

## THE SOCIAL FUND: OPPORTUNITIES FOR REFORM

### 1. SUMMARY

#### Introduction

The Social Fund comprises a number of schemes, some of which are grants (e.g. community care grants) and some of which are loans. The loans divide into two main categories: budgeting loans (for planned expenditures) and crisis loans (for unplanned expenditures).

The total value of the budgeting loans is currently around £400 million pa, with average loans of around £400 being given to around 1 million people each year. Eligibility is restricted to those on Income Support, and the loans are interest-free to the borrower, with repayment through automatic deductions from the borrower's Income Support payments.

The Social Fund was introduced in 1988 as a way of saving government money in comparison with the grants-based system that it replaced. Since then, there has been little political debate about its future; what debate there has been has focused on whether or not the budgeting loans scheme should revert to a grants scheme. We are not aware of any substantive discussions about whether the loans scheme could itself be reformed to provide greater benefit. Apart from the saving of government money, any underlying philosophy of the Social Fund has been lost in the mists of time. Whatever its past, it is now time to re-visit and re-formulate its purpose.

There are also signs that reform of the loans scheme could become politically topical over the next few years. In 1999, the government significantly expanded the overall budget for the scheme and introduced a number of changes to re-orient the approval process from 'what you want to spend the money on; to 'who you are and whether you need a loan'. In 2001, the Social Security Select Committee issued a report on the Fund which concluded that the government should "*take a radical look at the Social Fund, so that it may work to enhance the strategy to reduce child poverty, rather than work against it.*"

In this context, this paper discusses the possibilities for reforming the budgeting loans scheme to help alleviate problems of financial exclusion, both for low income households in general and for disadvantaged young adults in particular. Sections 2 to 5 largely comprise factual information, with this summary identifying a few ideas for possible reforms.

Note that the material does not directly discuss any of the following issues:

- The relative merits of loans versus grants.
- Minimum income standards, and the adequacy/inadequacy of current levels of government benefits and/or the national minimum wage.
- The problems that some people face once they get into debt, for example once they become entangled in the judicial system for non-repayment of fines and/or loans.

Although each of these issues is of great importance, they are not directly related to the future of the budgeting loans scheme.

## Rationale For Reform

The government recognises that there are major problems in current credit arrangements for people on low or uncertain incomes: many do feel the need to borrow from time-to-time but the mainstream financial institutions do not want to lend to such people because they consider it unprofitable. Whilst credit unions offer a potential solution, they are unlikely to do so on a sufficient scale in the foreseeable future. So, unless friends and relatives can help out, people have to find other sources of credit.

If a person buys a washing machine for £400, uses a mail order catalogue and repays over a year, then they will end up paying around £500. If they use a rental purchase scheme, then they will end up paying around £600. If they use a 'reputable' moneylender, they will pay around £700. And if they use an 'unlicensed' moneylender, then they could end up paying anywhere from £1,000 to £2,000.

In contrast, if they could use the Social Fund, then they would end up paying a total of £400. Furthermore, the cost to the government is less than one might expect: because repayments are automatic via deductions from Income Support, both the costs of recovery and the levels of default are relatively low (estimates of operating costs ranging from £40 to £100 million pa and total defaults of around £20 million compared with total lending of £400 million).

But, currently, the scheme is somewhat restricted in its scope: only people on Income Support are eligible and, within this, overall cash limits means that only around half of 'valid' applications are actually successful in practice.

### ***Idea 1: widen the numbers of people who are eligible to apply for a Social Fund loan:***

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 were desired to widen access to the scheme, then it could either be opened to all those on low incomes or it could be linked to specific benefits or tax credits.

The recent introduction of tax credits (Working Families Tax Credit etc) for low income households provides a particular opportunity for moving in this direction whilst still retaining the (efficient) methods of repayment through automatic deductions. In this way, the Social Fund could become useful to people in low paid unemployment as well as the unemployed.

The following table provides numbers who would be eligible using different criteria.

Eligibility criteria	Numbers (millions)
<b><i>Benefit/tax credit threshold</i></b>	
Existing recipients (IS >24 weeks)	3½ <sup>1</sup>
All IS recipients	4 <sup>2</sup>
In receipt of means tested benefits (IS, JSA, FC, DWA)	6 <sup>3</sup>
In receipt of means tested benefits and WFTC <sup>4</sup>	6½
<b><i>Income based threshold</i></b>	
Individuals on low (below half average) income	10 <sup>5</sup>

***Idea 2: expand the size of the fund, or even remove the cash limit:*** clearly, there is no point widening the eligibility criteria unless the total size of the fund is expanded, as new borrowers would otherwise simply displace current borrowers. Obviously, one potential response to this situation would be to raise the cash limits.

