Indebted Working-Poor Households and Their Policy Implications

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Introduction

Having grown rapidly over the past two decades, household debt in Korea is today a major source of socioeconomic risk factors. Despite the recent tightening of loan regulations, the stock of household debt has continued to swell. In the fifteen years to 2017, gross household debt more than tripled from KRW465 trillion to KRW1451 trillion. As a share of GDP, the increase represents a rise from 61.1 percent to 83.9 percent. The ratio of household debt to disposable income soared to a high of 185.9 percent in 2017. Such an upsurge is the outcome of a complicated interplay of a number of factors, including low interest rate, the sense of relative deprivation due to rising housing prices, increased individual investment in real estate driven by the felt need to prepare for old age, the interest groups benefiting from housing market booms, and some unintended effects arising from policies on real estate loans.

Household debt leads to reduced disposable income and, in turn, to a decline in the personal savings rate and decreased domestic consumption, with its inherent default risk elevating especially when paired with real estate market disturbances or interest rate hikes.

The impact of growing household debt is especially severe on low-income families, whose ability to repay is limited. The focus of this study is on those in working poverty, who in most cases have valid reasons to take on debt and are considered as having the potential to repay their debt.

The Working Poor: Their Characteristics and Living Conditions

Those living under the poverty line, as of 2015, accounted for 16.3 percent of the population, representing 22.6 percent of all households. Of all households with a working-age head, 13.2 percent (or 11.0 percent in headcount terms) were living in poverty.

[Table 1] Composition of the population and households by income level

	All households		Households with a working-age head	
	Households	Household members	Households	Household members
Low income	22.6	16.3	13.2	11.0
Lower-middle income	32.6	33.8	34.4	34.5
Upper-middle income	22.6	25.3	26.0	27.3
High income	22.2	24.7	26.4	27.2
Overall	100.0	100.0	100.0	100.0

Notes: 1) This study assigns households into four income groups—low (equal to or less than 50 percent of the equivalized national median income), lower-middle (50~100 percent), upper-middle (101~150 percent), and high (more than 151 percent)
2) The ages of working-age heads are restricted to between 20 and 64.
Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

The working poor are often characterized as “disadvantaged” in terms of living conditions and employment status. The percentages of monthly-renter households and single-parent households were about twice as high in the working-poor as in all households with a working-age head. More than 4 in ten (41.9 percent) working households had at least one member either self-employed or working in a non-regular employment position. Those with no employed member accounted for 23.6 percent; 22.7 percent had one member working in a permanent position; 11.8 percent had two or more members employed, including in permanent positions.

[Table 2] Working-poor households: their living conditions and employment status for 2015

		Income level				Overall
		Low	Lower-middle	Upper-middle	High	
Living conditions	Number of members (avg.)	2.6	3.2	3.3	3.3	3.2
	One-person households (%)	26.5	18.0	15.4	17.2	17.9
	Single-parent households (%)	20.7	11.2	9.1	9.2	12.7
	Monthly renter (%)	31.8	20.1	10.3	5.7	15.3
	With students (%)	49.0	60.5	59.3	54.2	56.9
	Number working-age members (avg.)	1.8	2.2	2.3	2.5	2.2
	Number of members working (avg.)	0.9	1.4	1.7	1.9	1.6
Employment status	No employed member (%)	23.6	3.4	1.5	1.0	5.5
	One or more members in non-regular employment (%)	41.9	29.3	16.8	10.6	23.6
	One member employed in a permanent position (%)	22.7	38.1	33.2	25.7	31.5
	One member in a permanent position and one or more in non-regular employment	8.3	16.8	20.2	17.6	16.5
	Two members in permanent positions	2.7	9.7	20.7	31.3	16.6
	Two members in permanent positions and one or more in non-regular employment	0.4	1.9	4.6	6.1	3.4
	Three or more members in permanent positions	0.4	0.7	3.0	7.8	3.0
Total		100.0	100.0	100.0	100.0	100.0

Note: 1) Figures are of households with a working-age head
2) Non-regular employment includes temporary work, daily jobs, self-employment and unpaid work
Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

Debt in working-poor households

The working poor's growing debt may be attributed above all to their vulnerable employment status and low income. Households in working poverty, with an income only 23.8 percent of the all-household average (KRW11.00 million vs. KRW46.28 million), carried on average a debt load of KRW56.47 million—74.9 percent of the all-household average of KRW75.44 million. While secured loans accounted for the largest share of their debt, working-poor households, compared to their higher-income counterparts, were also carrying too much credit-based and credit card debt.

