

# A debt effect?

How is unmanageable debt related to other problems in people's lives?



**citizens  
advice**

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# Summary

In the years after the financial crisis, levels of unsecured personal debt in the UK fell from a historical peak of 23% of disposable income in 2008 to its current level of around 15%.<sup>1</sup> That trend has now started to reverse. Unsecured debt is now growing faster than incomes and faster than secured debt, and the Office of Budget Responsibility (OBR) has forecast the level of unsecured debt to return to pre-crisis levels by the end of the decade.<sup>2</sup>

Within wider concerns about the possible impact of a return to such high levels of debt on the economy, there is an ongoing challenge faced by the individuals and families who have unmanageable debt, of managing their financial situation.

## Unmanageable debt is unevenly distributed

Five per cent of adults in the UK have unsecured debt equivalent to six months or more of their income, when you take into account their financial assets such as their savings, which is commonly used as an indicator of unmanageable debt. When looking at different groups in society however, the proportions of people with unmanageable debt are far higher. For example:

- Those in the **lowest income** group are three and a half times more likely than the highest earning fifth of the population to have debt worth more than six months of their income (7% compared to 2%)
- **20-29 year olds** are twice as likely than 30-39 year olds to have debts worth more than six months of their income. (14% compared to 7%)
- **Private renters** are nearly twice as likely as those with a mortgage, and five times as likely as those who own outright, to have debts worth six months of their income. (10%, 6%, 2% respectively)

## The impact of unmanageable debt

Those high levels of debt are a concern, not just due to the financial strain they can cause - households can end up paying back far more than they borrowed and their repayments can mean they don't have sufficient income - but because unmanageable debt is closely related to wider problems in people's lives. Unmanageable debt has been shown to be related to financial exclusion, family breakdown and poor physical and mental health.

In this research we use data from the latest wave of the Understanding Society survey to investigate the statistical evidence for the relationship between high levels of debt and a range of wider issues; unemployment, low pay, physical health problems and poor mental health, that our advisers see on a daily basis.<sup>3</sup> We find strong evidence of the close link between unmanageable debt and poor mental health.

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<sup>1</sup> Citizens Advice, (2016) [Unsecured and Insecure](#)

<sup>2</sup> OBR, (2016) [Economic and Fiscal Outlook](#)

<sup>3</sup> For a full methodology, see Appendix 2

## **Debt and mental health**

Looking at the relationship between unmanageable debt and mental health more closely, we found people with unmanageable debt are 24% more likely to have a mental health score in the bottom quarter of the population.<sup>4</sup>

When looking at the relationship from a different angle, comparing the population as a whole with people with below average mental health scores, they are:

- Over a fifth more likely to have debts
- Twice as likely to be behind on a household bill
- Nearly two thirds more likely to be behind on their council tax

The close relationship between unmanageable debt and poor mental health is the result of ‘two-way’ causation. Debt both contributes to, and is a product of, poor mental health.

## **Our experience of giving advice**

Those findings chime with our own experience of giving debt advice to over 350,000 people a year. More than half (54%) of our debt clients have a problem in at least one other area, such as with their employment or housing, and nearly three quarters of debt clients say they felt anxious or stressed because of their debts.

## **The impact on behaviour**

A further impact, and a possible explanation for why unmanageable debt can lead to wider problems in people’s lives, is that debt can affect people’s behaviour. This research uses national polling data to show that people with unmanageable debt are more likely to say their debt stops them from taking major life decisions. For instance:

- 49% say they are less likely to start a business (compared to 33% generally)
- 41% say it makes them less likely to study or retrain (compared to 27% generally)
- 34% say it makes them less likely to move location (compared to 25% generally)
- 28% say it makes them less likely to change jobs (compared to 19% generally)

## **More preventative advice**

Unmanageable debt can affect people’s welfare, particularly their mental health, and influence their attitudes and how they make decisions. Advice services can help mitigate that effect by helping people to avoid getting into problem debt in the first place.

Money guidance should be offered to people at key moments in their lives in order to:

- Help people adjust to major changes in their lives
- Prompt people to review their financial situation, sort out any problems before they get become unmanageable, and to save for the future
- Encourage people, who are already struggling to manage their debt, to get help and so limit its wider effects

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<sup>4</sup> Mental health scores are assigned to survey participants based on answers to a number of questions in the Understanding Society survey. The method of scoring is commonly used by health researchers. See Appendix 3 for a full methodology. 21% of those with high debt have poor mental health compared to 17% of those who don't.

# Introduction

Between 2008 and 2015 the amount of personal debt in the UK, as a percentage of disposable income, fell from a peak of nearly 170 percent to less than 150 per cent. That picture is now set to reverse with the OBR forecasting the debt to income ratio to increase over the next five years, potentially outstripping its pre-crisis high by the end of the decade.<sup>5</sup> In response to that forecast there has been renewed concern around the level of private debt in the UK and its potential impact on the economy. That attention has generally focussed on secured or mortgage debt - of over £1.4 trillion of private debt in the UK £1.2 trillion is secured on people's houses.

Less attention has been given to levels of unsecured debt, made up of credit card borrowing, personal loans, and overdrafts. As with secured debt, levels of unsecured debt as a proportion of disposable income fell after 2008, from a pre-crisis peak of 23 per cent to a low of around 14 per cent. The average unsecured debt held by people with debt, fell from £3,500 in 2010-12 to £3,400 by 2012-14 and fewer households have any unsecured debt.<sup>6</sup>

That trend has now started to reverse and unsecured debt is growing faster than both incomes and secured debt.<sup>7</sup> Beyond those wider trends and economic concerns around the potential impact of high levels of debt on the economy however, there is an ongoing story of the problems that unmanageable debt causes individuals and families.

Having debt is not necessarily a bad thing. Borrowing allows people to smooth their incomes over time - to borrow when their income is low relative to their needs - and so is crucial to people's financial wellbeing. Borrowing can also play an important role in allowing households to make investments, purchase high value items and spread the costs of special occasions over time.

However debt also places financial pressures on households. Repayment means that indebted households forego current and future consumption.<sup>8</sup> Households can end up paying back substantially more than they borrowed and those struggling to make ends meet can end up in a 'debt-spiral' where households borrow more to service existing debts.<sup>9</sup> Debt can create a type of 'hidden poverty', where debt repayments leave a household with insufficient income.

