statistical overview of the current financial health of low earners, as well as charting developments in the thinking around financial health in recent years, such as the growing interest in financial capability and behavioural economics.

Chapter 2 offers some snapshots of the financial health of the low earning households we met during the course of our research. These offer an important reminder that there is no such thing as a typical low earner. Nevertheless it also highlights some clear themes that cut across all the households we met:

- *Financial health is a dynamic concept that changes over time:* a snapshot cannot fully illustrate the financial health of a household. Our research with low-earning households shows that changes in financial health are often the rule rather than the exception. Our findings also show that these changes in financial health are not linear, instead depending on a wide range of inter-related factors, as well as being determined by historical and legacy issues.
- *Financial health is a complex concept for low earners:* their low pay leaves them juggling a wide range of tapers and thresholds for tax credits and eligibility criteria for some benefits. All of these are paid through different channels, at different times, and to different household members. Therefore changes to one part of the system of support will have consequences that cannot always be anticipated. Any changes to tax systems, tax credit or benefit regimes must be undertaken with great care.
- *Small changes can be very destabilising:* these snapshots illustrate just how destabilising changes in circumstances can be for families living on the edge of economic independence. Delays in public service responses – it takes 26 working days to process Housing Benefit, for example – can precipitate crisis in these circumstances. Similarly, unexpected bills and costs – for example from a vet, or a dentist, or a bout of ill health – can drive people to use credit to tide them over.

  Chapter 3 goes behind the balance sheet. Here, we capture the sometimes invisible factors that nevertheless have a significant impact on how people think about their money and manage their finances. For example:

- *There is no such thing as a pure economic decision.* Given the freedom to do so, respondents did not talk about their finances purely in numerical terms. Instead, choices, regrets, aspirations, family anecdote and personal habits were all woven seamlessly with the concrete details of incomings and outgoings.
- *It is a household's hidden assets and liabilities that are central to financial decisions.* These hidden factors included entrepreneurialism, social networks, and mental and physical health. Household members' perceptions about these factors often appeared to have a greater sway over decisions than external factors such as loss of income or changes to the interest rate.
- *To fully understand a household's financial health we must consider their*

participation in the informal economy as well as the formal economy. This economy does not simply encompass the black market but a wider set of activities that includes e-Bay, car boot sales and allotments. This informal economy can save households money, but participation in it takes time.

Chapter 4 then reflects on the implications of this research for public policy and the way in which financial inclusion and financial capability are tackled. We argue that there are three important foundations in this field that need to be built upon:

- *Resilience* – the ability or otherwise people have to protect themselves from crisis has been a source of wide interest recently. We suggest here that the concept probably needs to be broadened to focus not only people's ability to protect themselves, but also their ability to recognise and grasp opportunities.
- *Behavioural economics* – the rise and rise of behavioural economics has already begun to challenge the rational man model of policy development but more work is needed to apply this thinking to the field of financial health.
- *Financial capability* – the Resolution Foundation has welcomed the mainstreaming of the financial capability concept. This report hints at the importance of considering financial agency as well as capability. The question of how evenly or not resources are distributed within households also may need further consideration if we are to fully understand the nation's financial health.

This report offers a fresh set of findings about how low earning households think about their money and make financial decisions. We hope that the research presented in this report provides a useful challenge to some of the common assumptions that cloud the debate about how to improve the financial health of low earning households.

ANY!
GAMMON
£10=
£16
£19
£18
3
BIG

CONTENTS

1. Understanding household finances — Page 8

2. The household finances of low earners: snapshots and case studies — Page 13

3. Getting behind the balance sheet — Page 27

4. Policy considerations for improving financial health — Page 36

1. UNDERSTANDING HOUSEHOLD FINANCES

A century ago, Maud Pember Reeves chronicled the hardships of what she called 'ordinary working class life' in *Round About a Pound a Week*. Her study, which took place between 1909 and 1913, was galvanised by the angst that gripped the nation following the discovery of extensive rickets, poor health and feebleness among working class men who signed up to fight in the Boer War. Pember Reeves deliberately set out to study not the poorest or the most needy, but rather the families of manual working men at ordinary levels of pay. She wrote for an audience of middle class reformers, and her findings challenged many of the assumptions about the causes of ill-health and malnutrition.

Far from money being frittered away on beer, tobacco and gambling, she chronicled the meticulous budgeting of women trying to keep their children healthy and going without in order to ensure that their husbands had enough food to get through a tough working day. She showed families choosing to put money into local funeral insurance schemes rather than putting more food on the table – highlighting the social stigma of a pauper's funeral and the powerful impact of status concerns on financial decisions. Her study also captured the importance of the informal economy – the loans of money and food between neighbours and families when some fell on hard times – and the significance of marriage, particularly for women, in shaping people's financial situations.

Today much has changed. The families Pember Reeves wrote of were poorer than today's working families in both absolute and relative terms. The pound that families lived off in 1913 is roughly £370 a week now, or £19,250 a year[1]. There is a complex infrastructure of tax credits and benefits designed to supplement this income. Homeownership and access to credit are facts of life for the vast majority of the population. Women's place in the labour market has been transformed in the last generation.

Despite these changes, many of the assumptions that Pember Reeves challenged are still in play when we turn to the question of how low earning households manage their finances, and what more can be done to maintain their fragile economic independence. Too often debates in the media assume that families who are struggling financially are in these circumstances because of poor money management, bad character and over-consumption.

In fact, as the FSA baseline survey of financial capability showed in 2006, many facets of financial capability have little correlation with income. Their comprehensive survey indicates that, as Round About a Pound a Week showed, low income households may in fact be better, rather than worse, at keeping track of their incomes and outgoings than wealthier households. Furthermore, the

massive expansion of the mortgage and consumer credit markets in the generation leading up to the credit crunch has made credit an everyday means of managing expenditure, and debt a commonplace experience that does not automatically provide evidence of a family in financial crisis.

Looking beyond day to day budgeting to longer-term financial matters, the survey also shows that as a nation, we are poor at planning ahead, regardless of our income. Too few people are saving, either for a rainy day or for later life. This will matter more than ever to younger generations, who are growing up in a world where final salary pensions are rare, and increasingly it is individuals, rather than the state, who will need to pay for their retirement and any care needs.[2] Poor financial health means individuals will ultimately depend on the state, and taxpayers, to support their needs in hard times or in old age.

A focus on low earners

The Resolution Foundation has had a long-standing interest in the spending and saving behaviours of the 14 million adults living in the 7.2 million low earning households in the UK. These are the households who find that, when the economy is growing strongly, it is possible to get by with careful budgeting and planning, without major difficulties. In general, low earning households are not ‘going without’ in the way that families living in poverty are. While the use of debt may store up problems for the future, they can afford a few treats like a trip to the cinema, or a takeaway meal for the family every now and then. There’s enough food for the table, a budget for running a car and a mobile phone or two. While there might not be enough for an annual holiday, with a bit of planning, presents can be bought for Christmas and birthdays.

