REFORMING SOCIAL FUND BUDGETING LOANS

DISCUSSION PAPER

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SOME BACKGROUND FACTS

The Social Fund was originally introduced as a means of saving money, replacing grants made under the previous Supplementary Benefit scheme with a mixture of non-discretionary payments and discretionary grants and loans. The Budgeting loans section of the Fund consists of interest free loans for important 'lumpy' expenses which are difficult to budget for from within a weekly income. It is restricted to those on Income Support, partly because the previous grants system had been, and partly because repayment was easy to achieve (direct deductions from future Income Support payments).

Some basic facts:

- Loans are available between £30 and £1000. 1997/8 average was £319.
- £311m was lent in budgeting loans in 1997/8, £344m for 1998/99, and a budget of £385m for 1999/00.
- Over a million applications for budgeting loans are made each year.
- Eligibility is restricted to those on IS or JSA (IB) for 26 weeks or more.
- Loan applications are assessed according to purpose of loan, family hardship, ability to repay and overall budgetary constraints.
- Repayments are directly deducted from the borrowers' benefit.
- Loans are interest free.
- Recovery rates are about 90%.

THE CASE FOR REFORM – WHY, WHAT AND WHO?

The present purpose is defined by the DSS as "*Budgeting Loans are intended to help those in receipt of Income Support or income based Job Seekers' Allowance to spread the cost of intermittent expenses over a longer period. They represent an interest-free credit facility for those in need of financial assistance to cope with such expenses*."

There are two, not unconnected, issues which provide an impetus for the reform of the budgeting loans scheme:

- ***Perceived iniquities in the scheme.*** These include concern about large variations in the amount available because of local budget caps, lack of right to a loan, and lack of a right of appeal to an independent tribunal.
- ***Financial exclusion.*** A concern that low income households cannot easily access affordable credit as they are not an attractive group for the mainstream financial institutions.

In both cases, one can argue that a desired outcome is an increase in funds available to those living on a low income and in need of affordable credit. Reform of the current restrictions on using the budgeting loans (eligibility, assessment procedures, capped fund) might go some way towards meeting that desired outcome. The issues that therefore arise are:

- Is there a need for reform – what alternatives exist?
- What should future loans be for?
- Who should be eligible for a reformed loans scheme?
- Should cash limits be raised, or even removed?

1. IS THERE A NEED FOR REFORM - WHAT ALTERNATIVES EXIST?

Those without a current account in the household are more than four times as likely to use sources such as the Social Fund, money lenders, family and friends, and pawnbrokers than those households who have access to a current account.[1] The Office of Fair Trading concluded that "*The use of high street credit was found to be strongly related to household income and to whether or not the household had a current account.*"[2]

Furthermore, "*the banks and other high-street sources of credit are moving away from serving the credit needs of low-income consumers. The shrinking branch network, a more systematic assessment of credit risks, and the imposition of relatively high minimum loan values have further reinforced this tendency*".[3]

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[1] Office of Fair Trading, *The Consumer Survey*, Appendix 4, table 2.1.

[2] Office of Fair Trading, *The Consumer Survey*, Appendix 4, p. 6.

[3] Office of Fair Trading, p. 30.

The table below illustrates the use of different types of credit used by various groups of the population.[4]

Household Type	High street credit[5]	Low income credit[6]	Non commercial credit[7]	No credit
All households	66%	2%	5%	27%
By level of income:				
Very low[8]	25%	5%	15%	53%
Low	32%	3%	8%	55%
Not low income	82%	1%	3%	15%
By current account in household:				
Active account	75%	1%	4%	21%
Dormant account	25%	2%	15%	55%
No account	14%	6%	15%	64%

There are difficulties with looking towards alternative lending schemes to meet the credit needs of individuals on low incomes:

- Banks and Building Societies often find it unprofitable to lend small amounts of money, and many low income families do not own a bank or building society savings account – and fewer still own a current account.
- Credit Unions usually require a level of savings before a loan is granted, and are currently only small in scale.
- Licensed money lenders do not require collateral or savings but loans can be expensive, not least because of the costly method of door-to-door collection.
- Borrowing from friends and family is attractive but their own funds may be limited and borrowing may place strains on personal relationships.

Issues for discussion

Are there gaps in current provision relating to low income consumers?

If so, should the Budgeting Loan scheme be aiming to fill these gaps?