[Table 3] Income, assets and debt across households of different income levels

		Low	Lower-middle	Upper-middle	High	Total
Household income	Current income (as % of average)	1,525 (26.9)	3,468 (61.2)	5,711 (100.8)	10,397 (183.5)	5,667 (100)
	Labor income	753	2,536	4,245	7,021	3,955
	Business income	424	727	1,178	2,652	1,326
	Property income	58	54	122	541	205
	Transfer income	289	150	165	183	181
	-Public transfer	214	122	134	159	147
	-Private transfer	76	29	31	24	34
	Disposable income (as % of average)	1,100 (23.8)	2,831 (61.2)	4,683 (101.2)	8,548 (184.7)	4,628 (100)
Asset and debt		Low	Lower-middle	Upper-middle	High	Total
	Gross asset	18,952	23,105	36,289	68,902	38,373
	Gross debt (as % of average)	5,647 (74.9)	5,093 (67.5)	7,275 (96.4)	11,792 (156.3)	7,544 (100)
	Financial debt	4,458	3,966	5,486	7,787	5,456
	-Secured loans	3,569	3,164	4,434	6,483	4,443
	-Credit loans	710	643	862	1,161	848
	-Credit card loan	136	64	69	32	66
	-Unpaid credit purchases and installments	39	94	118	110	97
	-Unpaid contributions to a mutual pot, etc.	3	1	3	1	2
	Rent deposit	1,189	1,127	1,789	4,005	2,087
	Net assets (as % of average)	13,305 (43.2)	18,013 (58.4)	29,014 (94.1)	57,111 (185.3)	30,829 (100)

Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

Working-poor households' high debt service burden, which in 2015 totaled an average of KRW1.256 million (or 114.4 percent in ratio to disposable income), can be explained in part by the high interest rates that are attached to low credit scores. As their exceedingly-high debt service ratio suggests, working-poor families often pay down their debt with yet more debt, which lead to more arrears and defaults. The percentage of those in arrears with principal repayment was twice as high in indebted working-poor households as in indebted households of all income levels (24.2 percent vs. 12.9 percent). Working-poor families cited "income decline" as the primary reason for their arrears in debt service payments.

[Table 4] Household debt and debt service as a percentage of disposable income

		Low	Lower-middle	upper-middle	High	Overall
	In debt	58.7	70.7	74.6	75.1	71.3
	Not in debt	41.3	29.3	25.4	24.9	28.7
	All	100.0	100.0	100.0	100.0	100.0
Debt service ratio per year (as % of disposable income)		1,256 (114.2)	1,217 (43.0)	1,815 (38.8)	2,508 (29.3)	1,750 (37.8)
Interest payment per year		307	222	270	384	291
Principal repayment per year		949	995	1,546	2,124	1,460

Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

Most of the increase in household debt in working-poor families is attributed to living expenses. Almost half (45.1 percent) of indebted low-income working households said they were cutting spending on food and eating out, compared to 36.1 percent, 27.8 percent, and 18.9 percent, respectively, of their lower-middle income, upper-middle income and high-income counterparts. Six in 10 indebted working-poor families said they were taking on more debt to finance living expenses, education or health care. The fact that a whopping 38.2 percent of indebted households saw their debt grow due to their need to finance living expenses is worthy of policy attention.

[Table 5] Causes of household debt increase, by income level

	Income level						Overall
	Low			Lower-middle	Upper-middle	High	
	Subtotal	Working-poor	Elderly				
Residential housing	8.7	9.1	7.3	17.2	28.5	28.7	19.5
Non-housing real estate	0.7	1		5	12.7	14.9	7.3
Deposit for *jeonse* or monthly rent	9.8	9.8	9.7	9.8	7.6	8.1	9
Securities investment					0.5		0.1
Debt repayment	8	7.3	10.2	7.6	5	3	6.4
Business loan	8.3	9.1	5.6	9.3	6.6	8.6	8.3
Marriage loan	1.4	1.8		4	8	7.8	4.9
Medical expenses	12	6.7	29.2	3.1	0.9	0.7	4.4
Education expenses	12.2	15.2	2.6	18.3	18.6	17.5	16.7
Living expenses	36.9	38.2	32.7	22.3	11.1	6.1	20.8
Other	2	1.8	2.6	2.4	0.5	4.6	2.6
Overall	100	100	100	100	100	100	100

Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

Debt in households with a working-age head constrains consumption expenditures and, as this study finds, when debt repayments are taken into account, increases the in-work poverty rate from 11.0 percent to 26.4 percent.

[Table 6] Change in working poverty rate with debt repayment taken into account

Model 1 → Model 2		Model 2				
		Low	Lower-middle	Upper-middle	High	Overall
Model 1	Low	11.0				11.0
	Lower-middle	10.1	24.4			34.5
	Upper-middle	3.3	7.7	16.3		27.3
	High	2.0	1.7	5.1	18.5	27.2
	Overall	26.4	33.8	21.3	18.5	100.0

Note: Model 1 classifies income groups based on household disposable income minus debt (principal and interest) repayments

Source: *Survey of Household Finances and Living Conditions for 2015*, Statistics Korea (2016)

Some myths about debt in working-poor households

The debt problem of working-poor households is, in part at least, about the conditions affecting them. Existing theories tend to make much of the rational choice model: borrowers take on debt to maintain certain consumption levels that are consistent with their expected permanent or life-cycle income. However, it is important to bear in mind the fact that people in working poverty, every so often in life, unwillingly take on debt and willingly bear the repayment obligations. An example would be when individuals take on debt in order to meet the medical costs incurred in treating their ill family members, knowing that the burden of repayment can be daunting on them. This implies that decisions working-poor households make as to whether to save or to spend are affected to a great extent by conditions—their disadvantaged employment status and living conditions. But even in choosing debt, they make not so much an irrational choice as another rational choice toward protecting their families.

