How household debt influences inequality

James Wood *writes that private debt contributes to increasing inequality, as highly indebted households provide a revenue stream to the financial sector, where profits are distributed to financial employees, managers, and executives, as well as to the most affluent households which hold the concentrated ownership of financial assets.*

Britain has one of the highest levels of inequality in Europe. As such, the severely negative social and political consequences of inequality have seen it emerge as one of the defining issues of Britain's modern political economy. Although technological change, globalisation, and labour market flexibility have often been blamed for the rise of inequality in advanced economies, much of Britain's inequality is down to the growth of its financial sector. British finance re-emerged in the 1980s due to the inter-related processes of financialisation, which are made up of the shift towards the shareholder value model of corporate governance, the rising share of corporate profits generated by the financial sector, and the increased public engagement with financial services.

Financialisation contributes to inequality by increasing incomes for financial sector workers, particularly managers and executives, in relation to non-financial sector workers, as well as by driving returns on investments for affluent households who hold the concentrated ownership of financial assets. Although several studies have examined the effects of 'high finance' on driving inequality, relatively few have looked at the distributional consequences of the more mundane relationship between households and the financial sector in Britain.

Private debt is one of the major drivers of financialisation and it is the most widely diffused mechanism directly connecting households to the financial sector. The most highly indebted group are middle-income households, who leverage their incomes to access large volumes of mortgage credit to buy homes. The sustained demand for homeownership has contributed to rising house prices, which are considered the main determinant of household indebtedness in Britain. As interest payments on private debt provide a revenue stream for the financial sector, household debt may actually exacerbate pre-existing inequalities by increasing incomes for financial sector workers and asset holders at the upper end of the distribution scale. Therefore, this research examined whether, and to what extent, increases in household debt contribute to increases in inequality in Britain.

This was evaluated using an econometric analysis of the real volume of household debt and four measures of inequality: the Gini index; the top 5% income share; the Palma index; and the ratio of income distributed to the top 5% in relation to the middle 40%. This variable is selected as the middle of the income distribution is the most highly indebted, and it is posited the income generated from interest baring debt-instruments is distributed to the upper end of the income scale.

Household debt contributes to rising inequality

The results show that household debt has significant and positive effects on all four measures of inequality in Britain between 1966-2016. An examination of the specific inequality variables suggests household debt contributes to rising inequality by increasing the share of income at the upper end of the distribution, while reducing the concentration of income away from the middle. Therefore, household debt contributes to rising inequality by providing a revenue stream from highly indebted middle-income households to the financial sector, where it is distributed to managers, shareholders, and top-earning employees.

Private debt may not cause inequality in and of itself. Although household debt is widely diffused throughout British society, there are other countries with higher levels of household debt as a share of GDP than Britain, including Australia, Switzerland, Denmark, the Netherlands, Norway and Sweden, each of which demonstrate lower inequality outcomes than Britain. This suggests that there are other related factors enabling household debt to contribute to rising inequality in the British case.

The answer may lie in how household debt is produced, as British financial institutions are focused on maximising shareholder value. Until the early 1980s British mortgages were largely provided by stakeholder-oriented building societies, but the financial reforms of the 1980s encouraged many building societies to convert to shareholder-oriented banks. These reforms facilitated a significant increase in the mortgage market share captured by profit-oriented shareholder value maximising financial institutions, increasing revenues to be distributed to employees, managers, and shareholders. The production of debt in Britain may be considered highly profitable in comparison to countries dominated by more stakeholder oriented financial institutions, such as Denmark, whose mortgages are largely provided by non-profit co-operatives. This could lead to employee compensation being much lower in such stakeholder-oriented financial sectors, which may influence inequality outcomes.

Asset-based welfare and inequality

The results of this analysis support those from the IMF in suggesting that inequality could be counteracted by government welfare spending. However, there has been little political will to implement such measures in Britain over the past 30 years. As an alternative, the British government has increasingly sought to facilitate access to welfare goods via systems of private debt. For example, debt-leveraged access to private homeownership is an increasingly important financial asset to reduce wealth inequality and support systems of asset-based welfare. Therefore, rather than mitigating inequalities in opportunity, income and assets caused by the withdrawal of the state provision of services, the results of this analysis suggest household debt may actually exacerbate pre-existing inequalities by further increasing incomes for financial sector workers, asset holders, and shareholders at the upper end of the distribution scale.

The results of this analysis show that the expansion of household debt has positive and significant effects across four measures of inequality. Therefore, private debt should be recognised as a key mediating intersection between various income and wealth inequalities, which contributes to the disparate social relations between affluent and less-affluent households in Britain.

Note: the above draws on the author's published work in *The British Journal of Politics and International Relations*.

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