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[4] The ONS Omnibus survey (1998), as analysed by the Office of Fair Trading in *Vulnerable Consumers And Financial Services*.

[5] 'High Street Credit' includes: mortgage, bank or building society loan, loan from another financial institution, overdraft facility, credit card, store card, credit arranged from retailer.

[6] 'Low income credit' includes: credit weekly from the home, pawnbroker, money lenders, etc.

[7] 'Non commercial credit' includes: family and friends, Credit Unions, and the Social Fund.

[8] In the OFT analysis, 'very low' and 'low' income are defined according to different household types (crude equivalisation):

	Very Low	Low
Single non-pensioners	<£4k	£4k-£6k
Lone parents	<£5k	£5k-£7k
Non pensioner couple, no kids	<£6k	£6k-£9k
Couple with kids	<£7k	£7k-£12k
Pensioners single	<£4k	£4k-£7k
Pensioners couple	<£6k	£6k-£9k
Other	<£7k	£7k-£8k

If so, would it be competing with, or complementing, existing loans schemes? Would it crowd out mutual lending schemes such as Credit Unions?

2. WHAT SHOULD THE LOANS BE FOR?

Currently, the Budgeting Loans scheme mainly provides credit for consumption – to help smooth income and expenditure peaks and troughs. At present, one is eligible for a Budgeting Loan if it is for the following purposes:

- Furniture and household equipment.
- Clothing and footwear.
- Rent in advance and/or removal expenses to secure fresh accommodation.
- Improvement, maintenance and security of the home.
- Travelling expenses.
- Expenses associated with seeking or re-entering work.
- Hire purchase and other debts (for expenses associated with items a) to f) above).

Note that all that the recipient is required to do is simply state that the loan is for this purpose – no proof is necessary. The restrictions remain in place largely to cover the DSS from legal or political embarrassment.

One possibility is for one section of a reformed budgeting loans scheme to be focused upon loans for investment – in education, starting out in self employment. Another would be arrangements whereby those wishing to borrow to enter self employment receive preferential terms (longer repayment schedules, lower interest rates)?

Note that, in such a scenario, there might be some overlap between the Social Fund and plans currently mooted to introduce Individual Development Accounts (match-funded savings accounts which can only be used for investing in education, self employment or further education).

Issues for discussion

Should the main purpose of a reformed Budgeting Loans scheme remain helping meet intermittent items of lumpy expenditure? Or should the government take no view on what the money is used for?

Should loans be restricted for certain purposes? Should assessment of the purpose of loan be retained or removed?

How would a reformed scheme interact with other financial assistance (regular benefits, one-off grants, subsidised savings) which are or could be paid to individuals?

3. WHO SHOULD BE ELIGIBLE FOR THE REFORMED LOAN SCHEME?

Currently, the formal eligibility requirement of the Budgeting Loans scheme is receipt of Income Support or JSA (income based) for 26 weeks or more.

If it was desired to widen access to the Budgeting Loans scheme, it could either be opened to all those on low incomes or it could be linked to specific benefits or tax credits. The following table provides numbers who would be eligible using different criteria.

Eligibility criteria	Number
Benefit/tax credit threshold	
Existing recipients (IS >24 weeks)	3,495,000[9]
All IS recipients	3,938,000[10]
In receipt of means tested benefits (IS, JSA, FC, DWA)	5,700,000[11]
In receipt of means tested benefits and WFTC[12]	6,600,000
Income based threshold	
Individuals on low income (in households below ½ average income (BHC))	10,700,000[13]
Individuals on very low income (in households below 40% average income (BHC))	5,000,000[14]

The OFT analysis of access to credit found that households on incomes of below about £9,000 (depending on size and make-up of household) either use no credit or more expensive forms of credit.

The graph overleaf demonstrates that either an income-based (households below half average income, AHC) or linkage with both income support and WFTC will reach our target audience – low income households facing difficulties in accessing affordable credit.

Issues for discussion

Should the formal eligibility criteria be widened?

Should the reformed scheme be open to all those on low income, or to those on particular benefits and tax credits?

At what income level should a reformed scheme be targeted at?