In theory, the best way for working-poor households to get off the debt treadmill is through increasing their income. By moving on to better-paid jobs, the indebted working-poor can expect to see their repayment burden considerably lightened and thus to find themselves in a better position to work their way out of the debt cycle. This study finds that the working-poor can expect their repayment burden to decrease on average by 64.8 percent by raising their disposable income to the average for all households with the same number of working members in the same employment status categories.

However, it is important to understand that realities are exceedingly unfavorable to working-poor, who, often working in low-pay, precarious positions, are less likely than their higher-income counterparts to move on to better jobs. Among the factors that keep middle-aged and older people with lower levels of education and women, who together account for a large share of the working-poor population, from moving on to better jobs are education attainment discrepancies, gender wage gap and other discriminatory practices that prevail in Korea. In addition, the burden of care on single-parent families and households with a female head, who take up another large part of the working-poor population, is an issue that calls for more than simply assisting with job placement and transition.

Also deserving of consideration is the impact that current credit rules may have on working-poor households. Tightened since 2014, Korea's credit rules will eventually slow the growth of household debt and, subsequently, reduce the stock of household debt. But they may also add to the difficulties working-poor families face. Consider a labor market environment, such as Korea's, where a large group of job seekers, including middle-aged and older retirees, have nothing for it but to choose small startup businesses. To be sure, there is a need for restructuring of self-employed businesses. But it should also be understood that current labor market conditions are such that much of what adds to the stock of household debt is attributed to the perennial demand for microbusiness startup loans. As credit tapering intensifies and amortization as a method of paying off loans becomes more widely employed, the burden of debt repayment on the working poor gets more onerous.

High interest rate, tied as it is to low credit scores, presents itself as yet another condition that makes it hard for low-income families to break free from the cycle of debt. Even with the government's recent move to lower the interest rate ceiling and tighten lending regulations, many low-income households are still struggling with the high interest rates attached to their loans. Small though it may be in absolute terms, the debt low-income earners have entails a high repayment burden. Our analysis finds that those aged 35~54 with children and those living in a rented home (on a monthly lease or on *jeonse*) are more likely than others to take out large credit card loans. If coupled with an unexpected event such as job loss or business downturn, a credit card loan may turn into a struggle for the borrower, adding rapidly to the burden of debt repayments, becoming defaulted.

An interview survey conducted in September last year as part of this study suggests that household debt and its growth are a consequence not only of rational choices, but also of conditions. Some of the surveyed were over-indebted due to an illness of a family member or loans taken out by their spouse. Some divorcees among those heavily-indebted cited their former spouse's debt as the cause of their divorce and current indebtedness, seeing their debt grow still further as the increased burden of care for children dimmed their employment prospects.

The impact of household debt is particularly severe on working-poor families. Indebted low-income earners inevitably need to cut down on consumption in order to pay down their debt. This leads to reduced household spending on children's education and living expenses.

Apart from strong determination, working-poor families require outside support to escape the debt cycle. This study finds that a network of family members, friends and social support groups plays a great role in helping working-poor families in debt work their way out of debt. What this suggests is that not only do indebted low-income earners need loans and support with terms more favorable than those set forth by financial institutions and other lending companies. They also need to be encouraged by network-based psychological support.

Conclusion

One's debt is not entirely of one's own making. Policy approaches to household debt require a shift of attention to external conditions, to what changes should be made to help indebted low-income families reduce their need for additional borrowing. Such policy changes should involve addressing the problem of household debt with not only financial policy measures but also various social protection programs. Startup support and job placement services are designed to help those with low income increase their earnings and eventually move out of the debt trap. Financial policy tools should work toward making the burden of debt repayment less onerous for working-poor families. Social protection programs should be able to cushion the impact that debt has on people's lives, with a view to keeping household debt from growing further.

In the last ten years, much of the focus of policy response to the problem of household debt has been on financial mechanisms. Policy attention should now turn to improving employment conditions for working-poor households, especially so as to help more of their unemployed members find work. The wage differentials prevalent in the labor market should be narrowed, other discriminatory practices done away with, and the quality of service jobs improved. Also, regulations on lenders must be tightened so that working-poor individuals in debt will not need to suffer from inordinately-high interest rates.

A basic standard of living should be guaranteed to heavily-indebted working-poor households. Efforts in this direction would require, as a first step, a system that merges or connects the agencies responsible for processing social welfare payment claims and those responsible for providing consultation and support services for heavily-indebted individuals. Of these low-income working families, those with growing children should be provided with increased support for education, housing and living expenses, with a view to safeguarding the children's basic social rights.

Heavily-indebted low-income earners should not be denied social services and social welfare benefits (for example, pubic rental housing) on the grounds of default. The suggested strengthening of support for working-poor families is the least that should be done to change conditions in a way to allow anyone who has fallen behind to have a chance to get back on track. In an environment where lagging behind in the race of economic gains means being stigmatized and kept stuck in deprivation, it stands to reason that fear of risk often stifles attempts to challenge and innovate.