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<sup>5</sup> OBR, (2016) [Economic and Fiscal Outlook](#)

<sup>6</sup> ONS, (2016) [Wealth and Assets Survey](#), Wave 4

<sup>7</sup> Bank of England, (2016) [Statistical Release: Money and Credit](#)

<sup>8</sup> BIS (2013) [Credit, Debt and Financial Difficulty in Britain](#), showed that around 30% of households with annual income less than £13,500 who had borrowed money, reported spending 30% of their income servicing debts (BIS, 2013).

<sup>9</sup> FCA, (2014) [Consumer credit and consumers in vulnerable circumstances](#)

Beyond those immediate financial pressures there is growing evidence that unmanageable debt can have a wider effect on people's lives. Debt is closely related to financial exclusion and has been shown to be associated with issues such as family breakdown, lower labour market participation and health issues.<sup>10</sup>

Those findings chime with our own experience of helping over 350,000 people each year with debt issues and align with wider research on the impact of personal finances on people's wider well-being. Previous research has shown, for instance, that holding assets at a young age has a positive impact on later life outcomes, independent of other crucial characteristics.<sup>11</sup> If assets play a positive role in people's lives there is good reason to believe that debts play a negative one.

In this research we bring together a number of pieces of analysis to investigate the statistical evidence for the relationship between unmanageable debt and wider problems in people's lives, seen by our advisers on a daily basis.

In **Chapter 1** we look at the number of people with unmanageable debt using a range of measures and show that the burden of unmanageable debt is unevenly distributed.

In **Chapter 2**, we look at how that problem debt is related to a range of negative characteristics in people's lives. How it is related to being unemployed, being in low pay, and the chances of experiencing poor physical or mental health. One challenge that emerges from the research is the difficulty of quantifying the extent to which unmanageable debt is a *cause* of those wider problems.

Building on those findings, in **Chapter 3** we look more closely at the relationship between unmanageable debt and poor mental health, which is the most consistent finding from research into the wider effects of debt on people's lives. We look at how different types of debt, in particular problems paying household bills, are related to poor mental health.

Finally, in **Chapter 4**, we recommend that the new money guidance body, which will direct more funding to frontline services, should focus its funding on more preventative money guidance, targeted at people at key life moments to help them make the most of their resources and avoid financial difficulties.<sup>12</sup>

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<sup>10</sup> House of Lords, (2014) The Impact of Personal Indebtedness in United Kingdom Households, Especially on Children

<sup>11</sup> McKnight, (2011) [Estimates of the asset-effect: the search for a causal effect of assets on adult health and employment outcomes](#).

<sup>12</sup> The Government has [announced](#) that it will create a new public financial guidance body, which will come into effect in April 2018 and has consulted on the role and duties of that body. The new delivery model will replace the Money Advice Service, and merge the functions of TPAS and Pension Wise.

# 1. Who has unmanageable debt?

Within wider discussions about the potential impact of rising levels of personal debt on the economy, there is an ongoing challenge for the individuals and families who hold that debt. The number of people estimated to have unmanageable levels of debt depends on how it is defined and measured.<sup>13</sup> Definitions of what constitutes unmanageable debt vary from the impact of repayments on living standards to households that regularly miss or are behind on payments, as well as subjective definitions such as finding debt a burden.<sup>14</sup>

Despite that variation, studies of problem debt have converged around a common set of indicators used to measure problem debt.<sup>15</sup> The most widely used are:

- A high debt to income ratio
- A high debt repayment, or servicing cost, to income ratio
- Persistent debt or household bill arrears
- Debt which is reported as burdensome

For each of those measures there are further questions around what level of debt indicates it may be problematic. Is debt unmanageable when it is equal to three months household income, or six? Are debt repayments problematic when they amount to a quarter of a household's income or half of it? How long does a household need to be in arrears for, and by how much, to have unmanageable debt?

Those measures, as would be expected, produce differing results as to the number of people in problem debt. A useful snapshot was provided in 2010, which found that:<sup>16</sup>

- 15 per cent of all households had credit commitments of more than 40% of their income
- 9 per cent of households made debt repayments of more than 25 per cent of their income, 8 per cent made payments of over 50 per cent
- 4 per cent of households were behind with at least one unsecured credit commitment by two months or more
- 14 per cent of households said their debts were a heavy burden, 6 per cent said their unsecured debts were

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<sup>13</sup> The lack of a common definition for what constitutes problem debt is regularly highlighted in research. See for instance, Bryan, Taylor and Veliziotis, (2010) [Overindebtedness in Great Britain](#)

<sup>14</sup> The European Commission, (2008) [Towards a common operational European definition of over-indebtedness](#)

<sup>15</sup> Alesso and Iezzi, (2013) [Household Over-Indebtedness Definition and Measurement with Italian Data](#)

<sup>16</sup> Bryan, Taylor and Veliziotis, (2010) [Overindebtedness in Great Britain](#)

It is not the purpose of this research to update that picture, but instead to look at how unmanageable debt is related to negative outcomes in other areas of people's lives. In order to do so, we have used data which allows us not only to investigate how heavily indebted people are but to analyse how that debt is related to other circumstances and challenges in people's lives. For that reason, this research only provides high level estimates of the extent of unmanageable debt.

In order to focus on how debt relates to the wider problems in people's lives we use data from the Understanding Society survey. This provides both periodic detailed information on people's financial situations, and information on their wider circumstances. We analysed that data to look at people's level of unsecured debt, looking at both gross and net debt. The gross debt measure is made up of a range of questions on the types of debt people hold - it excludes student loans - and for the net debt figure, the value of financial assets, such as savings or a current account balance, is taken away from the gross figure. (For a complete methodology please see Appendix 1)

These figures are then used to compute the debt to income ratio for:

- Individuals whose total per capita **net and gross** debt holdings were equal to at least **three months** of their income
- Individuals whose total per capita **net and gross** debt holdings were equal to at least **six months** of their income

Holding debt equivalent to three or six months worth of your income are indicators that a person may be over indebted or be struggling to manage that debt. It by no means captures all the people who are struggling financially, many of whom do not have high levels of unsecured debt. People behind on their bills for instance, may hold no unsecured debts at all - 43 per cent of Citizens Advice debt clients last year were behind on a household bill whereas less than a third were struggling with unsecured debts. Similarly, those with three or six months income worth of debt will not always be struggling to manage that debt.