However, any cash limited fund inevitably retains inequities whereby often equally deserving applicants do not receive credit because they are applying in the ‘wrong’ geographical area or are not deemed sufficiently ‘needy’. Hence there is an argument for removing the cash limit entirely, or making it so high that it ceases to be relevant.

Note that increasing the size of the Fund is not likely to significantly increase net government expenditure because, as discussed by the Select Committee, operating costs would not have to rise proportionally.

One of the problems with pursuing either of these ideas is that they do not fit with the current de facto ‘philosophy’ of the budgeting loans scheme which is effectively centred on limiting government expenditure.

***Idea 3: overtly re-position the budgeting loans scheme so that one of its purposes is as a source of credit for those on low incomes.*** We are not aware of any reasons why this is not a practical and cheap option for a government wishing to increase access to affordable credit for those on low incomes.

### **The Budgeting Loans Scheme And Disadvantaged Young People**

Breakdowns of budgeting loans are not available by age, but they are available by family type:

	With children	Without children	
Single adult households	55%	25%	80%
Couple households	15%	5%	20%
	70%	30%	100%

Thus, the vast majority of budgeting loans (85%) are given to single people, mostly (but certainly not exclusively) to single parents with children. This pattern is consistent with the use of budgeting loans by young adults (if the age profile was older then one would expect a greater proportion of the loans to be to couples).

Pre-1999, household essentials (appliances, furniture, clothing etc) and rent in advance were two of the major categories under which budgeting loans were approved.<sup>6</sup> DSS data suggests that, since 1999 (when the restrictions on what the loans could be spent on were removed), budgeting loans are mainly used for household essentials and to pay bills. Both patterns are consistent with helping people achieve the transition of young people into independent living.

It is less clear that all potential applicants are aware than the scheme is no longer linked to needs for particular items and that they are eligible to borrow up to £1,000.

***Idea 4: for YMCAs to ensure that they understand the rule changes introduced in the 1999 reforms and that they communicate these to their clients as a routine part of transition planning.***

This idea assumes that budgeting loans are potentially important for to support a move to independent living. This is not actually immediately clear. Are loans of up to £1,000 sufficient to support a move to independent living (e.g. when leaving a YMCA)? Is the scheme currently relevant to those leaving a YMCA given the current restriction of eligibility to those who have been on Income Support for more than six months (e.g. people might be leaving because they now have a job and are on a more stable footing)?

Incidentally, this latter question raises the possibility of a more limited variant of widening the numbers of people who are eligible to apply for a loan by simply extending it to those who used to be on Income Support but have recently got a job.

Of course, one of the major criticisms of the current loans-based scheme is that there is something rather odd in the government requiring loans to be re-paid by people who are already having to survive on an inadequate income. Obviously, moving to a grants-based system would address this but there are no signs that the government would countenance such a change.

Assuming a loans-based system continues, the issue that then arises is whether there are any alternatives to straight re-payment of the loan.

***Idea 5: allow re-payment of some budgeting loans through payments in kind rather than money.*** For example, one possibility would be for people to be able to ‘re-pay’ their loan by spending time undertaking voluntary work of some description.

Such an idea would fit with the wider idea of ‘time banks’ whereby people can gain credits for doing a variety of socially and personally useful work. As Tessa Jowell has said (New Economics Foundation Conference, March 2001): “*Time banking is hugely powerful. It builds the capacity of a community and the capacity of individuals... We want to develop ways of meshing in formal learning with voluntary or community activity. For example, we would like to enable parents involved in childcare, whether through childminding or playgroups/nurseries to build childcare qualifications while they are doing it... We hope that many of our new Neighbourhood Nurseries will also be able to offer parents support, for example through training. In that way, we can help lone parents and others move into jobs or to start new businesses.*”.

***Idea 6: turn the loan into a grant if the person found paid work.*** Such an approach would recognise the consequent saving to government benefit payments as well as providing an additional incentive for the person to move into work. It would also help the person feel that their new job represented a ‘new beginning’.

## **Conclusion**

There are two main criticisms of the current budgeting loans scheme. First, it is 'mean' - certainly in comparison with what existed before - and there is something peculiar in requiring repayments from people who already have inadequate incomes. This is the essence of the argument for moving back to a grants-based scheme. We are sympathetic with this view and have, for example, argued in other papers for substantial rises in minimum income levels for people not in work. But it has not been the focus of this paper.