In line with many other households across the UK, low earning households do less well when it comes to planning ahead than they do in managing limited weekly and monthly budgets. However low earners are disadvantaged when it comes to planning ahead: the market for financial products and services that suit their needs remains under-developed, despite the massive growth of credit unions in recent years. And as we have argued elsewhere[3], low earners are ‘squeezed’ when it comes to financial advice as well as the actual products and services – a further impediment to low earners wishing to bolster their financial health in the long-term.

In addition, analysis conducted by the Resolution Foundation last year highlighted some worrying indications of a deeper financial vulnerability, which has been exposed as a result of the economic downturn and the contraction of the consumer credit and mortgage markets, and exacerbated by recent rises in the cost of living. What we found is that while there are many similarities between low earners and

the wider population in terms of financial capability, low earners are closer to crisis. In other words, they are living closer to the edge of their means, where a small change in circumstances – a reduction in hours, or a rise in utility prices, for example – could push them into a situation where their fragile economic independence is compromised.

Our analysis revealed this financial vulnerability in a number of different ways. First, in terms of day-to-day finances, we found that low earners were more exposed to the threat of job losses and reduction in hours than higher earning, more skilled people. The increase in food and fuel costs also disproportionately hit low earning households.

Second, we found that low earners have fewer safety nets to protect them if times do get difficult. Low earning households were much less likely to own insurance to cover unexpected crises, from illness to burglary to job loss – with just 39 per cent of low earners, compared with 58 per cent of higher earners, owning a life insurance policy. Furthermore, low earning households – particularly those under the age of 55 – were much less likely to be saving adequately than higher earners, with 44 per cent of this age group having less than one month's income in the bank, and nearly three quarters having less than two months of income saved.

Thirdly, looking at long-term financial security, we found that even before the recession, low earners were less likely to have a pension, even after their reduced access to occupational pensions is taken into account. 50 per cent of low earners choose to access an occupational scheme where they are available. 55 per cent of low earners (compared to 44 per cent of the overall population) continue to believe that the state pension will be their main source of retirement income.

In summary, our analysis found that:

- Low earners are experiencing significantly higher debt-to-income ratios than higher earners, despite historically low interest rates
- Low earners are finding that their existing debt is becoming more expensive to service due to tighter lending practices and fewer lenders are offering products that meet their credit needs
- The recession has not had a significant impact on savings activity, but overall low earners were under-saving before the recession and the evidence is not yet showing that they are saving more, even if this is something to which they aspire
- Rises in food and fuel costs in 2008 may have limited the amount of money some low earners could put aside
- Low earner levels of anxiety about their financial situation are rising

There are as many different low earner household types as there are low earner households, While some will have been hit hard by the economic downturn, others will be benefiting from reduced mortgage payments, for example. But there is some evidence that the recession is altering people's attitudes, even if their material circumstances stay the same. We found that three million low earners are now worrying about money 'all the time' – twice the number who felt this way in 2007.

This finding is supported by research carried out by the Personal Finance Research Centre at Bristol University, which in 2009 uncovered a shift in attitudes within low income households – where people had become more pro-active money managers since the advent of the economic downturn, adopting strategies such as shopping around or switching brands in order to cut back on discretionary spending. They also found that attitudes towards the use of credit had hardened, with people expressing strong views about their desire to avoid falling into unmanageable debt. Such 'precautionary restraint' did not always translate into changed behaviours, and it will take time to understand whether these findings add up to a substantive change in social norms around spending.[4]

---

[1] IFS calculations based on wage inflation, and quoted by Polly Toynbee in the preface to Round About a Pound a Week (Persephone Books, London: 2008)

[2] Shaping the Future of Care Together (Department of Health, London 2009) http://careandsupport.direct.gov.uk/greenpaper/

[3] Closing the Advice Gap: providing financial advice for people on low incomes (Resolution Foundation, London: 2006) http://www.resolutionfoundation.org/documents/ClosingtheAdviceGapReportfinal_001.pdf

[4] Facing the squeeze: A qualitative study of household finances and access to credit in a 21st-century recession (PFRC/ Money Advice Trust: 2009) http://www.pfrc.bris.ac.uk/completed_research/facing-the-squeeze.html

2. THE HOUSEHOLD FINANCES OF LOW EARNERS: SNAPSHOTS AND CASE STUDIES

This chapter introduces the low earners who participated in our research, and provides snapshots of their household finances. These serve as a reminder that there is no such thing as a typical low earner; however it is possible to identify a number of important themes that cut across the diverse situations of the households we visited.

Later this year, the Resolution Foundation will publish the first ever Financial Health Index. This is a simple way of measuring the nation's financial health. We plan to publish it annually in order to monitor changes over time at both a composite level, and at the level of the individual indicators we propose to use.[5]

However this is a complex area to study. We know from our own work and that of others that financial health depends on positive financial choices as well as the absence of financial difficulty. It is influenced by a wide range of factors such as environment, lifestyle, availability of financial services and personal choice.

Given this complexity, the Resolution Foundation decided to augment the Index, and complement its statistical approach through a research project that utilised a more qualitative methodology. While quantitative data can tell you what behaviours people are choosing and how many are doing so, qualitative work can help to unpack why certain behaviours are chosen. As we will see in the remainder of this report, it also helps to illustrate the web of relationships between different factors that shape the decisions and overall financial health of any given household. This chapter presents the low earning households we met during the course of our research.

Method

We recruited 12 households to take part in the research using a recruitment screener designed to ensure that we were able to talk to a range of different kinds of people and household compositions. Each of the 12 participating households were asked to complete a financial 'scrapbook' before meeting with one of our researchers. The scrapbooks contained a number of tasks designed to elicit various types of information and to get respondents thinking about the financial issues we would ask them about during interview. Tasks included daily and weekly expenditure diaries, monthly balance sheets, thoughts about the future exercises, questions about attitudes to money, 'what if' scenarios, a financial life history and more. We then conducted lengthy in-home, face-to-face interviews with them to unpack the information they had provided and to explore an exhaustive range of issues related to their financial health and attitudes toward money. The interviews

were conducted by trained ethnographers who used ethnographic fieldwork methods to elicit as much contextual information as possible during the interviews. This enabled us to understand exactly the ways in which financial decisions were woven into daily life and family relationships.[6]

Themes

After identifying some themes that cut across our diverse group of respondents, we introduce each of the households as a snapshot, before going on to explore three different households in greater depth.

Financial health is a dynamic concept that changes over time
These snapshots show that change, rather than stability, is the norm for low earning households when it comes to their finances. And we will see just how powerful historical and legacy issues can be when it comes to determining a household's financial health in the present. If our research households show that change is the norm, they also show that changes in financial health are not linear but instead depend on a wide range of inter-related factors. Some of these are external issues such as a change in employment status or the acquisition of new assets, but many are less obvious and are often forgotten such as: personal relationships, health, and attitudes toward money, spending and saving.

