THE FINANCIAL Diaries

INVESTIGATING THE FINANCIAL LIVES OF THE POOR

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FOCUS NOTE: Debt and household Finance

KEY POINTS:

- The majority of households are NOT over indebted.[1]
- Formal debt drives the debt payments of highly indebted households in the urban and peri-urban areas while informal debt tends to dominate debt payments in the rural areas.
- High indebtedness is more prevalent among medium and high income households in urban areas whereas over indebtedness happens at ALL income levels in the rural areas.

Indebtedness is a concern that faces both financial service providers and regulators alike. Despite a number of research efforts, however, important questions have persisted regarding indebtedness and lower income populations, such as whether the poorest are the most indebted and how a debt trap arises.

The Human Sciences Research Council (HSRC)[2] provides some insight by showing that for the poorest categories of income, a larger number of people found themselves in the high consumption debt category (where consumption debt > 20% of income) in 2000 data compared with 1995 data. Moreover, the same study shows that the average indebtedness of the lowest income groups increased over the same time period.

The Financial Diaries study contributes to this picture by:

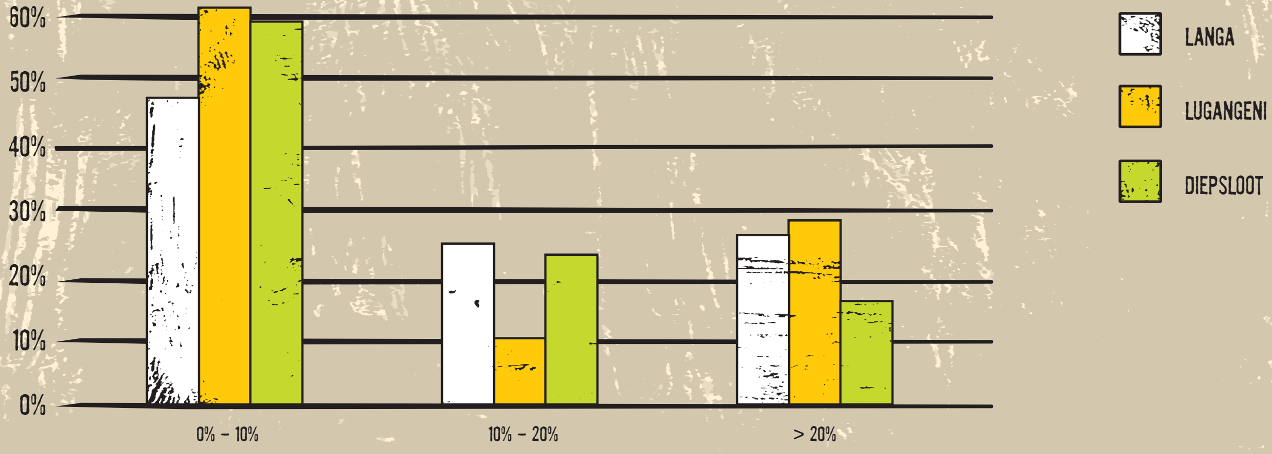
- Considering ALL forms of debt, including formal debt: loans, accounts, store cards, debts under administration and wage advances as well as informal debt: mashonisa loans, one-on-one loans, stokvel loans and credit at the local spaza shop.
- We also consider this in terms of ALL forms of income, including regular (net and gross) wages, casual work, business profits, rental income, remittances and social grants.

1 This report defines over indebted households as those that spend 20% or more of gross monthly income on debt.

2 Human Sciences Research Council (2003): "Household Indebtedness in South Africa in 1995 and 2000" Report prepared for the Micro Finance Regulatory Council, available on www.mfrc.co.za.