We look at both the population as a whole and for just those people who hold debts. The survey found that a total of 30 per cent of people held some unsecured debt in 2012/13.<sup>17</sup>

In total, 12 per cent of households have debts equivalent to three or more months income and seven per cent have debts equivalent to six months income or more. When looking at 'net' debt which takes into account the financial assets people have; money in bank accounts, savings accounts, and stocks and shares for instance, and take that away from their overall level of debt, these figures are nine and five per cent respectively.

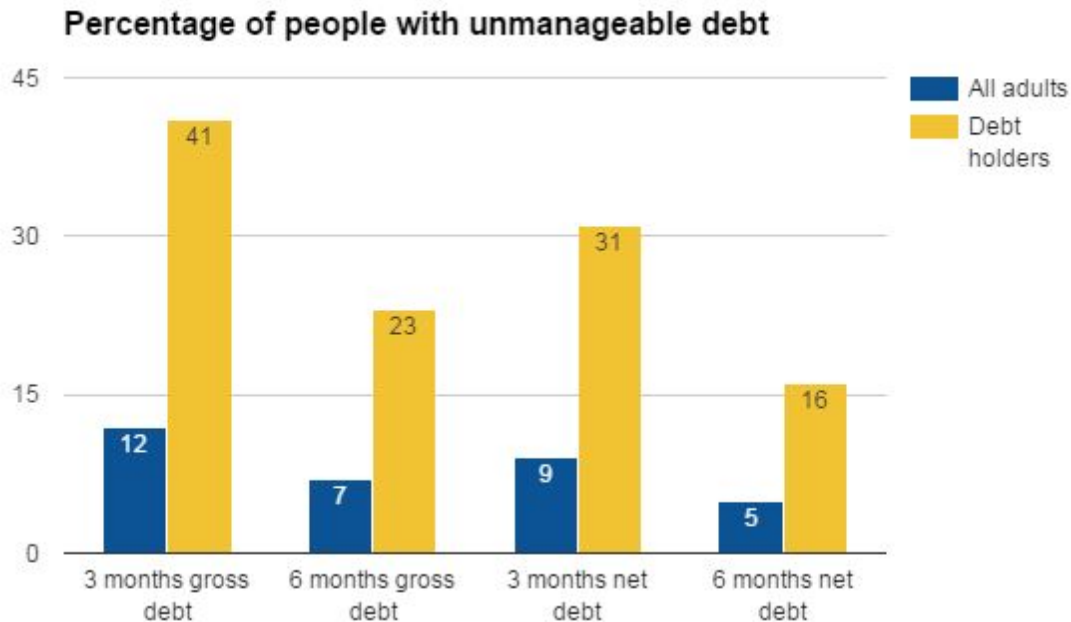
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<sup>17</sup> The most recent [Wealth and Assets Survey](#) (Wave 4) found that 46 per cent of households had some form of unsecured debt.



As shown by Figure 1, those figures are considerably higher if we look just at the people that hold unsecured debt. Twenty three per cent of that group have debts equivalent to six months of their income, 16 per cent do when taking their assets into account.

**Figure 1: The level of unmanageable debt in the UK**



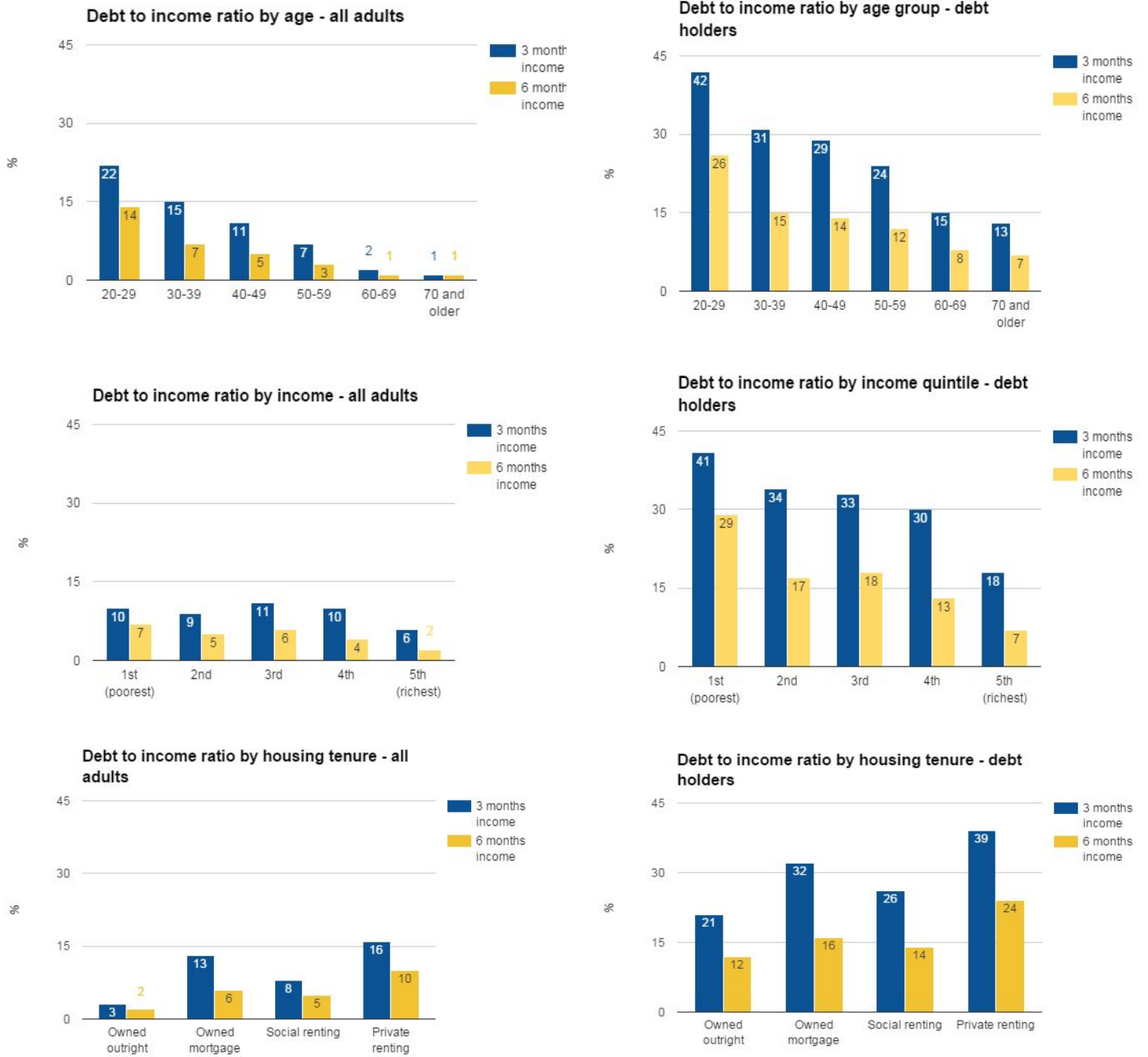
**Source: Understanding Society Policy Unit, Institute for Social and Economic Research**

As discussed above, those figures do not reflect the total number of people with unmanageable debt. What they do provide is an objective measure of the number of people who are likely to have difficulty managing their debts, which can then be used to analyse the relationship with other features of people's lives.