Financial health is a complex concept
'How much do you earn?' seems a simple enough question at face value. But as these snapshots of low earner finances show, the headline figure of household income disguises a far more complex picture of incomings and outgoings, expenditure and savings. Even allowing for the ups and downs in salaries which many low earners experience because of the kind of work they do (8.1 per cent of working age low earners are on 'non-standard' contracts[7], and half a million low earners have more than one job), as these snapshots show, people's approach to accounting for their income varies widely.

Most people simply default to 'salary' when asked about income. However, for those who are paid by the hour or by the week, it can be difficult to calculate the monthly income figure that is required by many of the benefit and tax credit claims forms. Working out a typical month's income is also made more complex by overtime agreements, unpredictable hours, and the challenges of juggling more than one job.

Some count government support such as working tax credits, and some do not. Some households enjoy income from rent, or from other activities such as foster care, but do not consider this part of their 'income' as it is not earned in the same

way a salary is. Similarly, on expenditure, we found that when we asked people to keep diaries, some households only accounted for regular spending. Some left out one-off costs despite the significant impact that these could have on the financial health of the family. Others excluded pensions payments because they were regarded as a 'sink fund' for any spare cash at the end of the month rather than a 'payment' as such.

Small changes can be very destabilising
These snapshots illustrate just how destabilising changes in circumstances can be for families living on the edge of economic independence. As we found in Closer to Crisis, safety nets such as Housing Benefit and Council Tax Benefit can take a long time to fall into place – and this gap between a family's need and a public service response can precipitate crisis for households who have very little set aside for changes in circumstances.

Similarly, the unexpected bills and costs that are an inevitable part of modern life – for example from a vet, or a dentist, or a bout of ill health – can drive people to use credit to tide them over. We met several households whose significant debts began with such an event and resulted in a cycle of expensive credit as debts consumed larger amounts of monthly income in repayments, resulting in the need to borrow more to cover everyday expenditure.

Snapshots

The interviews were conducted with one or two people in each household who had a grasp of the overall finances of the household. Below we refer to the households by the first names of the people we spoke to.

Jim
Jim is in his early sixties. He is married and lives with his wife and two step-children. Before the industry declined, he had a successful career as a tobacconist. More recently he has set up a painting and decorating business for himself, but as prices are forced down, and his health deteriorates, he is having to rely more and more on incapacity benefits.

Chris
Chris is in his late twenties. He lives in a house that he owns himself, with his girlfriend, his sister and his sister's boyfriend. Chris has a very large amount of debt but he also has a good career prospects in the construction firm he works for and there are several ways in which he could increase his income.

Amelia
Amelia is 57 and lives with her husband (who she is currently in the process of divorcing) and their two teenage children. They couple still live together for financial reasons. Amelia is a teaching assistant and her husband has recently been made redundant. Amelia says she knows little about how to make financial decisions and is nervous of having to become independent again.

Sara
Sara is in her late fifties and lives in a house on her own in a 4-bed family house that was left to her in a divorce. She works part-time as an administrator in a leisure centre. Her daughters have left home and Sara is planning to sell the large family home in order to better manage her bills. Sara has no pension but is not worried. She plans to use the equity in the house to cover her future.

Alan
Alan (37), and his wife Sarah, both work for Royal Mail and have been worried recently about their futures. Neither feels that they have transferrable skills if they were to lose their jobs. They have three children between four and seven years old. They have little in the way of long-term financial security and they do not have any savings or large assets.

Kelvin
Kelvin is 37 years old and lives with his girlfriend and her daughter. He works as a gardener for a larger gardening and landscaping firm on a daily basis, but he does not have a permanent contract. He has recently recovered successfully from health problems and from serious debt trouble, but the ill health of other family members presents a potential risk that Kelvin will have to face more financial pressures in the future.

Mick
Mick is a 52 year old window cleaner. He lives with his wife who works for a low wage in a shop. They have two children. One is at university and the other spends half of her time living in the family house and the other half of her time at her boyfriend's house. Mick sees his window cleaning business as large step down from his former career in sales. He had been unfairly dismissed from his former job and although he had won a tribunal, his career was over. The payout was not large enough to sustain the lifestyle he and his wife had been living and they have some debt problems as a result.

Bruce
Bruce lives with his wife Wendy, her son from a previous marriage, and their two daughters. Bruce has benefitted from the recession. Whilst colleagues in the plumbing and engineering firm he works for were made redundant, he has been

promoted. Wendy chooses not to work. They have an agreement that one of the parents will stay at home while the children are young. They are hoping to buy the house they live in under the right-to-buy scheme but have recently found it difficult to get a mortgage.

Gareth

Gareth is 38 and works in IT for his local education authority. He lives with his wife who works in the same council, as a housing officer. They have two young children. Gareth feels that his job is precarious and that he no longer has the IT skills he would need to find a new job. He also thinks he is not well-paid and that he has no prospects of having his pay raised in the future. Gareth and his wife struggle to meet weekly financial needs and live with few luxuries.

CASE STUDIES

Sue

Sue is in her late fifties. She lives alone, in a house she owns, in northeast London. She has two daughters in their twenties, who have both left home. One has moved to Australia and is planning to get married to her long-term partner soon. The other is recently graduated. This daughter is working but not in a job she loves. She wants to find a job in the field of her university study. Sue wants to support her in that.

Sue grew up in a working family, but never with a great deal of money. She left school at 16 with some 'O' levels, and initially worked in a bank where she received some further secretarial training. In 1978 she got married and at that point, she says, "his money was my money." She gave up working completely after the birth of her first child. Her husband was not wealthy when they married, but he had good prospects and did in fact go on to become quite successful, running his own engineering consultancy. Sue describes her married life as 'comfortable', with foreign holidays and enough money to fulfil all of her material needs and desires. The couple divorced 12 years ago on reasonably good terms, and Sue was able to use her share of the divorce settlement to buy the house that she currently lives in.

Now, Sue lives with much less. She works most days, as a teacher and administrator in a nursery. She loves working with children, but it doesn't pay well. She supplements this small income with a bit of administration work in her ex-husband's consultancy. She says it is his way of providing her with some extra cash.

The figures below represent Sue's incomings and outgoings in the way she understood them.

Assets*	
House	**2 bedroom semi in northeast London**
Savings bond	**£15000**
Savings account	**£3000**
Current account	**£1000**

*Sue also takes a share of a family trust fund. She says that she is always told that it could run out at any time and that the monthly payment it makes should not be relied on. Since she does not have direct access to the fund and cannot draw on it any more than she already does, we have included it below in the monthly income figures.