THE MAJORITY OF THE SAMPLE IS NOT OVER INDEBTED, BUT A SIGNIFICANT PORTION IS

Percent of households in each indebtedness bracket



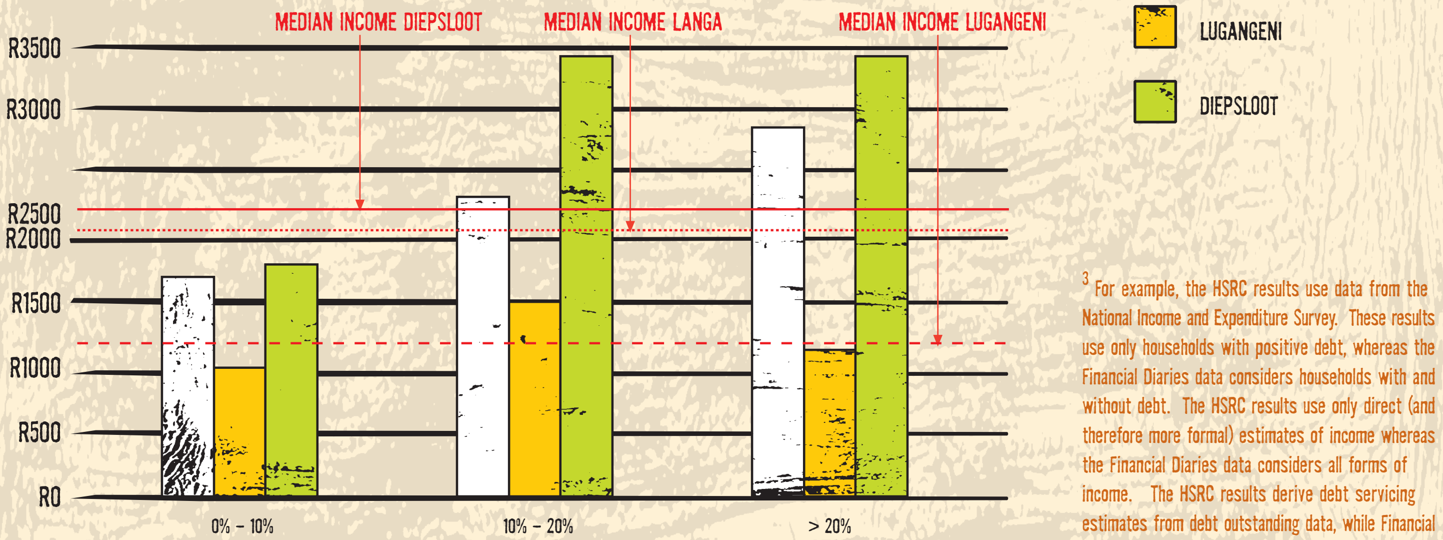
International and local research considers a person to be in a state of "over-indebtedness" when he/she has consumption debt greater than 20% of annual income. The Financial Diaries data set uses the 20% benchmark for monthly debt payment and income to define over indebtedness, but a number of caveats apply to making direct comparisons with other results.[3]

Using the 20% benchmark, most households in the sample are NOT over indebted. In Langa, about 27% of households are over indebted, while in Luganeni, close to 30% of households are over indebted. In peri-urban Diepsloot, a small 16% of households would be considered highly indebted. In all areas, roughly half of the households pay between 0% and 10% of their monthly income to debt.

HIGHER LEVELS OF DEBT ARE SEEN IN MEDIUM TO HIGH INCOME HOUSEHOLDS IN URBAN AREAS, BUT IN ALL INCOME LEVELS IN RURAL HOUSEHOLDS

A significant divergence between urban and rural indebtedness is the difference between the income profile of a highly indebted household versus the area average. In Langa and Diepsloot households, the median income of highly indebted households is higher than the area median, but in Lugangeni, the median income of highly indebted households is roughly in line with the median of the entire rural sample. This suggests that while the wealthier households in the urban and peri urban areas are more indebted, high indebtedness is not contained to the higher income households in rural areas.