Second, even within its loans-based paradigm, the scheme suffers from a paucity of vision, never really having moved away from its original motivation of saving government money. It is this criticism which the ideas in this paper have sought to address. In summary, the ideas are:

1. Idea 1: widen the numbers of people who are eligible to apply for a Social Fund loan:
2. Idea 2: expand the size of the fund, or even remove the cash limit:
3. Idea 3: overtly re-position the budgeting loans scheme so that one of its purposes is as a source of credit for those on low incomes.
4. Idea 4: for YMCAs to ensure that they understand the rule changes introduced in the 1999 reforms and that they communicate these to their clients as a routine part of transition planning.
5. Idea 5: allow re-payment of some budgeting loans through payments in kind rather than money.

## 2. THE SOCIAL FUND: THE FACTS

The Social Fund comprises a combination of grants and loans.

The grants are of two main types:

- **Community care grants.** Grants which address the needs of those moving from institutions into the community, and assist those living within the community.
- **Other one-off grants,** including Sure Start Maternity Grants, funeral payments and cold weather payments.

The loans are also of two main types:

- **Budgeting loans** are interest free loans for important intermittent expenses which are difficult to budget for from weekly income. Those who have received Income Support (or income based Job Seeker's Allowance) for 26 weeks are eligible for budgeting loans.
- **Crisis loans** are also interest free and are available in an emergency to people with no alternative means of avoiding risk to their health or safety. All those "*without sufficient resources to meet the immediate short-term needs of himself or his family...*" are eligible for crisis loans.

	Grants		Loans	
	Maternity and Funeral Grants	Community Care Grants	Budgeting Loans	Crisis loans
Applications received	270,000	643,000	1,700	1,300
Awards	220,000	220,000	1,000	1,000
Awards as % of decisions	80%	35%	60%	75%
Gross expenditure	£55M	£100M	£400M	£60M
Recoveries	N/A	N/A	£375M	£50M
Net expenditure	£54M	£100M	£25M	£10M
Average Award	£100/£900	£450	£400	£70

The total administration cost of operating the Social Fund is around £250 million p.a..

The budgeting loans, crisis loans and community care grants are collectively termed ‘the discretionary Social Fund’, reflecting the fact that there is some discretion about whether to accept or refuse an application. The other one-off grants are termed ‘the regulated Social Fund’.

The Social Fund was originally introduced in 1988 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. Its introduction was part of a wider reform of social security which, inter alia, included the move from Supplementary Benefit to Income Support.

The stimulus for its introduction was the spiralling costs of the previous needs payments in the 1980s, which rose from less than £50 million in 1982 to more than £350 million by 1988. In this sense at least, its introduction was a success: net expenditure to the government has been substantially reduced.

### **3. BUDGETING LOANS**

The most controversial aspect of the Social Fund's introduction was the use of loans to replace grants, particularly within the Budgeting loans scheme, combined with the introduction of an overall budget cap.

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).

Key facts:

- The minimum loan available is £30, the maximum is £1000. The 1999/2000 average was around £400.
- The total value of the loans in 1999/2000 was around £400 million.
- Over a million applications for budgeting loans are made each year.
- Eligibility is restricted to those on IS or income-based JSA for 26 weeks or more. There are roughly 3½ million eligible recipients.
- 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 to the borrower.
- Recovery rates are about 95% of gross expenditure.
- Over half of budgeting loans are made to those who have been in receipt of benefit for more than 3 years.
- Around 50% of budgeting loans go to lone parents, with 20% going to disabled people. 80% go to single people, and 20% to couples.

Following criticism about the somewhat paternalistic nature of the scheme's operation (loans were only given for 'approved' items of expenditure), the scheme was revised as part of the 1998 Social Security Act. The key changes included:

- A move to fact-based decision-making based on clear, factual criteria.
- A move from approval based on 'a demonstrated need for specific items' to approval based on 'a demonstrated need for financial assistance for intermittent expenses'.
- Removal of the investigation of need, including removal of 'intrusive and paternalistic questioning'

#### 4. RECENT REVIEWS OF THE ADEQUACY OF THE SOCIAL FUND

There appears to be a complete lack of debate about the future of the either the Social Fund in general, or the budgeting loans scheme in particular. The only external assessments since 1992<sup>7</sup> that we are aware of comprise:

- ***The 2000/2001 review by the Social Security Select Committee*** (<http://www.publications.parliament.uk/pa/cm200001/cmselect/cmsocsec/232/23202.htm>, with their summary of conclusions and recommendations in Attachment A). This review concluded that “*the scheme in its present format needs urgent overhaul and an injection of funds. Without such action, there is a strong possibility that the wider social policy objectives of the Government will be endangered.*” Its overall recommendation was that the government should “*take a radical look at the Social Fund, so that it may work to enhance the strategy to reduce child poverty, rather than work against it.*”
- ***A Citizen's Advice Bureau report produced in 2000.*** This report documented the ways in which CAB clients have suffered increased "stress and hardship" and made a variety of recommendations for improving the present system. The simplest change would be to replace the loans with the old single grant system. This would cost less than 0.4% of the current social security budget.
- ***A number of statements by the Liberal Democrats in 2000*** to the effect that the system is mean and that it should revert to being grants-based rather than loans-based.
- ***Our own 1999 analysis of the policy options for lessening financial exclusion (Meaningful Choices The Policy Options For Financial Exclusion,*** with the relevant extract from the management summary in Attachment B). Our analysis concluded that many poor people faced major problems in obtaining affordable credit and that neither mainstream banks nor credit unions offered an adequate solution in the short to medium term. It suggested that “*one of the future purposes of the Social Fund should be as a source of credit for those on low incomes, and that this represents a practical medium term option for a government wishing to increase access to affordable credit for those on low incomes*”
- ***Our own 2000 assessment of the budgeting loans scheme, Reforming Social Fund Budgeting Loans: A Citizenship Loan Scheme?*** This assessment reinforced our view above that the budgeting loans scheme could usefully be reformed to become a source of affordable credit for people on low incomes by extending the eligibility criteria beyond those on Income Support and by increasing the overall size of the fund. It also concluded that the scheme should be amended to address perceived iniquities, such as the 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.
- ***A article by Professor Bob Holman***<sup>8</sup>, which also argued for an increase in the budget and/or for a return to a grants-based system.

Internally, the only recent assessment that we are aware of is a 2000 report commissioned by the DSS to survey the views of recipients to the 1999 revisions made to the budgeting loans scheme.<sup>9</sup> The conclusions from this review were generally favourable to the revisions that had been made, but also made a number of specific recommendations for change.

## 5. RATIONALE FOR REFORM

Whilst the 1999 reforms can be regarded as a step forward in reducing the perceived paternalism of the budgeting loans scheme, they clearly do not represent a major reform or change of direction. Thus what is currently in place is still largely as originally shaped in 1988.

Apart for the recent Social Security Select Committee review, political discussion about the future of the Social Fund over the last ten years has largely been characterised by its absence. Where there has been debate, it seems mostly to have been along the lines of either revert to a grants-based scheme (Labour when in opposition, Liberal Democrats now) or retain the system largely as is (Conservatives when in power, in effect Labour now).

*Whilst not under-estimating the importance of the loans versus grants debate, a sole focus on this issue begs the question of whether opportunities are being missed if, as seems likely, the government retains the current loans-based scheme without further reform.* The reasons for believing that such opportunities are, in fact, being missed stems from a twofold analysis.

First, as the government itself recognises<sup>10</sup>, *there are major problems in current credit arrangements for people on low or uncertain incomes:*

- There is a demand for credit from those on low incomes: half of those low or very low income use credit of one type or another<sup>11</sup>
- This need is not currently being fully met by mainstream financial institutions: because typical loan amounts are small and credit risks are relatively high, the profitability of such credit is at best problematic.
- Whilst credit unions are a potential solution, they are unlikely to be *the* major solution for the foreseeable future: they are currently only small scale, the necessity to save beforehand makes make problematic for many people, and they (arguably) have a natural tendency to gravitate towards the better off.
- As a result of the above, demand for credit from moneylenders is high and (arguably) increasing. But such credit typically has an APR in excess of 200% and, at least at the outer reaches, is difficult to regulate.

Second, *the budgeting loans scheme has some very attractive features:*

- The scheme is a relatively cheap/efficient way of lending money: automatic repayments via deductions from Income Support lowers the costs of recovery are small; the automatic nature of these repayments means that the proportion of defaults is very low.
- The scheme is very attractive to its borrowers: small, one-off fixed term loans; regular, fixed repayments; zero rates of interest; and widely available to those who are eligible.
- The scheme is sustainable: the combination of small loans and regular repayments means that loans are typically paid off in a relatively short period of time, making the money received available for new loans.