Monthly income		Monthly outgoings	
Work: Teaching	**£447**	**£20**	Buildings and contents insurance
Work: Admin	**£216**	**£13.50**	Water
Interest on savings	**£26**	**£70**	Gas
Family trust fund	**£155**	**£50**	Electricity
Working Tax credit	**£31.41**	**£30**	Home phone and internet
		£12	TV license
		£35	Mobile Phone
		£24	Car insurance
		£10.74	Life insurance
		£20	Cable TV
		£35	Petrol
		£3	Oyster
		£200	Food
		£40	Clothes
		£15	Hobbies (painting and theatre)
		£10	Cinema
		£7	Charity donation
		£82	Gym
		£8	Clubs and organisations
		£4	Membership of Royal academy
	£875.41	**£689.24**	

There are a number of things to say about Sue's balance sheet. During the research, we talked through the figures at some length with Sue and as far as she understood it, it was correct. The problem was, that when we also looked at her daily expenditure, the totals did not seem to match. In fact, Sue was spending a lot more money than she realised. Her daily expenditure regularly exceeded £50.

Upon examination, what was missing from her balance sheet was her expenditure on things for her daughter, extra bits of food and eating out, things she buys for her personal well-being (like vitamins), a visit to a doctor and so on. It is the normal, yet unstructured spending that she had not included in her balance sheet. So, instead of seeing a surplus in terms of incomes and outgoings, Sue has to dip into savings every month, and her assets were actually declining. As Sue says:

“Thinking about money is quite stressful for me because I’m very aware that my outgoings are larger than my income. This inevitably means that my savings are gradually reducing – a situation that cannot go on forever.”

In fact, there are other, bigger things that are missing from Sue’s balance sheet. For example, there was a looming problem with the roof of the house that Sue felt would need £4,000 to fix. If her daughter decided to marry in Australia she would have to choose whether she could afford to be there for the wedding. Also, Sue is unlikely to work for much longer. She is approaching retirement, and knows that the state pension she will receive will mean a significant reduction to her income.

All of *these* things can be quantified and built in to the picture of Sue’s household finances with enough probing and discussion, of course. But what would be more difficult to include is the financial significance of Sue’s relationship with her ex-husband. Sue maintains a close relationship with her ex and has not had a significant relationship with anyone else since their divorce. They continue to take joint decisions with regard to their children and Sue speaks of him fondly. She also relies on him for advice in many aspects of her life, especially financial matters. He has taken a large part of the financial responsibility for their daughters (such as supporting them through university) and also supplements Sue’s income by offering her a small amount of work in his firm. Sue feels that if things became very difficult financially, he would look after her.

In other words, what Sue’s ex provided was a level of financial security to Sue that cannot be easily quantified but is nonetheless very significant when trying to understand her financial health and the way in which she made decisions about money. It is not an arrangement that is made up of concrete sums and it has no formal or legal basis. Instead, it is a hidden asset, albeit an uncertain one. And it is one that allows Sue some freedom to make financial decisions, despite having a limited income.

Leyla and Dean

Leyla and Dean have lived in the same house for 28 years, the past 13 of those with their dog, Snoopy. Leyla works in the NHS as a phlebotomist (specialised clinical support workers who collect blood from patients for examination). She loves her job and sees her role as critical to patient care. Dean suffers from heart disease. Two years ago he had to undergo major heart surgery and had to stop working as a gas fitter. They have one son who is married with his own daughter and no longer lives with them.

Dean stopping work began a period of financial stress for the couple. Two years before his surgery they had assessed their financial situation and found that they were £30,000 in debt:

“We never thought about money. We would go out: spending, eating out. If we didn’t have the money in the bank it was on the card. It was all too easy. We’d go on holiday. Put it on the card. Silly. You don’t realise. When you actually sit down and add up what you owe. We owed £30,000. I felt physically sick when that hit home.”

They went to the Consumer Credit Counselling Service and worked out an ambitious repayment plan, with the idea of clearing the debt in three years. The plan initially worked well. But it was then that Dean became ill. They began to fall behind on payments. Credit card companies and debt collectors called with greater frequency.

Managing this period of their lives was difficult. Dean did not know, for example, that he was entitled to receive an early pension from the gas company due to his ill health. When he did find out, it took four months to process the paperwork before he could receive it. Meanwhile, Leyla tried to find out about what benefits Dean might be entitled to. She says she found out more from other people than through official channels. Eventually they were able to secure Disability Living Allowance for Dean, but not without a fight. In the meantime Leyla herself had stopped working in order to take care of Dean. She began to draw her NHS pension. But the pension didn’t bring in enough to service the debts, so she began work again. In the meantime she was also advised, rightly or wrongly, to explore the possibilities of reducing her working hours and to start claiming various benefits herself. She never did take this option.

When they finally managed to secure their various entitlements, the couple did manage to pay off their debts. And they now feel secure. But their lifestyle has changed dramatically. The holidays and trips out to eat are no more. They think more carefully about how to save money on a day-to-day basis and Leyla’s focus especially, has turned away from what luxuries she might afford, and toward their future and how she might be able to leave something to their son and his family.

They have found new ways of managing expenditure, as their balance sheet below suggests. Leyla mentions their new Quidity card for online shopping which prevents them from spending more than they have, for example.

“We don’t owe anybody any money now. We are comfortable now. Not rich. We’ve still got to be careful. And after the past 4 years, I’m very careful with money. I’ll never have a credit card again.”

Monthly income		Monthly outgoings	
Work	**£798**	**£400**	Mortgage
Pension and Disability Living Allowance	**£870**	**£15**	Buildings and contents insurance
		£10	Water
		£53	Gas
	528	**£53**	Electricity
		£32	Home phone and internet
		£12	TV license
		£15	Mobile Phone
		£40	Car insurance
		£15	Vet fees
		£100	Petrol
		£50	Debit card payments
		£300	Food
		£20	Clothes
		£30	Eating out
		£40	Memberships and standing orders
	£1668	**£1182**	

There are several important aspects of Dean and Leyla's current situation that are interesting to note. The first and perhaps most important is that it would be very difficult to understand how they are living now without understanding something of their history. The snapshot of a couple living, debt free and careful, with one small income, a pension and Disability Living Allowance, is a snapshot that only makes sense with reference to how they arrived here.

Their story is one of fluctuating financial fortunes and of shock at moving from a system of earning and credit, to a position of need, entitlement and benefits. They were not able to easily negotiate this change. Leyla's decisions were based on several different, sometimes conflicting factors: fear of social stigma, misinformation, concern for Dean and the need to look after him, and the perceived duty of providing for her son's family. They were well aware of the stigma that comes with moving from a situation of earned income to one of relying on benefits. They have had to learn to live within their means, to negotiate with the state and with financial institutions, charities and service providers. And they have had to turn their attentions from short-term fulfilment to long-term management.

