Wales Centre for Public Policy
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Poverty and social exclusion: review of international evidence on household debt

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Summary

- Action on household debt alleviation, prevention and rehabilitation is important in light of recent increases in problem debts among low-income households, and the role of debt in entrenching poverty and affecting several dimensions of social exclusion.

- Common approaches to addressing household indebtedness (e.g. debt advice and debt relief, regulation and improved access to low-cost credit opportunities, the boosting of financial literacy and capability, and asset-based welfare policies) largely do not tackle the root causes driving demand for borrowing among low-income households (namely low income). As such, they cannot be considered silver bullets to reverse these trends.

- However, a holistic, integrated financial inclusion strategy will need to include all these elements, and other factors that bear on households' financial resources, as well as their interaction with the social security system.

- There are connections between household debt and policy areas covered in other reviews, for instance:

    - **Digital exclusion:** Digital inclusion can boost financial literacy and capability and facilitate access to debt advice and support.
    - **Take-up of cash transfers:** interventions to increase uptake (e.g. of the Council Tax Reduction Scheme) are important in light of arrears being a significant driver of debt. Data-sharing can improve the support citizens receive.
    - **Transport disadvantage; Food insecurity; Fuel poverty; Affordable housing supply; Early childhood education and care; Digital exclusion:** Debts are multi-layered and many households (not just the poorest) are vulnerable to problem debt because of the range of intersecting demands on their resources.

- The review concludes with some promising actions, including:

    - Strategies to increase household resources, council tax reform, and pressure to change certain aspects of current social security design can help tackle causes of household debt.
    - Effective alleviative and rehabilitative measures require greater coordination between debt advice services and other agencies and services as well as improved links with debt relief services.

Background

The Wales Centre for Public Policy (WCPP) was commissioned by the Welsh Government to conduct a review of international poverty and social exclusion strategies, programmes and interventions. As part of this work, the Centre for Analysis of Social Exclusion (CASE)[1] at the LSE was commissioned to conduct a review of the international evidence on promising policies and programmes designed to reduce poverty and social exclusion across twelve key policy areas. This report focuses on household debt.

The key questions addressed in each of the twelve policy reviews are:

- What effective international poverty alleviation policies, programmes and interventions exist?
- What are the key or common characteristics/standards and features of these different approaches?

The questions are addressed by providing:

- The Welsh context of each policy area and main initiatives being undertaken by the Welsh Government;
- Detailed information on the relationship between the policy area and poverty and social exclusion;
- A summary of evidence of lived experience, which could help to understand how people may experience and respond to policy interventions;
- An overview of the international evidence of policy effectiveness (including case studies); and
- Challenges and facilitating factors associated with policy implementation.

In addition to the twelve policy reviews, we have produced an overview report which summarises the key evidence from each of the individual reviews, highlights connections between different policy areas and reflects on all the evidence to make a number of policy recommendations, or promising actions, within each of the twelve

[1] The Centre for Analysis of Social Exclusion (CASE) at the London School of Economics and Political Science (LSE) was established in 1997. It is a multi-disciplinary research centre exploring social disadvantage and the role of social and public policies in preventing, mitigating or exacerbating it. Researchers at CASE have extensive experience in conducting policy reviews covering evidence in the UK and international literature.

areas. Please refer to the Annex for detail on methodology, including how the twelve policy areas of focus were chosen.

This work forms part of a suite of reports produced by WCPP as part of its work on poverty and social exclusion for the Welsh Government. As well as this work by CASE, there are two reports on the nature, scale and trajectory of poverty and social exclusion in Wales – one focusing on quantitative data and evidence, and a second focusing on lived experience evidence (Carter, 2022a; 2022b). WCPP also commissioned the New Policy Institute to conduct a review of international poverty alleviation strategies (Kenway et al., 2022) which examines overarching governmental approaches to tackling poverty.

Introduction

Household debt has risen to unprecedented levels across the UK (TUC, 2019). While levels of indebtedness in Wales have been found to be generally slightly below those in other parts of the UK (Winckler, 2014), there is evidence that Welsh household finances have been hit particularly hard during the Coronavirus pandemic: Citizens Advice estimated that £73 million had been accumulated in arrears on household bills (e.g. rent, utilities, council tax) between the start of the pandemic and late 2020, and over 280,000 people in Wales reported falling behind on payments (Dutton and Hardy, 2020). Households with children, people who are unemployed, or people with disabilities have been more likely to face debt problems. Further evidence from the Centre for Cities (2020) found that cities in Wales, Northern Ireland and the North of England reported the highest levels of problem debt, witnessing the highest increase in County Court Judgments. There are also geographical disparities within Wales, with high levels of indebtedness and personal insolvency in the south Wales valleys in particular, and to a lesser degree in the north coast and some rural areas (Winckler, 2014). Across the UK, households in the poorest fifth of the income distribution are disproportionately more likely to experience problem debt (17.7%, compared to 9.7% for the second poorest fifth and just 0.6% for the richest quintile), in line with trends in England (JRF, 2020a).