When we break the data down further by income, age and housing tenure, it is clear that the likelihood of having unmanageable debt varies considerably between groups. Figure 2 highlights the proportion of people in each group with a *net* debt to income ratio of three and six months, for both all adults and those with debts. Taking the most severe measure of unmanageable debt - a net debt to income ratio of six months or more:

- Those in the **lowest income** group are three and a half times more likely than the highest earning fifth of the population to have debt worth more than six months of their income (7% compared to 2%)
- **20-29 year olds** are twice as likely than 30-39 year olds to have debts worth more than six months of their income. (14% compared to 7%)
- **Private renters** are nearly twice as likely as those with a mortgage, and five times as likely as those who own outright, to have debts worth six months of their income. (10%, 6%, 2% respectively)

**Figure 2: Net debt to income ratio by income, age and housing tenure**



Source: Understanding Society Policy Unit, Institute for Social and Economic Research

## 2. Debt and wider issues

Holding unmanageable debt not only imposes a financial burden on people and families, but is closely related to problems in other areas of their lives. One of the reasons unmanageable debt is so difficult to define is that the concept is commonly extended to include not only debt that causes financial constraints but also to mean debt which is associated with those problems. In that sense, defining problem debt can become circular - debt becomes problem debt when it leads to wider problems.

The research highlighting those relationships is now well developed. Previous studies have found:

- A strong and consistent link between high levels of personal debt and **lower standards of living**.<sup>18</sup> For example, high debt has been shown to lead to reduced spending on food and other household essentials.<sup>19</sup>
- Highly indebted individuals can be **financially excluded** and struggle to access mainstream credit products pushing people into a cycle of ever more expensive borrowing over time, such as using 'payday loan' products.<sup>20</sup>
- Debt can have a harmful effect on personal relationships and contribute to **family breakdown**.<sup>21</sup> More than half of respondents to a survey run by the Money Advice Service indicated that personal debt had had a negative impact on their family life.<sup>22</sup>
- High levels of indebtedness can be viewed by unemployed people as a **disincentive to find work**, with any additional earnings eaten up by interest repayments rather than resulting in higher disposable income.<sup>23</sup>
- There is strong evidence of an association between personal debt and **mental and physical health problems**. Crucially, these links have been shown to be independent of the effects of poverty.<sup>24</sup>

That research is an important foundation for building our understanding of the way debt affects people's lives, but has two main limitations. First, it tends to rely on qualitative data so does not identify the extent to which unmanageable debt affects people, as separate from the wider challenges they face.<sup>25</sup> Secondly, where the research is based on quantitative data it tends to focus on a single outcome - for instance there is a rich literature around the relationship between problem debt and mental health, but

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<sup>18</sup> Dearden, Goode, Whitfield and Cox, (2010) Credit and debt in low-income families

<sup>19</sup> Stepchange and the Children's Society, (2014) Exposing the impact of problem debt on children

<sup>20</sup> Kempson, Whyley, Caskey and Collard, (2000) In or out? Financial exclusion: a literature and research review

<sup>21</sup> Pleasence, Buck, Balmer and Williams, (2005) A Helping Hand: The Impact of Debt Advice on People's Lives

<sup>22</sup> Money Advice Service, (2013) Indebted Lives

<sup>23</sup> Hartfree and Collard, (2014) Poverty, debt and credit: An expert-led review

<sup>24</sup> Lea, Behaviour Change: Personal Debt

<sup>25</sup> Salter, (2014) The Borrowers

those findings are often not compared directly to the range of issues associated with having unmanageable debts.<sup>26</sup>

## i. The impact of debt

In order to build on that research we commissioned the Understanding Society Policy Unit at the Institute for Social and Economic Research (Policy Unit) to conduct new analysis of the Understanding Society survey. Using the most recent data, the Policy Unit looked at the relationship between high levels of personal debt and a range of characteristics. Looking at individuals with gross and net debt of equal to three and six months or more of their income, the research estimates the relationship between high levels of debt and four social characteristics, or outcomes.

The analysis controlled for age, marital status, housing tenure, sex, equivalised household net income, self-reported health (for health outcomes) and region. (A full description of the methodology can be found in Appendix 2)

The analysis found that there was a statistically significant positive relationship between high levels of personal debt and poor mental health, no statistically significant relationship between debt and low pay or poor physical health and a negative relationship between unmanageable debt and unemployment. The strength of each relationship is outlined below:<sup>27</sup>

**Figure 3 - People with unmanageable debt are:**

24% more likely to have poor mental health	No more or less likely to be in low pay	No more or less likely to be in poor physical health	20% less likely to be unemployed
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### ● Poor mental health

Understanding Society contains a measure of mental health which converts answers from a range of questions into a single mental functioning score resulting in a continuous scale. We define poor mental health as individuals in the bottom 25% of the distribution of survey participants.<sup>28</sup>

<sup>26</sup> Fitch, Hamilton, Basset and Davey, (2011) The relationship between personal debt and mental health: a systematic review

<sup>27</sup> As the relationships were broadly similar, and for simplicity, the strength of the relationships are only reported in terms of high levels of gross debt

<sup>28</sup> Mental health scores are assigned to survey participants based on answers to a number of questions in the Understanding Society survey. The method of scoring is commonly used by health researchers. See Appendix 3 for a full methodology.

Having a gross unsecured debt to income ratio of three months or more has a positive and statistically significant effect on the probability of self-reporting poor mental health. Those with gross unsecured debt equal to at least three months of their income are 24 per cent more likely to report poor mental health than those with a lower debt to income ratio. The outcomes for those with a debt to income ratio of more than six months were broadly similar.