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[9] November 1997, IS recipients more than 24 weeks rather than 26 weeks. From Social Security Statistics, 1998, table A2.29

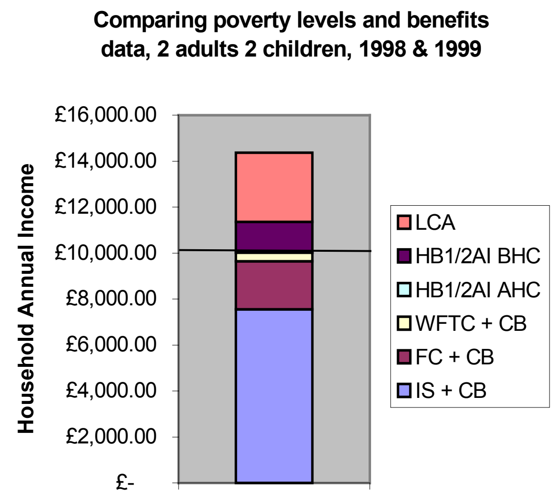
[10] From Social Security Statistics, 1998, table A2.29

[11] 4.1 m recipients of income based benefits in August 1998, Cross Benefit Analysis Bulletin May 1999 (IS, JSA, FC, DWA), 1.618 million recipients contributory and means-tested recipients aged 60 or over (IS and state pension).

[12] Current estimate of WFTC claimants in 2000/01, cited in *Sharing the Nation's Prosperity*, Cabinet Office, Feb 2000, pp. 103-4.

[13] 1997/98.

[14] 1997/98. Table F2 (BHC), HBAI p.161. Numbers include the self employed.



This graph compares different income thresholds together with estimates of benefit and tax credit income for a family of two adults, and two children aged 3 and 8. For the estimates of income from FC and WFTC it is assumed that one partner is working 30 hours a week. All data is based upon 1998 figures except where stated.

The graph is intended to be indicative only

LCA — a poverty line built up by the Family Budget Unit based upon estimates of expenditure which provide a standard of living which is "Low Cost But Acceptable".

HB½AI BHC – equivalised income of a household at half the average income, before housing costs.

HB½AI AHC – after housing costs.

WFTC + CB – estimated income (1999) of family receiving Working Families Tax Credit, Child Benefit and with one partner working on the National Minimum Wage (NMW).

FC + CB – estimated income of family on Family Credit and Child Benefit with one partner working on NMW.

IS + CB – estimated income of family on Income Support and CB.

4. SHOULD CASH LIMITS BE RAISED, OR EVEN REMOVED?

Loans are currently limited by the overall cash ceiling put on Budgeting Loans expenditure.

Current cash limits would, by definition, not be sufficient to cater for demand if either the scope of eligible loans was widened or the categories of eligible people was extended. If the scheme were to be reformed, but the cash limit retained at current levels, then previous recipients in receipt of Income Support would lose out to newly eligible borrowers – and, if the economic profile those newly eligible is higher than Income Support recipients, then these changes would be regressive in their impact.

Obviously, one response to this situation would be to raise the cash limits. More generally, however, a cash limited fund inevitably introduces inequities whereby often equally deserving applicants do not receive credit because they are applying in the 'wrong' geographical area, are not deemed sufficiently 'needy', or they want credit to purchase the 'wrong' item.

In this context, three broad options for change arise:

- The fund could be enlarged sufficiently so as to allow all applications for loans to be accepted.
- Private finance could be introduced, taking the expenditure out of the public accounts and also allowing the fund the expand and contract according to demand.
- Charges (interest rates) could be introduced – thus limiting demand.

One obvious problem with any use of private finance is that budgeting loans scheme doesn't create any revenue out of which a return on capital employed could be generated. Indeed, as loans are interest free and some debts are written off, the budgeting loans scheme as constituted represents a poor investment. Interest charges would need to be introduced, loan recovery would need to be tightened and administration costs would need to be cut for the reformed loan scheme to be profitable.

Another possibility might be for a reformed loans scheme to be operated by National Savings – who can raise funds cheaply.

Issues for discussion

Would a substantial rise in public expenditure be justified?

Would the whole fund need to be privatised to bring the advantages of private finance? Could public and private funds be merged –public funds providing the bulk of the budget and private finance providing a flexible top up?

Would it be acceptable to charge interest rates or would subsidy be needed?

THE PRACTICALITIES OF REFORM – HOW?

The operations of most lending vehicles are similar: they involve assessing a loan using various criteria, charging a price for the loan, and recovering the loan. The Budgeting Loan scheme has several advantages over other loan schemes in that the assessment process is now largely automated, credit risk is minimal, and repayments are automatically deducted from a stream of payments to the borrower.