Stuart

Stuart is one of our respondents who had been most directly affected by the current financial crisis. He lives with his wife and three young children in a large house in North West London. Stuart had worked all his life, since leaving school at 16, in the same industry. He had risen to a good position and had been earning very good money. When the financial crisis hit, his company had to restructure and Stuart lost his job. The household has been a 'low-earning household' for just over a year.

Stuart has moved quickly after losing his job to try and start up a consultancy business of his own. He wants, as far as possible, to maintain the lifestyle he and his family have been living. He is uncertain about the realities of building his own business and how much money it will bring in the long-term, but he is optimistic. In the meantime the family have had to get used to having less disposable income than they used to. Stuart has had a couple of contracts and has earned some money already with his new venture but the family do rely a lot more on his wife's earnings from her part-time job as an account manager for a local firm.

Before the financial crisis, Stuart had invested a lot of money in the family home and had extended the mortgage on the property. The family have a lot of equity tied up in the house but also a large amount to repay. The decline in interest rates that followed the financial crisis has made these repayments much more affordable.

Stuart has pensions for both himself and his wife that he pays into monthly, depending on how much is left over after the monthly spend. He also has some shares, though he wasn't sure how much they were worth. The balance sheet below represents the household expenditure. As for Sue, Stuart had miscalculated his balance sheet somewhat. Again, one-off expenses, that would be difficult to avoid, were not calculated in. This meant that the monthly surplus was not as high as it appears here. Unlike Sue however, Stuart was more careful to save what was left and not build up any debts.

Monthly income		Monthly outgoings	
Work: Consultancy and his wife's sales rep earnings	**£1700**	**£518**	Mortgage
Child benefit and tax credit	**£700**	**£40.89**	Buildings and contents insurance
		£39	Water
		£99	Gas
		£70	Electricity
		£43	Home phone and internet
		£12	TV license
		£60	Mobile Phone
		£42	Life insurance
		£22.50	Cable TV
		£100	Petrol
		£40	Train
		£550	Food and clothes
		£70	Hobbies and children
		£20	Cinema
		£20	Membership fees of gym
	£2400	**£1691.39**	

Stuart's household's finances and expenditure are a curious mix of the trappings of his high-earning past and his more frugal present. For example, Stuart still pays generously into a pension fund for both he and his wife. He has some stocks and shares and is considering buying more on advice from a friend who has made a lot of money on the stock market. He used his redundancy money to clear all of his debts. He also has life insurance, a large house with a large mortgage and a new 4x4 car (bought since he lost his job). And yet Stuart also describes having to cut down on meals out, on buying clothes without expensive brand names and having to plan buying Christmas presents so that they are affordable. He and his wife have started making home-made lunches to save money and they rely on the income brought in by child benefit and working family tax credits which together account for over a third of their income.

Interestingly, when discussing Stuart's balance sheet he is assiduous in accounting for all income and expenditure and yet does not include one of the family's most significant activities, which will potentially have a great financial impact. The family

are registered foster carers. Stuart says that the income is uncertain and they have not had any work for a while. They are called to look after children only if and when they are needed. They cannot rely on the sums of money it brings in, and for that reason he does not include it on his balance sheet.

When they do look after children though, Stuart says, it can be a good boost to the household income. In fact, along with setting up his own consultancy, he wants to foster more regularly because it presents an attractive financial option. The couple are good at it and do not find it is as taxing as others might. Stuart is proud of his relationship with his wife and feels that fostering strengthens the bonds they have. Furthermore the job comes with an expense allowances system that can be generous. This does not mean he would ever cheat the system but rather that he feels he can be creative in the way the money is managed to provide the best possible for the fostered children while also maximising his family's own financial situation.

Stuart's entrepreneurial drive is not all that gives him cause for optimism. Thanks to his previous employment and the contacts he made while working his way up the corporate ladder, Stuart is well connected to people who know a lot about managing money, setting up businesses and providing professional services to businesses. He doesn't feel that he has been cut completely adrift to cope on his own. Instead, he sees opportunities. The possibility of stepping up their involvement with fostering children gives both he and his wife the option of working from home and providing more childcare. His business may or may not be very successful but it is clear that the family has assets and resources with which to explore several options.

None of this should hide the fact that Stuart and his family are currently living with a reduced income and are having to make changes to their lifestyle in order to manage with less than they are used to. Where Stuart sees possibilities others might see more worrying uncertainties. Nonetheless, Stuart represents the ways in which the category 'low-earner' can include many different types of family and financial situation.

---

[5] For more information about this Index please see http://www.resolutionfoundation.org/financial_health_forum.html#FHI

[6] For more information about our research methodology please see Annex 1

[7] Labour Force Survey, July to September 2009. See also Tracking Income (Centre for the Analysis of Social Exclusion, LSE: 2006) www.sticerd.lse.ac.uk/dps/case/cr/CASEreport32.pdf

3. GETTING BEHIND THE BALANCE SHEET

This chapter delves behind the balance sheets and the snapshots described in Chapter 2. It explores the sometimes invisible factors that nevertheless have a significant impact on how low earners think about money and manage their finances.

Over the last decade debates about poverty and low income have evolved and developed, to the point now that there are few who would argue that lack of money is the sole problem, or that redistribution of money represents a complete solution to tackling inequality. With these broader understandings has come a recognition that a simple financial audit of a household's formal incomes and daily, weekly and monthly outgoings will not give us a full picture of a person's – and family's – economic opportunities and liabilities. Money is intertwined with financial capability, social capital and geography, for example.

Many of these factors can be detected in the types of low earning household outlined in the previous section, and in this section we look with sharper focus at three aspects of a household's economy that are often obscured by looking at the balance sheet alone. These are:

- The social dimensions of economic decisions
- Hidden assets and liabilities
- Informal economic activities

As we shall see in this chapter, all of these are less visible, but still very significant, influences on a household's financial decision making and overall health.

The social dimensions of economic decisions

While conducting the research that forms the basis of this report, respondents were asked to complete a financial audit, and were presented with forms, schedules and balance sheets to fill out. They were also asked to go beyond the formalities of the numbers and explain the different ways in which they perceived their personal economies. Given the freedom to do so, respondents did not talk about their finances purely in numerical terms. Instead, choices, regrets, aspirations, family anecdote and personal habits were all woven seamlessly with the concrete details of incomings and outgoings.

In other words, our respondents did not neatly divide their 'social' assets from their 'material' ones. Rather, they talked as if social assets were material assets, social decisions were material decisions, and matters of the heart were matters of the

wallet. The best example of this way of thinking is how several of the respondents talked about divorce, which was clearly both an economic and a social issue. For example, one of our respondents responded to our question about whether she owned her house with 'When I got divorced...'. As we saw with Sue's story, this response should not be dismissed as incidental to whether or not they own the house: it is an integral part of their financial relationship to that house. She did own the house, but her ability to continue owning it, and the fact that she owned it in the first-place, were intimately bound up with her relationship with her ex-husband. The personal and emotional elements of divorce become bound up with the hard facts of financial balance sheets.