- **Low pay**

We define low pay as earning less than two-thirds of the gross median hourly wage.<sup>29</sup> That group is then compared to all individuals who earn above the low pay threshold.

Having a gross unsecured debt to income ratio of six months or more has no statistically significant effect on the probability of being in low pay employment.

- **Poor physical health**

Understanding Society contains a measure of physical health which converts answers from number of questions into a single physical functioning score resulting in a continuous scale. We define poor physical health as individuals in the bottom 25% of the distribution.

Having a gross unsecured debt to income ratio of three months or more has no statistically significant effect on the probability of being in poor physical health.

- **Unemployment**

Having a gross unsecured debt to income ratio of three months or more has a negative and statistically significant effect (at the 1 percent level) on the probability of self-reporting being unemployed. Those with gross unsecured debt equal to at least three months of their income are 20 per cent less likely to be unemployed.

Broadly, the analysis confirms findings from the growing literature that confirms the association between problem debt and having poor mental health. We will consider this relationship in more detail in the following section.

Three aspects of the analysis stand out as limiting our ability to identify how debt affects people's lives more broadly using the quantitative data available in Understanding Society:

- There is a statistical challenge of isolating problem debt using a straightforward, non-subjective indicator, such as a high debt to income ratio. As the 'negative'

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<sup>29</sup> This definition follows that used by the International Labour Organisation.

relationship with unemployment highlights, the use of debt is conditional on individual circumstances such as being in employment and, as highlighted above, for many people taking on debt has a positive impact on their lives.

- The associations are not evidence of causal relationships between high levels of debt and any of the characteristics analysed - unmanageable debt both contributes to and is a product of wider negative characteristics.
- The findings do not explain *why* the relationships between high debt and the characteristics analysed exist.

### Measuring the debt effect over time

One major limitation of much of the research around the impact of debt on people's lives, is that it does not examine the extent to which debt is a *cause* of those issues.

This stands in contrast to the research around the impact of holding assets, which has found strong evidence of an 'asset-effect' where by holding assets has an independent positive effect on later life outcomes.<sup>30</sup>

Where studies have analysed the sequence of debt and outcomes using a longitudinal approach, they tend to do so in conjunction with the impact of wealth more generally<sup>31</sup> or focus on one type of outcome, for instance mental health or educational attainment.<sup>32</sup>

Further work needs to be done to understand the causal relationship between high levels of debt and other issues in people's lives and each relationship will evidently have its own explanation and complications. For instance, the results from our research show that the relationship between unmanageable debt and unemployment is affected by how likely unemployed people are to access credit.

## ii. Our experience of giving advice

Despite the statistical difficulties in assessing the precise impact of high levels of debt on people's lives, The wider research that shows debt is closely linked to a range of issues chimes with our own experience of delivering debt advice to over 350,000 people each year.

We know that debt is closely linked to a wide range of problems in people's lives. Data collected by advisers each time they give advice shows that 54 per cent of the debt

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<sup>30</sup> McKnight, (2011) [Estimates of the asset-effect: the search for a causal effect of assets on adult health and employment outcomes](#).

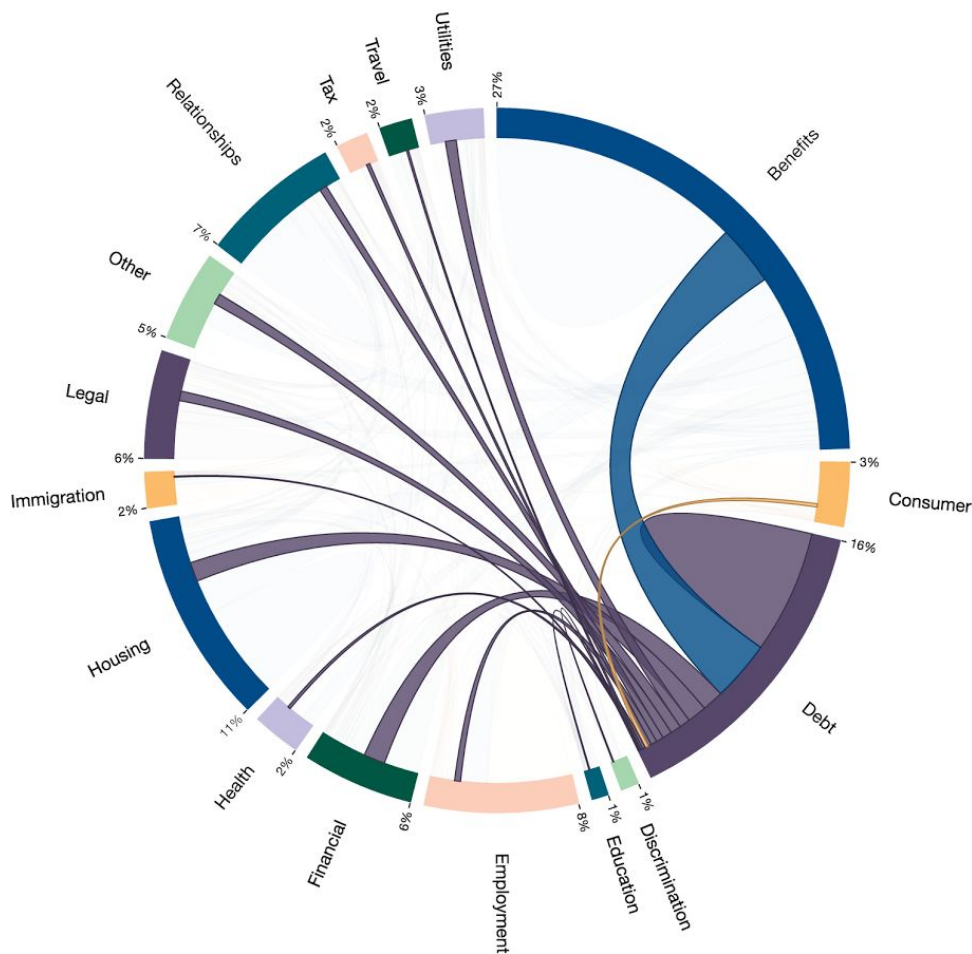
<sup>31</sup> Karagiannaki, E., (2012) [The effect of parental wealth on children's outcomes in early adulthood](#)

<sup>32</sup> Zhan, M. and Lanesskog, (2013) [The Impact of Family Assets and Debt on College Graduation](#)

clients we see also seek help with at least one other non-debt issue. Debt clients are more likely than clients with other problems to need advice in another area of their lives. The equivalent figure for housing, benefits, relationships and employment are 47, 47, 44, and 37 per cent respectively. We see a similar pattern among clients who originally approached us about an issue other than debt. Twenty per cent of clients who got advice on a serious, non-debt related issue turned out to need help with at least one debt problem.<sup>33</sup>

Figure 4 illustrates how debt is related to those other issues. Thicker lines represent closer links between issues. As can be seen, problems with the administration of benefits commonly co-occur with debt problems. This is likely to reflect not only the well-established links between unmanageable debt and low incomes but also the impact of unexpected hits to income, for example from a disputed benefit claim or mistaken calculation.