Median Income of Each Indebtedness Bracket (Rands)



[3] For example, the HSRC results use data from the National Income and Expenditure Survey. These results use only households with positive debt, whereas the Financial Diaries data considers households with and without debt. The HSRC results use only direct (and therefore more formal) estimates of income whereas the Financial Diaries data considers all forms of income. The HSRC results derive debt servicing estimates from debt outstanding data, while Financial Diaries data is based on actual payments, rather than an assumption that households meet scheduled payments of debt.

DEBT IS FORMAL IN LANGA AND DIEPSLOOT AND INFORMAL IN LUGANGENI

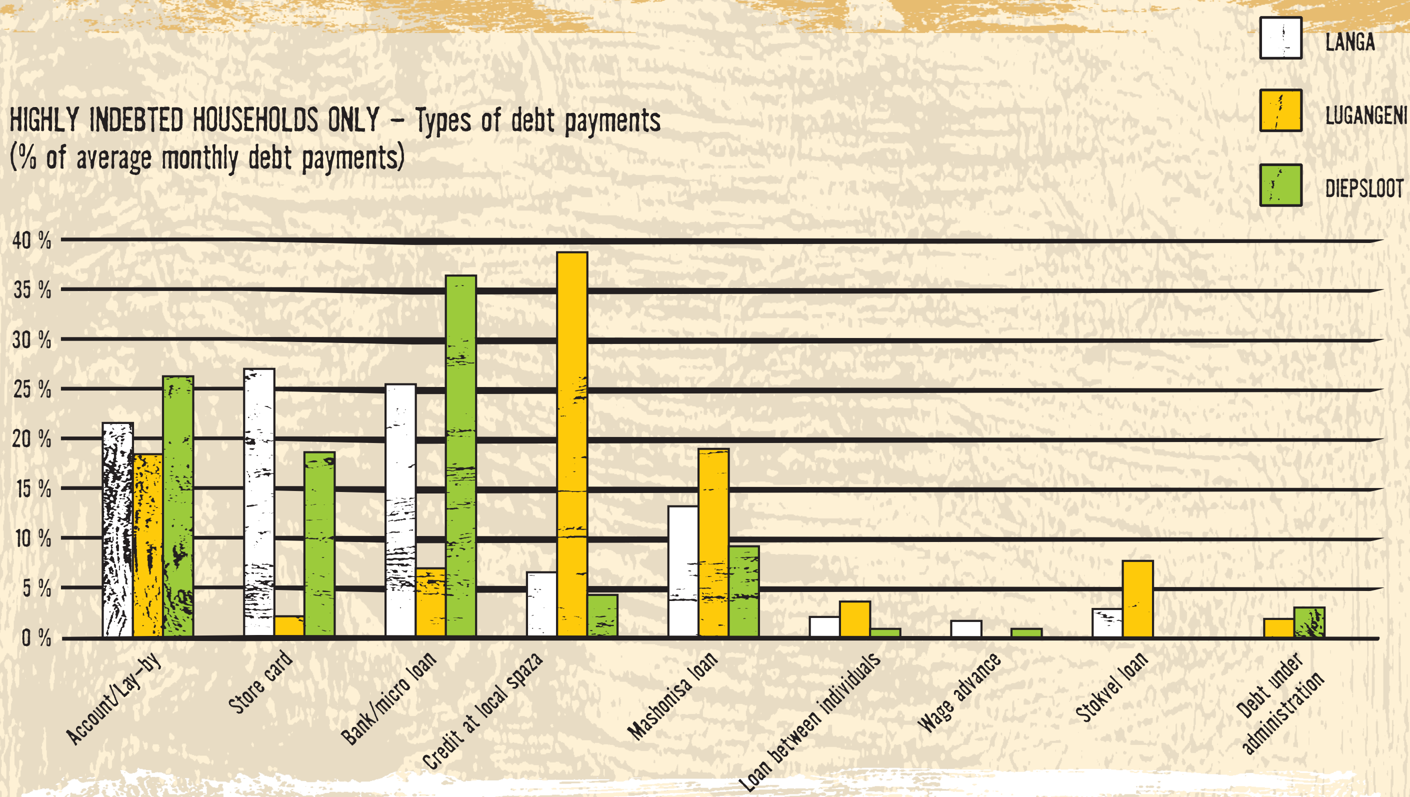
In Langa, it is primarily formal credit that results in high debt payments for highly indebted households. In Diepsloot as well, informal debt counts for very little of the debt payments of highly indebted people. But in Lugangeni, it is the informal debt such as credit at the local spaza shop that is dominant.