## **ATTACHMENT A**

### **SOCIAL SECURITY - THIRD REPORT SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS**

#### **Funeral Payments**

(a) Whilst we accept that there have been many changes to the Benefit system since 1997 which have taken priority, we believe that reform of Funeral Payments is long overdue and recommend that the Government increases the amount available to claimants for Funeral Payments to a more realistic total, reflecting the current charges for a funeral and that steps should be taken to ensure that the amount is reviewed annually to reflect increases in funeral costs. (Paragraph 12)

(b) We recommend that there should be greater flexibility in the rules governing eligibility for funeral payments, so that payments can be, for example, made to the parent of a deceased child, or to a close relative or close friend if it is reasonable to do so. The question of reasonableness should be decided at the discretion of the decision-maker, subject to guidance (as opposed to inflexible rules laid down in regulations as now); and with a right of appeal to a social security appeal tribunal on the exercise of that discretion. (Paragraph 13)

(c) In the case of applications from people who wish to bury the remains of the deceased overseas, we recommend that funeral payments (subject to the usual maxima applied to other funerals for which a Funeral Payment is available) should be allowed in respect of funeral costs (or equivalent religious observance) which are incurred in the UK, prior to transportation overseas. (Paragraph 14)

#### **Winter Fuel Payments**

(d) If the arrangements for Winter Fuel Payments are changed in the future to a more targeted benefit we will expect the fuel poor in other groups to be included. The element of benefits which is intended to cover fuel costs, to which the Minister referred in her evidence to the Committee, should keep pace with any increase in the cost of heating generally. (Paragraph 17)

#### **Community Care Grants**

(e) We recommend that the Department should commission research to re-examine the basis on which the Community Care Grant budget is currently allocated to local offices, including the relative weightings given to different client groups; the current accuracy of caseload measurement; and the accuracy of measurement of 'legitimate demand'. (Paragraph 38)

(f) We recommend that claimants should be given sufficient information to enable them to have a reasonable expectation of what is or is not classed as a priority. (Paragraph 43)

(g) We recommend that, failing more fundamental reform, the Community Care Grant budget should be raised substantially to a level which ensures that all applications which are classed as high and medium priority are met to the full amount required. (Paragraph 44)

### **Budgeting Loans**

(h) We recommend that better information be made available to applicants, to increase their awareness of their credit limit and the chances of an additional loan application being successful. (Paragraph 55)

### **Crisis Loans**

(i) We recommend that the annual percentage of Crisis Loans paid for "alignment" (37.3% in 1999-2000) is analysed in order to assess the underlying problems leading to the need for those Crisis Loans, how the causes could be addressed and that the results be published by the Secretary of State in the annual report to Parliament. (Paragraph 64)

(j) We recommend that the direction dealing with eligibility criteria for Crisis Loans be reviewed in order to increase access to Crisis Loans when applications for Budgeting Loans have been refused. (Paragraph 67)

### **Repayment and Rescheduling of Loans**

(k) We consider that the level of repayments and the repayment period should be much more flexible in order to minimise the hardship which claimants experience and to avoid them encumbering themselves with further high-priced debt. (Paragraph 71)

(l) We recognise that if the payment period was extended, in order to sustain the current level of loans, the budget would have to be increased. But we consider that, because the loans would still have to be repaid, there would be hardly any increase in net expenditure in the long term. (Paragraph 71)

(m) We consider that Benefits Agency staff should be expected to draw the attention of applicants to the possibility of rescheduling loans both at the time of application and subsequently if it becomes clear that the claimant is suffering additional hardship as a result of their Social Fund loan repayments. We recommend that Benefits Agency staff be so instructed. The possibility of rescheduling should also be more prominently displayed in publicity material and on application forms. (Paragraph 73)

### **Administration of the Discretionary Social Fund**

(n) We recommend that a rule be introduced that, if it is later shown that a person who has applied for a Budgeting Loan would have been eligible for a Community Care Grant in respect of the same need if he or she had been correctly advised at the time, a decision to award a Community Care Grant should be substituted and if a Budgeting Loan has been granted, the debt should be written off. (Paragraph 78)

(o) It has become quite clear to us that Social Fund applicants need more active and informed assistance from Benefits Agency staff both in accessing appropriate Social Fund payments and in dealing with their benefits more generally at a disruptive period of their lives. We would like to see better trained staff working directly and intensively with Social Fund claimants for short periods, acting as 'champions' to assist them in accessing the benefit help they need. (Paragraph 85)