**Figure 4 - The relationship between debt and issues in other areas of people’s life**



Source: Citizens Advice

<sup>33</sup> This data relates to clients that receive in-depth support from a caseworker because their problem is particularly severe or complex. This constitutes around 35 per cent of clients seen by local Citizens Advice.

Our case notes highlight how debt issues are linked to those wider problems. For instance, debt can act as a cause of, or exacerbate, the wider problems people face;

One client, who lived with his partner in private rented accommodation, got into rent arrears of £1,500 and was taken to court where a possession order was made. The client managed to reduce the arrears and the landlord agreed, verbally, that they would not enforce the order. The property was in a bad state of disrepair and the client had asked the landlord to complete repairs on the property but they had refused. The client is now concerned that if they continue to ask the landlord to make the necessary repairs to the property they will enforce the possession order and evict them from the property.

Debt is also caused by those wider issues in people's lives, for instance, when people with unpredictable and insecure income can be pushed into taking on debt in order to make ends meet.

In particular, the finding of this research that unmanageable debt is closely related to poor mental health reflects our delivery of debt advice. Nearly three quarters of Citizens Advice debt clients, for instance, reported they felt stressed or anxious because of their debt. Unmanageable debt increases anxiety and stress, disrupts sleep and can have a negative influence on general well-being.

### **iii. The impact of debt on people's behaviour**

The relationships identified do not establish the extent to which debt is a cause or a consequence of the wider challenges people face. Unmanageable debt is both caused by and can cause issues such as being stuck in low pay or poor mental health.

One of the ways debt can lead to worse outcomes is through affecting people's attitudes and how they make decisions. That can be direct, by constraining their ability to make those decisions, for instance being able to pay a deposit to a new landlord. As well as indirect, for example people with unmanageable debt can find it difficult to make important decisions about both their debt and other aspects of their lives, or make poor decisions they might otherwise not have taken.<sup>34</sup> People with unmanageable debt, for instance, are more likely to take a short term approach to managing their debts, paying back smaller, less expensive loans before cheaper larger ones.<sup>35</sup>

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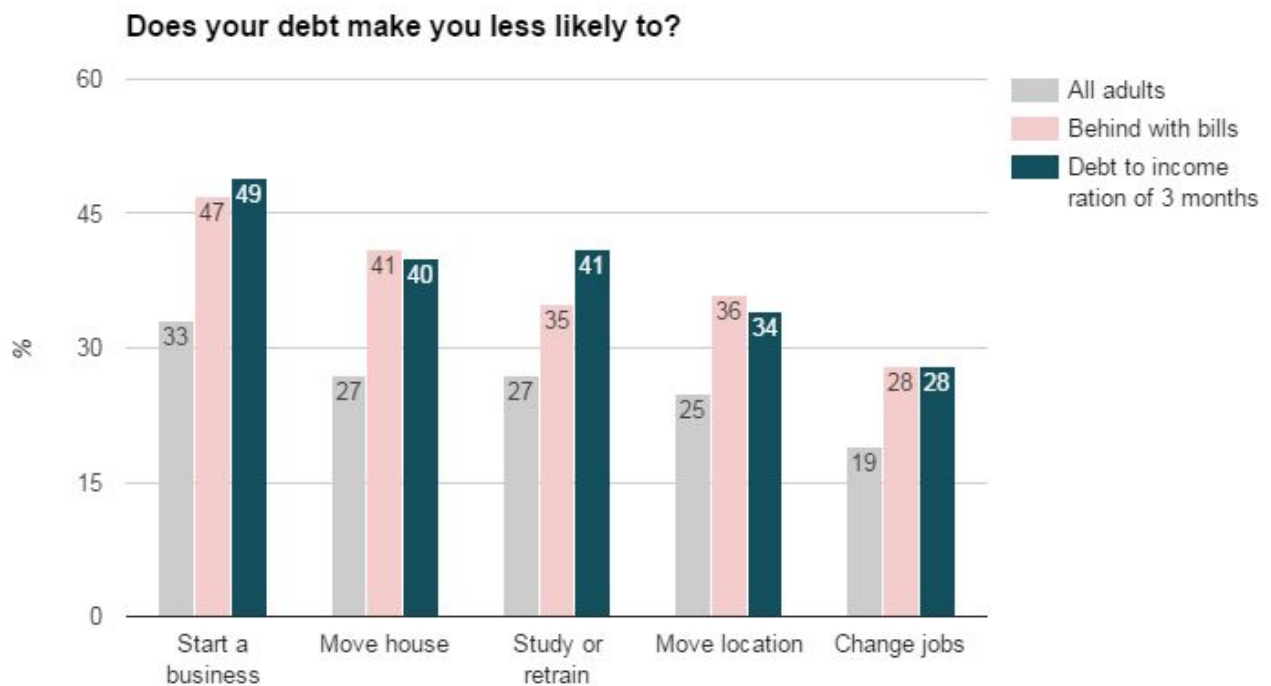
<sup>34</sup> Mani, Mullainathan, Shafir and Zhao, (2013) Poverty impedes cognitive function;

<sup>35</sup> Amar, Ariely, Ayal, Cryder and Rick, (2011) Winning the Battle but Losing the War: The Psychology of Debt Management



The impact of unmanageable debt on people’s behaviour is shown in new polling conducted for Citizens Advice by YouGov. The results are illustrated in Figure 5.<sup>36</sup>

**Figure 5 - The impact of debt on people’s decision making**



**Source: Citizens Advice analysis of YouGov Debt Tracker (sample size = 2109)**

The poll found that people felt significantly restricted by their debt. For instance, a third of people said they were less likely to start a business and 19 per cent of people said they were less likely to change jobs as a result of their debt.