5. WHAT SHOULD THE FUTURE ASSESSMENT PROCEDURE BE?

There are several criteria used in assessing loan applications, some of which are common to most loan schemes, including the Social Fund Budgeting Loan system:

- Purpose of loan.
- Overall budget constraints.
- Intensity of need.
- Likelihood of repayment: both ability to repay and propensity to repay.

Most examples of loan schemes in the UK and elsewhere (for example, Grameen Bank, moneylenders, credit unions) place a lot of administrative emphasis on assessment of a loan application – to minimise credit risk. This requirement is largely absent in the Budgeting Loans scheme as repayments are compulsory.

The present assessment procedure is described below.

Applying for a loan

To be eligible for a budgeting loan you have to overcome several hurdles:

1. **Benefit eligibility.** You must have been in receipt of Income Support or income-based Job Seeker's Allowance for 26 weeks (approximately 6½ months).

2. **Purpose eligibility.** You are eligible for a Budgeting Loan if it is for the following purposes:

- Furniture and household equipment.
- Clothing and footwear.
- Rent in advance and/or removal expenses to secure fresh accommodation.
- Improvement, maintenance and security of the home.
- Travelling expenses.
- Expenses associated with seeking or re-entering work.
- Hire purchase & other debts (for expenses associated with items a) to f) above).

3. **Individual priority.** As the overall budget of the Social fund is capped individual applications for loans are weighted with the purpose of ensuring that those most in need receive highest priority. An individual's application undergoes two tests. The initial test weights the application according to the applicant's length of time on the qualifying benefit and the size of their household. If this test doesn't lead to a loan then a wider test is carried out – for example, determining recent receipt of a secondary benefit (Family Credit/Working Families Tax Credit, Housing Benefit, Council Tax Benefit) and treating pregnancy as a an extra member of the household.

4. **Local budget priority.** Finally, the local office controls a set budget. If the applicant satisfies both eligibility and prioritisation criteria but the local budget has already been spent then an application can still be refused.

Once a person has cleared these hurdles, they are then eligible for a loan. However, when determining the proportion of a application to be actually awarded the Benefits Agency staff also take into account the following factors:

- Overall exposure to the Fund – no applicant is permitted to owe more than £1,000, even with multiple loans.

- Ability to repay – "*No budgeting loan may be awarded in excess of the amount which the applicant is likely to be able to repay.*"

- Local office budget constraints.

Issues for discussion

Can simpler assessment procedures be found?

If the aims are to ensure that funds go to those most in need, are there are other – less administratively intense – methods of assessing relative need?

If the reformed scheme has a method for introducing flexibility into the cash ceiling then the need for prioritisation will have been removed and many of the present assessment procedures could be removed. Could approval for a loan could be semi-automatic – perhaps achieved over the phone?

6. WHAT SHOULD THE FUTURE RECOVERY PROCEDURE BE?

Loans are currently recovered through direct deductions from the borrower's benefit. Most of the loans which are presently written off are from those who have moved off Income Support and beyond the reach of the direct deduction scheme. There are three possible reforms which could be made to increase recovery rates:

- Allow direct deduction from tax credits administered by the Inland Revenue.
- Allow Direct Debit from people's bank accounts. Currently, only around half of Income Support recipients have bank accounts, although this situation may change between 2003 and 2005 when all those on benefits will be migrated onto ACT payment of benefits – either into a bank account or a electronic benefit quasi-account.
- Increase the priority of Social Fund loan repayments in the direct deduction scheme – at present they are the last payment to be repaid, after utility bills, council tax and other payments.

Issues for discussion

In principle, should direct deduction remain as a method of recovering loans?

If so, should the government take the power to direct debit bank accounts for loan repayments?

7. SHOULD THE STRUCTURE OF THE REFORMED LOAN SCHEME BE CENTRALISED?

The Budgeting Loan scheme is currently administered by local Benefits Agency offices, managing their own devolved Social Fund budgets. This enables local needs to be closely met but, when budgets run out, devolved administration can lead to seemingly arbitrary decisions been taking in different parts of the country. If the assessment procedures were to be streamlined, then this might open up the possibility of the scheme being operated centrally – removing the need for a face to face interview.

A related issue is possible privatisation, with a view to achieving efficiency savings.

Issues for discussion

Would centralisation of administration be desirable?

If so, can the assessment procedure be streamlined so that the administration of the Social Fund is administered centrally?

Would privatisation of administration be desirable?