(p) We recommend that claimants should be able to telephone for an estimate, which should be logged, of how much they are likely to receive by way of a Budgeting Loan before an application is submitted, and secondly, that more information is given to applicants to explain a decision which has been made. (Paragraph 87)

(q) We recommend that the Department use the opportunity offered by IT modernisation to work towards a system where Social Fund customers are sent statements of account at the start of a loan, and then at six monthly intervals thereafter until the loan is repaid - showing the repayments made to date; the amount of the loan still outstanding; and the expected date when the loan will be repaid. The opportunity should also be taken to remind customers at regular intervals of the opportunity to reschedule their loans if they are experiencing financial difficulties. (Paragraph 88)

(r) We recommend that consideration be given to a review of the grades and training of the staff within the BA who deal with Social Fund claimants, in order that their expertise can be retained and channelled to provide active and informed assistance to the maximum benefit of claimants. (Paragraph 94)

(s) We recommend that the Department take more active steps to monitor the quality of service being provided to its Social Fund customers, by funding qualitative research; by customer surveys; and by more active liaison with welfare rights organisations. (Paragraph 99)

(t) We think there is a case for ethnic monitoring of Social Fund applicants. (Paragraph 100)

(u) We therefore recommend that a pilot programme should be set up by the Department of Social Security, in consultation with the Commission on Racial Equality, aimed at trialling a system of ethnic monitoring of Social Fund applicants. (Paragraph 100)

(v) We will expect to see a significant reduction in administrative errors. The increase of data-matching should make it possible for all claimants to receive the benefits to which they are entitled and better information should be made available to applicants in the form of detailed reasons for a refusal and a clear statement of the amount, repayment terms and period for successful applications. (Paragraph 102)

## **Reviews and Appeals**

(w) We recommend that the Secretary of State sets a target time for the handling of internal Social Fund reviews of a maximum of two weeks and publishes figures in the Annual Report on the Social Fund indicating both the performance of offices against this target, and the average waiting time experienced by claimants awaiting an internal Social Fund review. (Paragraph 105)

(x) We recommend that applicants to the Social Fund should be able to apply directly to the IRS for a review of their case, rather than going through the Benefits Agency. (Paragraph 106)

(y) We recommend that the contingency plans referred to by Sir Richard should now be taken forward in order to make the Independent Review Service compliant with the Human Rights Act and to provide assurance to claimants and others that a review of their Social Fund claim is truly and visibly impartial. (Paragraph 108)

## **Organisational Change**

(z) We recommend that claimants should continue to be able to claim Social Fund payments through the same offices where they claim Income Support or income-related Jobseeker's Allowance, not least so they can benefit from the assistance of a Personal Adviser once the use of such staff becomes widespread. (Paragraph 110)

## **Options for the Future**

(aa) We repeat the recommendations first made in our report on Integrated Child Credit, that the Government should establish a specific budget to fund research into the levels of income needed to avoid poverty; and that it should set up a working party involving policy makers, academics and other interested parties to assist the Government to devise publicly acceptable measures of such levels. (Paragraph 114)

(bb) We recommend that the Government review both the overall budget for grants within the Social Fund system and the eligibility criteria to overcome these weaknesses and to ensure consistency. (Paragraph 115)

(cc) Whilst it is clear that people on the lowest incomes struggle to repay even interest-free loans from weekly benefit, there does appear to be the potential for the role of the Social Fund to be expanded to a wider group of people, offering interest-free loans to people excluded from normal credit markets. (Paragraph 116)

(dd) It appears that little has been done so far by the DSS to take forward the recommendations of the PAT 14 report. We welcome the Minister's commitment to do so and recommend that this is done as a matter of urgency. (Paragraph 116)

## **Conclusion**

(ee) We urge the Government to use the opportunity offered by the re-organisation of DSS to take a radical look at the Social Fund, so that it may work to enhance the strategy to reduce child poverty, rather than work against it. (Paragraph 117)

(ff) At the start of the inquiry, we asked ourselves whether the Social Fund was achieving the aim set for it by past and present Governments. In particular, we asked whether it was helping the poorest and most vulnerable in our society. We have concluded that the scheme in its present format needs urgent overhaul and an injection of funds. Without such action, there is a strong possibility that the wider social policy objectives of the Government will be endangered. (Paragraph 118)