Our research showed that gender too continues to be a key social dimension that influences financial decisions. Women often fulfilled two well-worn social stereotypes – either portraying themselves as spenders who left money management to men, or as keepers of the household budget. Men in many cases also fulfilled the stereotypical role of primary earner. This was true even for those whose children had left home or where there were no children. These gendered relationships with household finances have various impacts on the ways in which decisions are made. For example, when it comes to decisions about staying at home to look after children, it is often the mother who is likely to stop working. The cost calculations were more likely to suggest that women, as the lower earners, were best placed to give up their part-time or lower paid jobs.[8] The more long-term impact of these decisions reveal themselves in the stories of some of the older women in our sample. Some were left without many career prospects and now have little earnings potential after divorce, bereavement or an episode of ill-health of their partner.[9]

The importance of social and cultural factors in financial decision making can often become more apparent when there are decisions to be made which have only a marginal effect on household income. For Bruce and Wendy for example, the decision for Wendy to stay at home to look after children rather than working, was based on a calculation of the difference between the benefits and tax credits they would receive with only Bruce's income, versus the income that Wendy's previous accountancy job generated. Though working would have generated a greater income, the differences were marginal enough for Wendy to be guided by her own beliefs about parenting, and to choose to stay at home with her children.

WESCO

Hidden assets and liabilities

Respondents revealed quite a sophisticated understanding of their overall financial situations that included all manner of 'hidden' assets and liabilities. These included, for example, a trusted promise of help from someone to one of our respondents if times got financially tough. And in another case, the potential for a loved one's long-term illness to place a financial burden in the future. Unlike divorce, which appears on the balance sheet very quickly (in the form of reduced income, or sold properties), these 'hidden' assets and liabilities may never appear in the sums. We might think of them instead as financial latencies. They are things which may, or may not at some future point be translated into hard cash, income, or outgoing. Despite their latency, they have a powerful influence over a person's sense of their own economic standing and consequently their financial decision-making.

Skills

One of the most important kinds of 'hidden' asset lies in a person's perception of their skills and entrepreneurial drive. In recent years government policy has been built on the assumption that increasing people's skill levels is the key to improving their progression in work.[10] This is reinforced by longitudinal evidence from Elias and Bynner who have shown that those who moved out of intermediate occupations and up the occupational scale tended to possess superior educational qualifications and, for women in particular, undertook more work-related training.[11] Furthermore, an evaluation of the governments Train to Gain programme has shown that 30% of those that gained a qualification via the system were subsequently promoted in their occupation.[12]

While formal skills are clearly important, our research also showed that in many cases it was a less tangible sense of enterprise and people's hard-to-measure social and personal skills that mattered in practice. Take Chris for example, a young man in his late twenties with a high level of self-belief in his future career prospects. On paper, things looked less rosy: through a mixture of bad luck and poor planning Chris was in a very large amount of debt when we met him. Part of this debt had come from using loans to secure a deposit on a house, which he owned and lived in. But most of it had come from credit card spending on an indulgent lifestyle of cars and long-haul holidays.

Chris works as a resident liaison officer for a construction company, and he feels that he has good career prospects ahead of him. He is frustrated by his debt and believes that if only he could clear the repayments which sap his monthly income, things would be much better. He recognises he needs to get better at saying no when tempted and is concerned about whether he will ever manage this. He worries about the fact that no matter how much he earns, he always feels like he is struggling.

One of the reasons Chris is struggling to rein in his spending habits is because he knows he has got some assets he could fall back on. His girlfriend is completing her last year at university and might be able to start bringing in an income fairly soon. Furthermore, Chris could forgo his decision to let his sister live with him and let out some of his rooms to provide a regular rental income. His house also had a small annex, which he currently uses to store an impulse-bought motorbike that he no longer uses. Chris has grand plans to turn this annex into a rehearsal studio that he can rent out to bands. All of these factors enable Chris to feel more secure at the same time as living quite a financially reckless lifestyle.

Social networks

Alongside skills, social networks represent another key hidden asset – or liability – when it comes to considering a person's financial health. Friends and acquaintances, family and colleagues can all be sources of financial help or advice. Where there are direct loans or gifts, such help is easy to account for but often this support is given in kind, making it harder to quantify.

For Stuart, a formerly high paid sales executive who had been made redundant at the start of the 'credit crunch', his social network was critical to his ability to stay afloat. He and a colleague who had also been made redundant were in the process of starting their own consultancy business. When we met Stuart, the business wasn't bringing in much income and he and his family were having to make cutbacks. Despite this, Stuart was confident that the new venture would be a success.

Much of this confidence, and his willingness to risk investment in this new career, came from the fact that he was able to draw upon a network of highly skilled, and in some cases wealthy, friends. He had benefited from free professional advice, discounts on help with his accounts and it was through his social networks that his first, albeit low paid, consultancy contracts came.

Social networks can be a liability as well as an asset, as we saw with Aimee and her husband Mick. Mick had been earning a very high wage as an IT recruitment consultant some years ago, but had fallen on hard times after experiencing an unfair dismissal. He won compensation, but not enough to make up for lost earnings for the length of time he was out of work. Since losing his job he had set up a small company doing window and office cleaning, but he feels he is working below himself, and his income is greatly reduced from the days when he worked in the IT sector.

The problem for him and for his wife Aimee is that they have been left with liabilities from the times when money was easier to come by. They carry debts of £30,000, mainly amassed through enjoying an expensive lifestyle. They are struggling to

adapt to their vastly reduced income, and carry the burden of feeling they need to live a certain lifestyle. That lifestyle is dictated by friends and peers, and it involves a great deal of conspicuous consumption – clothes, watches, expensive cars and so on. Even now, when money is a serious concern, Mick revealed that he had bought his wife an £800 Gucci handbag for Christmas. Mick and Aimee are not alone in finding peer pressure and 'keeping up' to be key drivers of financial decision making. In fact other research suggests that social comparison is one of the top three reasons cited for credit use.[13]

Mental and physical health

In many ways, hidden liabilities were easier to uncover than hidden assets, and health is one of the key liabilities that we uncovered time and again through the research. While there are obvious repercussions of an individual's ill-health on their personal finances, the picture is more complex when the household and family unit is taken into account.

For low earning households, the trade-off between earning potential and the need to provide unpaid care for ill family members is a very real one. The option of 'buying in' support or outsourcing personal care does not exist: in many cases the costs of this care exceed the salary a low earner can bring in. Therefore the interplay between health and financial issues is powerful. The linkages are not simply between an individual's health and their financial situation, but the health of any others in the household or family unit.

Take, for example Kelvin, who was doing better when we met him than he had been for some time. He had succeeded in repaying a lot of the money that he owed to various friends and family members. He had recovered from alcoholism and he was in a stable relationship, with a regular income from a regular job, albeit one which for which he had not received a full employment contract. His line manager at work had been off sick and Kelvin was hopeful that he might be in line for a promotion.