In Langa, not unexpectedly, formal indebtedness tends to be connected to those with a regular wage and a payslip. With the exception of one household, who was indebted due to one-on-one loans and stokvel loans, the sub-sample of highly indebted Langa households relied on regular wages for at least 75% of their income.

In Diepsloot, formal loan payments to either a bank or a micro loan made up roughly 37% of a highly indebted household's debt payments every month. Also high (26%) was the percentage of debt payments that went to accounts or lay-by's. Store cards were also important, as they were in Langa.

A key argument in debates on over-indebtedness is whether debt is used for "productive" debt, like business loans or mortgage debt, or "consumption" debt," like instalment credit for buying consumer items like a TV or clothes. However, when looking into the lives of Financial Diaries households, we found that this distinction was extremely difficult to make. Instalment credit was often used to buy school uniforms, which are necessary for children to attend school. Similarly, a stokvel loan may be taken to pay for a funeral. This reality does not mesh easily with the distinction between productive and consumption debt. If the lack of a school uniform would have prevented school attendance then it is difficult not to see this debt as productive.

HIGHLY INDEBTED HOUSEHOLDS ONLY – Types of debt payments
(% of average monthly debt payments)



HOW DOES A HOUSEHOLD FALL INTO DEBT?

* Names have been changed to protect the identities of the respondents.

CASE STUDY 1: Falling into debt to pay for a funeral

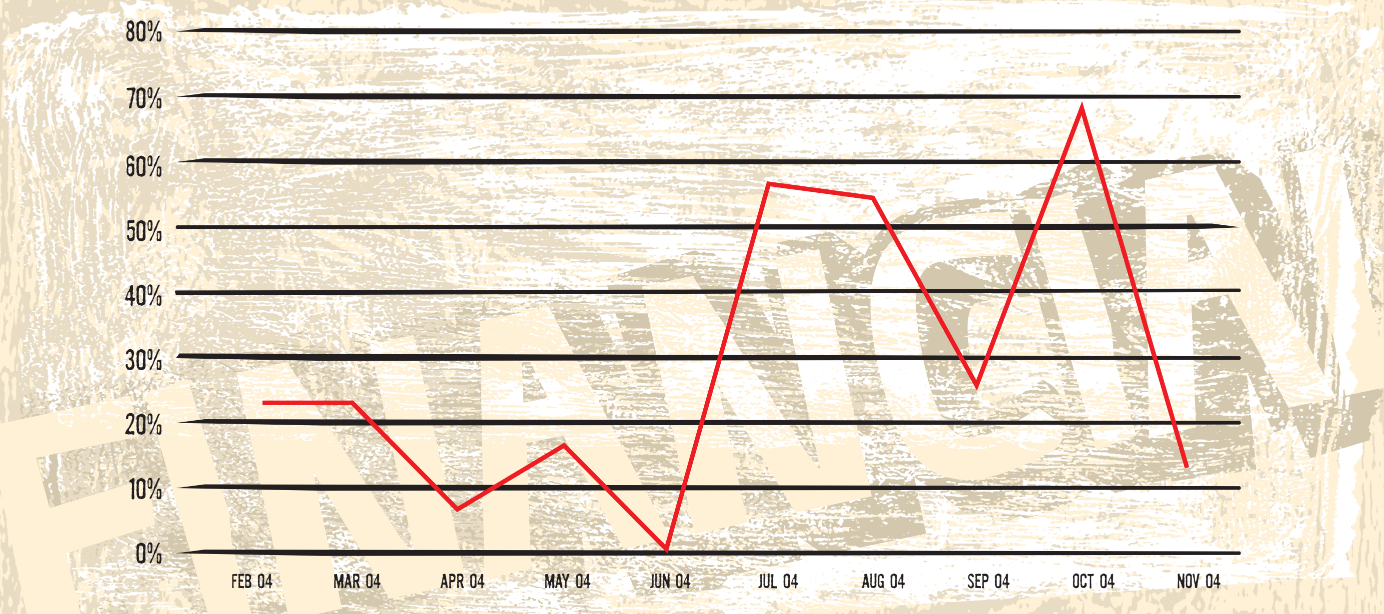
Mapeyi* is a 72 year old woman living in a house in the established part of an urban area. She came to this area when she was a young woman with her parents and she inherited their house. Her three grandchildren live with her. All four members of this household are supported by Mapeyi's old age grant. Every now and then she makes ginger beer to sell, but this is not a consistent business. The mother of two of the children works in a nearby factory and lives elsewhere in the township. She does not contribute to the children's upkeep. The other child lost her father when she was four months old and then lost her mother during the study year.