## ATTACHMENT B

### NEW POLICY INSTITUTE EXTRACT FROM *MEANINGFUL CHOICES: THE POLICY OPTIONS FOR FINANCIAL EXCLUSION*

#### **Problems: Limited Choices Again**

In many ways, the issues relating to access to affordable credit are similar to those relating to money transmission: they centre on the lack of choice available for those on low incomes and outside the banking system. Most of the population use credit cards, overdrafts and other facilities from banks and building societies for credit purposes. There is, however, a significant proportion of the population who cannot use such methods and instead rely on money lenders and, where eligible, the Social Fund. 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.<sup>12</sup> 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.*”<sup>13</sup>

There is a demand for credit from those on low incomes: half of those low or very low income use credit of one type or another<sup>14</sup> and there were 2½ million applications for Social Fund loans in 1996/7,<sup>15</sup> mostly small loans (average Social Fund loan: £300).

This need is not currently being fully met by mainstream financial institutions: “*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.*”<sup>16</sup>

So, the issues centre on supply rather than demand and the question is again one of choice: most of the population could use money lenders but choose to use banks and building societies; low income consumers have less choice. And the conclusion is again the same: access to affordable credit must be of concern to a government committed to tackling the problems of social exclusion.

In this context, we suggest that the challenge for Government policy is *how to ensure that options exist to meet the needs for accessible and affordable credit for people who want to borrow small amounts of money and for whom the current offerings in the market, for one reason or another, do not meet this need.*

#### **Solutions: Need For A Governmental New Initiative?**

Research into the ‘ideal service features’ of credit for low income consumers suggests that they include:

1. Small, one-off fixed term loans.
2. Regular, fixed repayments.
3. Low or no rates of interest.
4. Not conditional on the purpose for which the money is to be used.
5. Widely available to those on low income.

The ***Social Fund*** meets the first three of these characteristics, but historically not the fourth (assessment has depended on purpose) and often not the fifth (only eligible to those on Income Support and strictly cash limited, with substantial refusal rates). With imminent changes to the rules, whereby assessment will be based more on who the person is than on what they need the money for, the fourth characteristic may be eased but only at the expense of a worsening of the fifth, with certain types of people institutionally out-of-favour.

***Moneylenders*** may have advantages in terms of their flexibility of repayments, but they certainly do not meet the low-cost criterion (APRs are commonly more than 200%).

As discussed earlier, the ***mainstream financial institutions*** do not appear to be a complete solution. None of those we interviewed felt that small loans targeted on low income consumers were an attractive business proposition for such institutions: the costs involved in the decision-making and the credit risks both make them unattractive. So, if the aim is to improve access to affordable credit, the government must look either to change the environment in which existing lenders make their decisions or to alternative lending institutions.

One way of changing the environment would be to introduce legislation analogous to the United State's ***Community Reinvestment Act*** (CRA), whereby financial institutions are obliged to meet the credit needs of their communities (within overall prudential lending rules). But the banking system is different in this country and, anyway, the emphasis of the CRA is slightly more towards businesses in low income areas than at households with low income. Similarly, variants on the CRA, such as the Community Reinvestment Disclosure Bill, in which lending institutions have to reveal their lending activities on a postcode by postcode basis, do not necessarily help individuals' access to credit.

***Credit Union*** are alternative lending institutions, currently the subject of much debate. Whilst they are a potential solution, and clearly have a role to play, their current scale and historic rates of growth suggest that, at best, it will take some considerable time for them to become **the** solution. As a recent report concluded "*credit union development as typically undertaken has not created sustainable financial institutions that are able to serve large number of people, particularly in more disadvantaged areas.*"<sup>17</sup> Furthermore, the necessity of the existence of savings before a loan can be taken out means Credit Unions can be problematic for those on low incomes who find it difficult to save, or those who need credit at short notice.

A related, more recent, idea is that of ***gateway institutions***, which are membership organisations which act as intermediaries between the customer and mainstream financial institutions. They are an interesting idea with potential but again, at best, they offer a potential solution of sufficient scale in the longer term only.

Drawing all this together, we suggest that ***there are a variety of interesting ideas for promoting affordable credit to the more disadvantaged, which may well become major solutions over time. However, none offers an obvious short term solution on a large scale and other new initiatives are therefore worth considering.***

## **Our Proposal: A New Philosophy For The Social Fund**

*“The makings of a banking service are emerging within the benefit system in the operations of the Social Fund which offers loans, and in the system of direct payments which offer a direct debit system for some people on income support.”<sup>18</sup>*

The Social Fund was introduced by the previous government 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). Any underlying philosophy has been lost in the mists of time. Whatever its past, it is surely time to re-visit and re-formulate its purpose.