However there were two significant financial liabilities that hung over Kelvin's ambitions for his future. First, there was his sister, who had long-term physical and mental illnesses, and required full-time care and supervision. This had been something his parents had always done; however they were both in ill health themselves, and Kelvin was aware that at some point he was likely to have to take over the care of his sister. Second, Kelvin's girlfriend suffered from depression. As things stood she stayed at home and looked after her daughter (from a previous relationship) while Kelvin worked long hours. Kelvin talked about what he would need to do if her mental health deteriorated. By spending more time at home and forgoing overtime, he felt his career prospects looked much less rosy.

Informal economic activities

The ‘informal economy’ is a term that very simply refers to those economic activities that do not appear on any formal or official records. In more colloquial terms, it covers anything that is ‘off book’. The most commonly known type of informal economy in the UK is what many refer to as ‘cash-in-hand’ work: builders who give discounts for cash payment, for example.

The anthropologist Keith Hart, one of the first people to describe the informal economy in detail, defines it as encompassing those activities that are both entrepreneurial and also just beyond the bounds of the ‘regulated’, ‘formal’ economy within a state.[14] It goes well beyond simply the illegal trade in stolen goods, bribes and extortions that make up the black market. The informal economy is one that most people will participate in at some point – whether that’s paying the babysitter in cash, tipping a waiter, or not declaring all of the presents we receive, as income. The amounts of each individual transaction may not add up to much, but cumulatively they contribute to a lively informal economic sector in the UK.

Our research suggests that when it comes to managing household finances, what happens in this informal economy can be just as important for some low-earning households, as what happens in the more formal economy. For Wendy and Bruce informal economic activity bridged the gap between the amount of money they needed to maintain their lifestyle, which involved Wendy staying at home to look after their children, and the single income that Bruce brought in.

Wendy engaged in a range of activities from buying and selling on eBay (the internet auction site), to bargaining at boot-sales and turning their back garden space into a vegetable and herb garden. Her activities were sometimes designed simply to find cheaper options than the high street offered, but she also ran a surplus in an online credit account and was proud of the fact that she could actually make money as well as save it. The vegetable garden too had become an effective economic resource. Wendy had learned to grow several types of herbs and vegetables that played a significant part in the household’s weekly food consumption.

For those who had the opportunity to work more flexibly, or for themselves, there were also opportunities to do small bits of extra work for cash, manage schedules and shifts in order to roll one or two days of paid work into a single morning, and so on. Stuart’s approach to managing his foster care expenses would also fall into this kind of category. Often these kinds of activities are not discussed openly, but there was enough evidence given by the respondents to suggest that the use of informal economic activities to top-up income is not uncommon.

[8] This finding is reinforced by recent Department for Work and Pensions research on single-earning households where there is a potential second earner. See Collard, S. and Atkinson, A., Making Decisions about Work in One-Earner Couple Households (DWP research report no. 560, London: 2009) http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep560.pdf

[9] Analysis of the British Household Panel Survey shows that relationship breakdown has a larger negative effect on women, and the effects of it last longer. See also http://www.fsa.gov.uk/pubs/consumer-research/crpr79.pdf

[10] No One Written Off: Reforming Welfare to Reward Responsibility (Department for Work and Pensions, London: 2008) http://www.dwp.gov.uk/policy/welfare-reform/legislation-and-key-documents/no-one-written-off/

[11] Elias, B. and Bynner, J., 'Intermediate skills and occupational mobility', Policy Studies, 18(2), pp 101-124 (1997)

[12] Train to Gain learner evaluation: Evidence from Wave 1 research (Learning and Skills Council, Coventry: 2008) http://www.lsc.gov.uk/providers/ttg/promoting/

[13] J Watson quoted in Facing the Squeeze (ibid.)

[14] Money in an Unequal world K. Hart London : Texere, 2001

CRAGHOPPERS

4. POLICY CONSIDERATIONS FOR IMPROVING FINANCIAL HEALTH

The research behind this report highlights some important considerations that need to be taken into account when making policy to improve the financial health of low earners. This is particularly pertinent today given the growing importance all political parties are attaching to these issues. Just a few contemporary debates that reflect this interest include:

- The appropriate 'taper' up the income scale for tax credits. Both the Conservatives and the Liberal Democrats have committed to reducing credits for richer households, in order to target money on lower income households
- The extent to which tax credit systems should be personalised. While there are obvious benefits to creating a tax credit system that can adjust as people's circumstances change, greater flexibility begets greater complexity, as evidenced in 2005 when the changes to the system created widespread overpayments which in turn upset the delicate household finances of many low earning households[15]
- The best way in which to encourage people to save for their old age. The Labour government have introduced a limited form of asset-based welfare through for example the Child Trust Fund; however both opposition parties have questioned the effectiveness of this approach to incentivising saving
- Whether or not marriage should be recognised in the tax system, and if so, how. While taxation is assessed on an individual basis, eligibility for most benefits continues to be decided at a household level and this creates a series of unintended consequences for single and couple households alike
- Making work pay. Initiatives introduced by this government, such as the Minimum Wage and the Better Off in Work credit, reflect their belief that work is the best route out of poverty. But further work is needed to understand the role of potential second earners in this picture – a key issue that our research has highlighted
- Widening access to financial advice, and the importance of advice and guidance rather than information alone. The Money Guidance pathfinders have shown positive results. The challenge now is to ensure that the service is rolled out in a sustainable way nationally and that the focus remains on advice rather than information provision.

We believe that all these areas, and many beside, can only be resolved by a better understanding of the dynamics of financial health, as this report has described. On

this basis we believe that there are three foundations in this field that must be built upon.

Resilience

The concept of 'resilience' is growing in usage, with the recession giving it real bite as concerns grow about how households and families will weather the downturn. Drawing on research from the positive psychology movement, the notion of building resilience, and enhancing people's capacity to withstand crisis financially and emotionally, offers one clear direction for policy makers. Work around resilience is concerned with how people cope with adversity, and how more can be done to ensure that the right range of factors are in place – including mental wellbeing, social networks and economic assets – to help people navigate difficult times.[16]

What our research on household finances shows is that it is impossible to think about resilience without thinking about both the economic and social dimensions. Building emotional resilience is not a substitute for ensuring a household has an adequate income; equally, a steady income does not guarantee long-term resilience, given that financial health is determined by a complex and diverse range of factors that extend well beyond money itself. For example, skills and good health make a household's finances resilient, even in the face of some short-term financial risk.

By taking the deeper qualitative approach, we have been able to take a look not only at how resilient people's day-to-day and week-to-week finances are, but also to construct some measure of a household's future. We can begin to understand more about the relative level of financial 'risk' and 'opportunity' people face.