Mapeyi struggled to help contribute to the funeral of her daughter-in-law, which happened in June 2004. She took R250 from her grant, and received R1000 from her daughter, who borrowed at work. She also borrowed R1000 from the local spaza shop, from whom she used to take groceries on credit every month. When she borrowed the R1000, however, she stopped taking credit, because she wanted to pay back the loan first. She does not pay any interest for either the loan or the credit. She took the loan in June 2004 and managed to pay back the loan from her grant by October 2004.

The shop owner says that she rarely gives credit to anyone without a salary but Mapeyi is a special case because she's been in the neighbourhood so long and the shop owner knows she'll pay. She does however restrict the credit given to Mapeyi every month to R200 because she worries Mapeyi can't pay more. As the chart below shows, Mapeyi tends to manage her debt fairly tightly, paying back 10%–20% of her income to the spaza. During the four months she was paying back the loan, she used between 30% to 60% of her income to pay the loan and restricted the household expenditures.

When we left Mapeyi at the end of the study, she was joining a burial society because she was concerned about what she had experienced with her daughter-in-law's funeral. She says that she has a hard time keeping money aside and doesn't want the grandchildren to have that burden. She also applied for a foster care grant for the child who recently lost her mother. The social worker had come to see her and she was quite positive that the financial situation for the household would improve.

Mapeyi: Monthly Debt Payments as % of Income



HOW ARE HOUSEHOLDS MANAGING DEBT ON A DAY-TO-DAY BASIS?

CASE STUDY 2: High debt in the rural area
Average debt payments per month = 40% of total income

Madlamini* is a 65 year old widow who lives with her 37 year old son and seven grandchildren. Four of the grandchildren have the same mother, who is looking for work in Durban. The mother of the other three is working in Durban, but she doesn't earn much money and rarely is able to send anything home to them. Sometimes her son gets work as a herd boy, but he doesn't give the money to Madlamini. She says she knows he uses it for liquor. The family therefore subsists on her old age grant. She has never been able to get the daughters to organise child grants.

In addition to a tight budget, Madlamini also gets very confused about her money and she does not manage it well. She has a bad habit of taking credit from local traders, for an apron or some chicks, and then forgetting that she needs to pay them. Over the year that we were speaking with her, she took a total of eleven of these credit arrangements. The amounts tend to be for less than R100 but it still bites into the little money she has. She's also borrowed from a mashonisa seven times over the course of the year, paying 25% per month interest. She has also borrowed from neighbours and does not always pay back. Lastly, she takes credit from two of the local spaza shops and continuously has an outstanding balance with them.