***We suggest that one of the future purposes of the Social Fund should be as a source of credit for those on low incomes, and that this represents a practical medium term option for a government wishing to increase access to affordable credit for those on low incomes.***

This suggestion is made for pragmatic reasons: the Fund is an efficient and sustainable loans scheme. Whereas lending schemes which rely upon door-to-door collection tend to be very expensive - witness the high APRs of traditional moneylenders - the Social Fund collects repayments relatively cheaply and effectively through direct deductions from Income Support. Gross lending in 1996/7 was £284 million, of which £250 million was later recovered - a recovery rate of 88%. Whilst the administration costs are substantial (about £160 million in 1997/8), these cover the whole of the Social Fund, not just budgeting loans; furthermore, many of these costs are fixed, and do not therefore rise in proportion to the amount of money lent. That the government considers it ‘good value’ is illustrated by its plans to expand the gross expenditure on budgeting and crisis loans to £437 million in 1999/2000.

From the consumer perspective, the size of the loans made by the Fund, its affordability, and the shape of its repayments all fit with the objective proposed earlier of providing affordable credit for people who want to borrow small amounts of money.

The assessment process for Social Fund applications is currently being changed in two major respects. First, more rigorous national guidelines are being introduced, with less local discretion. Second, the criteria are moving away from ‘what is the money being loaned for’ and towards ‘who is it being loaned to’. These changes should make the Fund more attractive to those who successfully apply: by reducing the rules on what the money can be spent on, they should make the Fund more flexible in meeting people’s various needs and should lessen the questioning of need which is sometimes viewed as somewhat paternalistic. They should also make the operation of the Fund cheaper, as less detailed personal assessments will be required.

Combined with the significant expansion of the Fund, these changes represent a major shift of direction by the government, with this shift being in line with the idea of the Social Fund being a source of credit for those on low incomes.

Building on this foundation, we suggest ***that the government widen the potential scope of the recipients beyond those on Income Support to those on other benefits and, potentially, to those in receipt of the new in-work tax credits.*** There are no technical reasons why the Fund should not be extended to, for instance, recipients of the Working Families Tax Credit. Repayments of such loans could still be via direct deduction – albeit involving the Inland Revenue in the case of tax credits. It would allow the Fund to be extended to those in work (but on low wages), whilst still being collected efficiently.

Any extension of the population who are considered eligible for Social Fund loans implies an expansion of the Fund itself, if reduced access to those already eligible is to be avoided. But, as discussed earlier, the net cost of so doing would be relatively small, so long as the system of direct deductions is maintained.

## END NOTES

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<sup>1</sup> November 1997, IS recipients more than 24 weeks rather than 26 weeks. From Social Security Statistics, 1998, table A2.29

<sup>2</sup> From Social Security Statistics, 1998, table A2.29

<sup>3</sup> 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).

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

<sup>5</sup> 1997/98.

<sup>6</sup> The 1999 reforms reduced/eliminated the purpose of expenditure as a criterion for making a budgetary loan. The categories of expenditure for which a budgetary loan could previously be made comprised the following:

- 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.

<sup>7</sup> We are aware of two assessments prior to 1992: Huby, M. and Dix, G. *Evaluating the Social Fund*. HMSO, 1992; and National Audit Office, *The Social Fund*, HC190, 1991.

<sup>8</sup> The Guardian, Thursday February 15, 2001.

<sup>9</sup> Whyley C., Collard, S. and Kempson E., [Saving and Borrowing](#), DSS 2000.

<sup>10</sup> For example, see the Cabinet Office Policy Action Team report number 14.

<sup>11</sup> Office of Fair Trading, *The Consumer Survey*, Appendix 4, table 2.1.

<sup>12</sup> Office of Fair Trading, *The Consumer Survey*, Appendix 4, table 2.1.

<sup>13</sup> Office of Fair Trading, *The Consumer Survey*, Appendix 4, p. 6.

<sup>14</sup> Office of Fair Trading, *The Consumer Survey*, Appendix 4, table 2.1.

<sup>15</sup> Department of Social Security, *Social Security Statistics 1997*, TSO, London 1997. p. 107.

<sup>16</sup> Office of Fair Trading, p. 30.

<sup>17</sup> Jones, Paul A., *Towards Sustainable Credit Union Development*, ABCUL, Manchester, 1998, Draft, p. 2.

<sup>18</sup> Mannion R., S. Hutton, and R. Sainsbury, *Direct Payments From Income Support*, DSS research report no. 33 London, 1994, p. 84.