Strikingly, when we look at people with unmanageable debt, those figures are far higher. Looking at people with a debt to income ratio of three months income or more, they are far more likely to say their debt would stop them making key life decisions when compared to the general population:

- 49% say they are less likely to start a business (compared to 33% generally)
- 40% say they are less likely to move house (compared to 27% generally)
- 41% say they are less likely to study or retrain (compared to 27% generally)
- 34% say they are less likely to move location (compared to 25% generally)
- 28% say they are less likely to change jobs (compared to 19% generally)

The fact that people with high levels of debt are more likely to feel restricted in their choices is unsurprising. That feeling will to some degree reflect the real financial

<sup>36</sup> The sample size for the poll was 2,109 adults. Fieldwork was undertaken between 27th and 30th November 2015. The survey was carried out online. The figures have been weighted and are representative of all UK adults (aged 18+).

constraints on people in debt. However, in conjunction with the wider literature on the impact of debt on people's decision making process, the extent to which people feel their debt restricts their choices is a potentially important piece of the puzzle when explaining why debt can have a wider impact on people's lives.

One feature that stands out both from our experience at Citizens Advice and the evidence showing people's debt restricts their choices is the impact of high levels of debt on people's mental health.

In the next section, we build on the finding identified in this chapter that unmanageable debt is closely related to poor mental health outcomes. The close relationship between problem debt and poor mental health is the most consistent finding from research into the wider effects of debt on people's lives. For the first time, we will look at how being behind on bills, both utility arrears and council tax arrears, are related to poor mental health outcomes.

# 3. The impact of debt on mental health

Our research found that people with unmanageable debt are 24 per cent more likely to experience poor mental health.<sup>37</sup> That finding resonates both with wider literature and our own research with people who seek help with their debt.

In order to build on the existing evidence we conducted further analysis of the Understanding Society survey to look more closely at the relationship between problem debt and the likelihood of experiencing poor mental health outcomes.<sup>38</sup> Again the research controlled for age, marital status, housing tenure, sex, equivalised household income, self-reported health (for health outcomes) and government region.

To better understand the relationship between poor mental health and unmanageable debt, we looked at the relationship from a different angle, comparing people with a below median mental health score with the those above the median.<sup>39</sup> (A more detailed methodology can be found in Appendix 3)

A number of findings stood out. Those with a mental health score below the median are:

- 23 per cent more likely to hold unsecured debt (32% compared to 26%)
- 29 per cent more likely to have a net debt to income ratio of six months or more (18% compared to 14%)

The final figure is significant, having a net debt to income ratio of six months or more is a clear indicator of unmanageable debt. The figure takes into account any assets such as savings. Someone with high total debt, but who has assets as well, is more likely to be in a position to manage their debt payments over time.

A further finding that stood out from that analysis was the close relationship between poor mental health and being behind on household bills or being in arrears. People with poor mental health scores are:

- More than twice as likely to be behind with some or all of their bills (6% compared to 3%)
- Nearly two thirds more likely likely to have been behind with their council tax in the last 12 months (8% compared to 5%)

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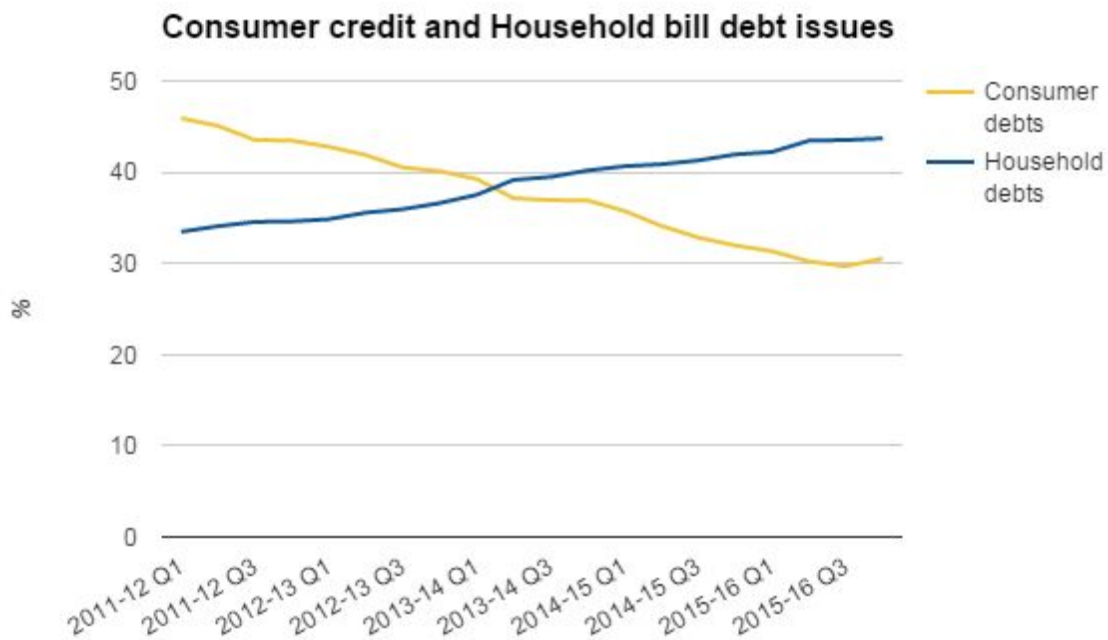
<sup>37</sup> Debt worth more than three months of their income.

<sup>38</sup> The research was conducted by the Policy Unit using the same methodology identified above (see Appendix 1).

<sup>39</sup> Below median mental health score is widely used by health researchers to test for relationships with poor mental health when a number of questions are combined to produce an overall score.

That is particularly concerning due to the recent trend in debt issues seen by Citizens Advice. Problems paying household bills now make up over 40 per cent of the debt issues we see, more than the number caused by problems with consumer credit debts. As shown by Figure 6, that is the result of recent changes in the types of debt issues seen by advisers.

**Figure 6: Proportion of Citizens Advice debt issues**



**Source: Citizens Advice**

There are two possible reasons for the striking relationship between poor mental health and being behind on household bills. Firstly, being behind on bills has a direct effect on people’s living standards and is more likely to lead to aggressive forms of debt collection. Secondly, that relationship may be a product of the challenge of managing bill payments and the inability of systems to facilitate customers with poor mental health.

