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INSIGHT

Low-Income Households' Financial Debts and Their Policy Implications

Governments need to formulate policies to help families deal with personal debt. Photo credit: KIF

Managing household debt is becoming increasingly difficult for low-income households.

Introduction

Recently, the share of low-income households that have incurred financial debts in the Republic of Korea has been falling. However, for low-income households with financial debts, the debt amount has been growing, driven by loans backed by non-resident properties. Meanwhile, unsecured loans taken out by low-income households have been steadily dwindling, raising concerns over their weakening access to funding and availability of loans. Closer monitoring is required in this regard to formulate effective policies to manage household debts.

Analysis

In the Republic of Korea, a household finance and welfare survey was launched in 2012 as an annual national survey jointly conducted by Statistics Korea, Financial Supervisory Service and the Bank of Korea to investigate households' assets, liabilities, earning and spending. This survey data provides information on households' liabilities?that combines rental deposit and financial debts including collateral-backed loans, unsecured loans, and credit card loans?by five income quintile groups. According to the 2017 survey results, the share of households with financial debts was the highest for the fifth quintile, i.e. the top-20% income households (70.3% as of March 2017), followed by the fourth quintile (70.1%), the third quintile (64.2%), the second quintile (52.8%), and the first quintile (25.0%). Since 2013, these shares have been falling across all income quintiles, and the fall was relatively sharper for the lowest three income quintiles?4.0 percentage points for the lowest, 5.9 percentage points for the second, and 5.1 percentage points for the third?compared to higher income quintiles (3.5 percentage points for the fourth, 2.3 percentage points for the fifth).

The average amount of financial debts held by households was also higher for higher-income households. Specifically, as of March 2017, the amount was 35.98 million won for the first quintile with financial debts, 45.69 million won for the second, 67.73 million won for the third, 89.13 million won for the fourth, and 157.68 million won for the fifth quintile. Note that the average amount has steadily grown across all income groups. The year-on-year growth rate of the average financial debts was 4.8% in March 2013, 6.2% in March 2014, 8.3% in March 2015, 8.3% in March 2016, and 8.4% in March 2017.

The growth of financial debts is largely due to a growth of collateral-backed loans. Since 2012, for all income groups except for the highest income quintile the share of collateral-backed loans in financial debts has sharply increased. The share rose from 61.5% (Mar 2012) to 71.8% (Mar 2017) for the first income quintile; from 73.4% (Mar 2012), to 78.4% (Mar 2016) to 75.3% (Mar 2017) for the second; from 75.9% (Mar 2012) to 80.7% (Mar 2016) to 79.4% (Mar 2017) for the third; from 80.0% (Mar 2012) to 82.6% (Mar 2014) to 81.8% (Mar 2017) for the fourth; the share stayed around 83~4% for the fifth quintile. Notably, the growth of lending to the lowest income quintile has been driven by loans backed by non-resident properties or non-residential real estates, while other income groups' debts have been led by mortgage loans taken out against homes they are living in. Specifically, for the first income quintile, the share of loans taken out against homes where they live inched up by 1.9 percentage points from 40.3% in March 2012 to 42.2% in March 2017, while that of loans taken out against other properties rose by 8.8 percentage points from 10.8% (or 2.54 million won) to 19.6% (or 7.05 million won) over the same period. In comparison, for the second, third, and fourth income quintiles, the share of loans taken out against homes where they live in each rose by 8.3, 4.8, and 3.9 percentage points, while that of loans taken out against other properties declined by 8.0, 0.6, and 2.5 percentage points, respectively.

For financial debts held by the lowest income quintile, the share of unsecured loans in all financial debts has declined, while that has risen for the fourth and fifth income quintiles. As of March 2012, the average amount of unsecured loans held by the first income quintile was 7.01 million won, representing 29.7% of all financial debts; however, in March 2017, the amount dropped to 4.69 million won (13.0%). A similar trend was observed for the second and third income quintiles. For the second income quintile, the same figure fell from 7.23 million won (20.7%) in March 2012 to 6.87 million won (15.0%) in March 2017; for the third income quintile, it fell from 7.37 million won (18.5%) to 6.87 million won (13.4%) over the same period. In comparison, the amount increased and its share in all financial debts fell for the fourth and fifth income quintiles. For the fourth quintile, the average amount of unsecured loans rose from 9.34 million won (16.8%) to 11.70 million won (13.1%), and for the fifth quintile, the same figure increased from 16.56 million won (13.2%) to 20.01 million won (12.7%) over the same period.

Insights

The fact that the share of households with financial debts is falling while the amount of loans backed by non-resident properties is rising suggests that the share of households that own properties other than for the purpose of actual living might be higher than expected among low-income households. Thus, it is necessary to monitor the uses of loans of low-income households closely in consideration of low-income households' demographic characteristics. Furthermore, policies on household debts management should be formulated based on this analysis.

Resources

Korea Institute of Finance website

Summary: *Six Lessons to Learn from Asia's World-Class Universities*

Case Study: *An Eco-friendly Approach to Waste Management*

Case Study: *Sustainable Water Management for Smart Cities*

Insight: *How East Asia Can Reduce Climate Change Impact*

Explainer: *Get On My Cloud - Explaining the MathCloud System of Learning*

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Explainer: *Using Television to Improve Education Systems*

Case Study: *Revitalizing a City by Reviving a Stream*

Soo Jin Lee

Research Fellow, Consumer Finance Division, Korea Institute of Finance

Soo Jin Lee received her master's degree in Philosophy and PhD in Economics from the Columbia University. She started working at the Korea Institute of Finance as a research fellow in 2012. She has taught at the Yonsei University in Seoul, Republic of Korea.

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