One way of looking at the financial health of a household then, is to try to understand the extent to which they face the risk of financial decline or the capacity they have to be better off. This is not only about a household's capacity to be resilient in the face of adversity, but also about their ability to seize opportunities and ensure that periods of instability lead to improvement rather than decline.

We therefore argue that while the current focus on resilience is useful, it is not enough. It encourages too much emphasis on risk and shock, and the extent to which people can cope with them, without looking in the other direction at a household's ability to look for and take an opportunity. Contrary to some of the thinking around resilience, stability is not always preferable to uncertainty. In fact, while periods of instability are always risky, they can also bring opportunity.

Our research emphasises the importance of considering opportunity and resilience, and to see these as constantly evolving over time. It would be wrong to

permanently label one household 'resilient' and the other as lacking that resilience. Instead time and effort needs to be invested in understanding a household's direction of travel. Stuart and Chris, for example, may prove to be low earners for only a relatively short period of their life. Sara, on the other hand, coming to the end of her working life, having to sell her house to provide an income and no longer with the financial support of her husband or children, is moving perhaps towards a position of greater hardship and struggle.[17]

Behavioural economics

Behavioural economics is a discipline whose time has come for government. The basic thesis – that classical and neo-classical assumptions about what constitutes rational economic decision-making are inadequate when it comes to understanding real human behaviour – is increasingly being adopted in fields as diverse as healthcare provision, policing and the management of public spaces.

This thesis has a vast hinterland that stretches well beyond economics into philosophy, anthropology and sociology, and there is still huge scope to revisit this literature and explore in greater depth what it might mean in the field of financial health.[18] Work already being undertaken – for example by the FSA and by the Financial Services Research Forum – underlines the potential here.

Their reports show that the gap between what people say and what people do is a particularly pertinent issue in the field of financial behaviour. For example, FSA research has shown that people are frequently over-optimistic about their financial resilience, and that they consistently fail to act on their desire to save more or spend less. Behavioural economists argue that humans will naturally procrastinate unless given the incentives to do otherwise,[19] arguing that people are far more likely to put today's pleasures over tomorrow's benefits.[20] In other words, any interventions by governments, banks or others need to be designed to go with the grain of these natural proclivities. Ignoring them simply reduces the chance of an intervention having an impact. The research presented here already suggests that such understandings may themselves be too simplistic. Procrastination is in the eye of the beholder and measures that people take to plan for the future may not always be 'financial'.

Similarly dismissing the financial decisions that do not fit into the 'rational man' model as being simple 'irrational' ignores the many logical reasons that lie behind decisions. Some of the financial decisions made by low earning households may not seem 'rational' in the classical economic sense. However by putting these decisions in the context of real life they become starkly rational. For example, for those low earning households without household contents insurance may well have made a rational calculation of the likelihood of them needing the insurance

against the cost of taking the policy out when money could be put to other more pressing needs such as new school uniform, a replacement cooker or an imminent wedding. Policy development needs to find new ways of building these insights into economic analysis.

Financial capability

The Treasury, as the lead government department, defines financial capability as:

‘a broad concept, encompassing people’s knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market.’

This definition clearly emphasises the importance of ‘financial know-how’ to financial health. It is not access alone that will build the resilience of the nation’s household finances, but also knowledge and capabilities. As noted in the introduction, the FSA’s Baseline Survey of Financial Capability shows that possession of this knowledge is not easily correlated to income levels. That said, it remains the case that low earners are under-saving, and much less likely to take out insurance or invest in a pension for their retirement than wealthier income groups.

Many definitions of financial capability include financial know-how and the willingness to act on that knowledge. In this context, care must be taken to avoid overlaying what constitutes financial capability with assumptions. For example, as we found in this research, there are many good reasons that a low earning household chooses not to maximise its income. As with Wendy and Bruce, many couple families make an active choice for mothers to stay at home – an active choice that demonstrates high levels of financial capability, and where economic considerations are weighed up carefully against ideological perspectives on child-rearing and parenting practice.[21] Equally, some of our respondents were actively choosing self-employment despite knowing they might be able to earn more in a job. For them, freedom and self-direction was more important than additional income.

There is a further insight from this qualitative work about financial capability, and that is its relationship to financial agency. Rarely are the resources of a household evenly distributed between its members. Therefore the financial health of that household may rest in the hands of one person and their actions, even if the other person has a high level of personal financial capability. Recent research has shown that responsibility for household finances and the extent to which resources are

pooled has altered significantly in recent years as family structures and social mores have changed; nevertheless our qualitative approach has underlined the risks of relying on household-level data alone to understand financial health.[22]

Conclusion

Thinking back to the research conducted by Maud Pember Reeves a century ago, it is the similarities rather than the differences between the households she met and the households that participated in this research that are most striking. Our findings support Pember Reeves' work: financial health is and always has been a complex, dynamic concept that evolves over a person's life. Financial assets are strongly related to other kinds of assets such as health and social networks. Personal relationships and power dynamics shape financial capability as much as knowledge and information.

The independence of many low earning households has always been fragile. Recent economic events have exposed and in some cases exacerbated this fragility. As we move towards a period of gradual recovery and the inevitable cuts it will bring, the challenge is to build the financial health of low earning households, but to do so in a way that starts with a fuller and more accurate understanding of how finances are managed in the first place.

---

[15] See for example Tax Credits: getting it wrong? 5th Report of Parliamentary Ombudsman HC1010 (HMSO: 2007) http://www.ombudsman.org.uk/news/press_releases/pr2007_06.html

[16] See for example Roberts, Y., Grit: the skills for success and how they are grown (Young Foundation, London: 2010) http://www.youngfoundation.org/publications/books/grit-the-skills-success-and-how-they-are-grown

[17] The Resolution Foundation is currently undertaking further research in this area. For more information please see www.resolutionfoundation.org

[18] See for example Meanings of the market: The free market in western culture, edited by James G. Carrier (Oxford ; Berg, 1997); The laws of the markets edited by Michel Callon (Oxford ; Blackwells/Sociological Review, 1998); The perception and measurement of transaction costs Peter J. Buckley and Malcolm Chapman, (Cambridge Journal of Economics Vol. 21:2, 1996)

[19] De Meza, D., Irlenbusch, B., Reyniers, D., Financial Capability: a behavioural economics perspective (Financial Services Authority, London: 2008) http://www.fsa.gov.uk/pubs/consumer-research/crpr69.pdf

[20] Offer, O., The Challenge of Affluence: self control and wellbeing in the United States and Britain Since 1950 (OUP, Oxford: 2006)

[21] Making Decisions about Work in One-Earner Couple Households, ibid.

[22] Ashby, K., and Burgoyne, B., Separate Financial Entities? Beyond Categories of Money Management (Journal of Socio-Economics, 2007)

Resolution Foundation

email: info@resolutionfoundation.org

www.resolutionfoundation.org

Registered charity no. 1114839

Company no. 5588883