Somehow, in addition to managing this debt, she has also managed to keep up with two burial societies and one funeral plan with an undertaker. She also belongs to a rotating stokvel into which she pays R100 every month. She has managed to keep up with these payments with her grant money every month and received a R300 payout in March and September.

As seen with both Mapeyi and Madlamini, informal debt can be a key driver of heavy debt burdens.

* Names have been changed to protect the identities of the respondents.

CASE STUDY 3: Managing debt in the urban area
Average debt payments per month = 10% of total income

Kenneth and Margaret* are the epitome of an up-and-coming young couple who are working hard and trying to build a life for their children. They live with their three children. Kenneth is 34 years old and Margaret is 32 years old. She has a standard 5 (or grade 7) and he has a matric. One of their children is 7 years old and goes to a school which costs R270 a quarter in school fees and R150 a month in transport. The other two children are two year old twins – for half the study year they were looked after by a domestic helper and then they were sent to their grandmother in the rural areas. The family came the urban areas three years ago from another area where they stayed in a backyard shack. As we were finishing the study, their household started receiving electricity and they began to add on a garage. They consider this their permanent home and they pay a mortgage loan for it each month.

Both Kenneth and Margaret are working full-time. Kenneth works for the South African Revenue Service. He's been working with them for eight years. His gross salary is R10,409 per month. He receives about R6,900 in his bank account (his "take home" pay) around the 15th of every month. He gets a bonus of about R7000 at the end of every year. Margaret has worked as a domestic worker in a private household since 2000. She works full-time and earns about R900 cash at the end of every month. Her money is specifically to be used to pay the domestic servant (R600) every month; to contribute R250 to her stokvel and to save R50 per month in her bank account, while Kenneth takes care of most of the other needs of the household. This is the highest paying job that Kenneth has ever had, but Margaret used to work as a cleaner and packer at a conference centre and was paid R1,200 per month. She was retrenched in 1997.

The household used a total of 21 financial instruments over the year, primarily formal. They each have a savings account with two different banks. The principle on the home loan is R53,000 and they pay R1,010 in cash every month. The loan was given in 2003. They also have a funeral plan with an undertaker, to whom they pay R70 per month in cash. In the event of a death, the funeral is then covered, including chairs, pots and tables. Margaret used to belong to an informal burial society that they joined last year but they left early in 2004 because of mismanagement of funds. Kenneth contributes R520 per month to a provident fund through his employer. He's not sure what the amount is in the pension fund, but as he has been working at SARS for eight years and has contributed at least R400 monthly during that time, assuming no capital appreciation, the balance should be at least R40,000. He also contributes R272 per month to an additional retirement annuity, which also gets deducted from his gross pay. In addition, he pays for medical insurance (R448 per month), life insurance (R252 per month) and R252 to a disability policy. Margaret joined a stokvel earlier in 2004. There are four people in this stokvel and they rotate turns each month. She contributes R250 each time. Margaret also hides money in the house from time to time for emergencies.

Kenneth and Margaret only pay 10% of their gross income to debt, which is a home loan. This case study highlights the fact that not all households manage their finances badly.

FURTHER RESEARCH TO COME

- What are the age and livelihood profiles of indebted households?
  - What factors might be important in determining whether households manage debt well or not? Do households ever escape from over indebtedness? Do debt levels change over time for most households?
- The Financial Diaries data is based on a household unit, but each financial instrument and income can be tracked on an individual basis. If one looks at individually - based debt servicing, how different does it look from the household perspective presented here?
  - National household surveys in South Africa and other countries tend to look at indebtedness on a stock basis (how much debt is owed) rather than on a flow basis (how households spend to service this debt). What is the status of net worth (assets less liabilities) in Financial Diaries households? How is net worth changing over time? Are households improving their net worth or is it deteriorating? What factors contribute to this?

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