As with earlier findings, it is not possible to determine the direction of causation; debt can both cause anxiety, stress and poor mental health, for instance:

One client came for advice about council tax arrears and a parking fine debt she could not pay. She was just about managing to pay her council tax arrears in installments but had been told by the bailiffs that were enforcing her parking fine debt that they could not accept that payment in instalments. The bailiffs sent her a letter saying if she didn’t pay the amount in full they would return and enter her

property in her absence. The client was extremely anxious by the time she came for advice.

As well as be a product of those issues, for example:

A client came for advice about debts her husband had taken on following a bereavement. Following the bereavement he had gone through serious depression and poor mental health and spent heavily as a result. The client had not been able to access support for her husband causing the relationship to breakdown. The client was worried that the family home would now be at risk and she would lose everything.

The advice sector, through money guidance and general advice has a crucial role to play both in helping people manage and get out of problem debt as well as avoid getting into debt as a result of wider challenges in their lives. In the final section, we outline how advice services can help mitigate the impact of unmanageable debt on people's lives by helping people to avoid, manage and escape debt problems.

# 4. Conclusion

Unmanageable debt contributes to, and is a product of, wider challenges in people's lives. While it is by no means a complete solution to a complex problem, the advice sector can help mitigate the wider effects of debt on people's lives by helping people to manage their money and avoid financial difficulties in the first place.

Currently however, not enough people get the help they need. In earlier research we found that too many people wait until they are in extreme financial difficulty before they seek help and that people are not offered help at key moments in their lives, when they need it most. We found, for instance, that up to 23 million people were not offered advice at key moments in their lives when they may have taken it.<sup>40</sup>

One way the advice sector can encourage more people to get help with their money is by providing more preventative money guidance - stepping in at key life stages to help people respond to those changes and avoid financial difficulties and make the most of their resources.

As a result of their review of the funding of public financial guidance, the government has announced that a new body will be created which will replace the Money Advice Service and merge the functions of TPAS and Pension Wise.<sup>41</sup> The new body should focus on funding money guidance which proactively targets both people who need help responding to unexpected events as well as those going through major changes in their lives such as having a child, moving house or starting a new job.

Offering people help with their money at those key moments would:

- Help people avoid getting into financial difficulties as a result of major changes in their lives
- Prompt people to review their financial situation, sort out any problems before they get become unmanageable, and to save for the future
- Encourage people, who are already struggling to manage their debt, to get help and so limit its wider effects

The decision to direct more money to front line money guidance is the right one. That increase in resources should be used to target guidance at people during key life moments in order to encourage more people to get the help they need and to help people maximise their financial resources and plan for the future.

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<sup>40</sup> Citizens Advice, (2016) [The preventative advice gap](#)

<sup>41</sup> HM Treasury, (2016) [Public financial guidance review: proposal for consultation](#)

# Appendices

## Appendix 1 - Methodology - Debt to income ratios

The analysis uses data from wave 4 of Understanding Society. Understanding Society is a representative longitudinal survey of the members of approximately 40,000 households (at Wave 1, 2009/2010) in the United Kingdom.

The overall purpose of Understanding Society is to provide high quality longitudinal data about subjects such as health, work, education, income, family, and social life to help understand the long term effects of social and economic change, as well as policy interventions designed to impact upon the general well-being of the UK population.

Understanding Society collects data (at particular waves) on assets and debt held individually or jointly by individuals in the household, or held jointly with an individual outside the household. It also provides users with net household income. We modify this to account for household composition (using the OECD equivalence scale). Finally we adjust this to account for inflation. Therefore the net income estimates we use in this analysis are real equivalised net household income.

The sample consisted of all individuals in wave 4 of the survey (2012/2013) for whom we had the necessary information to compute estimates of debt to income ratios. We modeled the correlation between gross and net debt and the outcomes using wave 4 of Understanding Society. The sample sizes used for these regression models varied between 38,000 and 47,000 individuals.

The two definitions of debt used are:

- Gross debt= sum of all debt components
- Net debt= (sum of all debt components)-(sum of all non-residential assets)

These two definitions are then used to compute to the debt to income ratio which is recorded at two levels

- Individuals whose total per capita **net/gross** debt holdings were equal to at least three months of their income
- Individuals whose total per capita **net/gross** debt holdings were equal to at least six months of their income

The full list of debts and assets is available on request.

## Appendix 2: Methodology - The correlation between debt and particular outcomes.

To test for a correlation between gross and net debt with the outcomes of interest we estimated probit regression models. This modelling approach is suitable in circumstances when there is a binary outcome.<sup>42</sup>

The fact that Understanding Society contains a range of individual and household sociodemographic and economic characteristics means it is possible to control for a range of factors which alongside debt, are likely to affect the outcome of interest. In the following analysis, the regressions controlled for: Age (including polynomials in age), marital status, housing tenure, gender, real log equivalised household net income (January 2013 prices), self-reported health<sup>43</sup>, gross and net debt (separately) and government region in which the household resided. The results are based on data from wave 4 (2012/13) of Understanding Society.

## Appendix 3: Methodology - Debt and mental health

Poor mental health is not directly observed in Understanding Society – it does not have information on clinical diagnoses of mental illness. Instead we use the mental component of the SF-12 survey instrument. This is designed to measure functional health (including mental health), and can be thought of as a measure of mental strain. Responses from respondents are computed into an index, which was originally scaled to fit the US adult population. Therefore in the analysis we look at people above and below the median score, where a higher score indicates better mental health, rather than talking about people who have or do not have a diagnosed mental health problem.

In addition to unsecured debt (both gross, and net of any financial assets), we looked at whether respondents were behind on paying any household bills at the time of the interview, and if they have found themselves behind in paying their council tax in the last 12 months. Our unit of analysis is the individual – but these questions are asked of only one person in each household. Therefore these variables should be interpreted as describing the household context – for instance, 93% of adults aged 16 or over lived in a household that was up to date on all of their household bills in 2012-13. Proportions are reported with 95% confidence intervals.

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<sup>42</sup> In the case of health, one usually estimates an ordered probit (which accounts for the ranking in self reported health). We also did this, the results were largely similar (in the sense of the sign of the coefficient estimate) and therefore we choose to present estimates based on a probit specification to ease interpretation. The ordered probit estimation results are available on request.

<sup>43</sup> Self-reported health is **excluded** in the model where it is the outcome of interest. In the models where physical and mental health are the outcomes of interest (using SF-12), self-reported health is included as a control variable. Similarly when self-reported health is the outcome of interest, sf-12 physical and mental health controls are included in the specification.



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