Problem debt is defined by the ONS (2019) as debt that sees households experiencing their debt as a heavy burden and having solvency and/or liquidity problems, e.g. falling behind with bills or credit commitments. The likelihood of experiencing problem debt during the pandemic varied between regions, with people in Wales particularly likely to anticipate financial difficulties compared to most other regions, at 17% (Round et al., 2020).

The Joseph Rowntree Foundation (2018) highlights a lack of savings and pensions as a potential future driver of poverty in Wales. More than a quarter of Welsh households did not have enough savings to cover their regular income for just one month at the beginning of the pandemic and one in ten regularly struggled to pay their bills (Bevan Foundation, 2020). Debt to public services also emerged as a key barrier to people accessing the support they need (Bevan Foundation, 2020). This is in line with UK evidence highlighting the impact of benefit debt and deductions resulting from benefit overpayment on those in poverty (Trussell Trust, 2020; Fitzpatrick et al., 2018). In particular, Cooper and Hills (2020) highlight the role played by the system of advance payments on Universal Credit, and the repayments this subsequently requires, which is shown to increase financial hardship and use of foodbanks (Trussell Trust, 2020).

Policy context

The Welsh Government has long acknowledged the need to facilitate a holistic and coordinated joint-agency response to financial inclusion. As per the recent Financial Inclusion Strategy for Wales, and the introduction of the Discretionary Assistance Fund (DAF) for urgent assistance, the Welsh Government has been active in several policy areas related to financial inclusion, including:

- Improving access to affordable credit (including support for the expansion of credit unions);
- Direct investment in advice services and the development of quality assurance system standards – devolved debt advice funding allows Wales to develop its own integrated approach to the commissioning of debt advice services; and
- A commitment to boost financial literacy and capability.

Other activities undertaken by the Welsh Government, especially in relation to council tax reform, are particularly important, in light of the identified drivers of debt among low-income families.

This report reviews international evidence on policies that represent **preventive solutions to household debt, such as policies that boost financial education and capability; asset-based welfare policies; and measures that focus on the supply of credit or the provision of information.** It also covers **debt advice services and debt relief and settlement procedures**, which represent alleviation and rehabilitation policies, focused on people who are already in debt – although it should be noted that debt advice can also prevent debt problems from spiralling further out of control. Debt relief and settlement procedures aim to resolve people's debt problems, often with partial cancellation of debts. Debt settlement procedures

are usually reserved for the most extreme forms of over-indebtedness and often entail payment in instalments over a specified period, or remittance of income above a certain threshold.

Relationship to poverty and social exclusion

In the UK, problem debt has increased in the last two decades and is strongly associated with poverty (Bramley and Besemer, 2018) as well as social exclusion. For example, unsecured debts can create problems by reducing households' financial resilience to financial shocks, leading over-indebted households to experience elongated periods of financial hardship. Debt problems also tend to be more persistent for poor households (Hood et al., 2018, Dearden et al., 2010). Low-income households are more likely to be in 'net debt', with unsecured debts of greater value than their financial assets (Hood et al., 2018), which make them more vulnerable to financial shocks. Being in arrears on debt repayments is highly concentrated amongst these households (Hood et al., 2018; Fitzpatrick et al. 2018; 2020), and debts are more commonly related to arrears on housing, local taxes and utility bills compared to consumer credit (Bramley and Besemer, 2018).

Short-term liquidity shortfalls leading to arrears are more likely to see people living in poverty borrow from expensive, high-interest credit providers – in fact, covering essential expenses such as food, transport and bills is the most common reason for taking out high-cost credit products (FCA, 2021; Fitzpatrick, 2020). This adds to the likelihood of borrowers becoming trapped in a debt spiral, despite protective regulation that has limited damaging practices which, for instance, encouraged rollover of loans (FCA, 2016). **The overall picture is thus one that portrays a mutually reinforcing relationship where poverty is a key cause of debt, which in turn can exacerbate financial hardship and vulnerability** (Atflied, 2016; Lea, 2021; Hartfree and Collard, 2014).

Households respond in different ways to problem debt and utilise coping mechanisms such as reducing consumption, liquidating assets or increasing labour hours when possible. Cutting expenditure imposes trade-offs with other aspects of everyday life and hinders families' ability to cover basic needs (e.g. housing, food, utilities, transport, and clothing) which in turn increases, for instance, the risk of food insecurity or fuel poverty. This can force families to rely on extended family and friends, food banks, charities and financial markets/lenders (formal and informal) to cover the costs of these essentials. In the UK, reliance on informal borrowing has increased in the past decades and is also more likely to be used by those in poverty (Bramley and Besemer, 2018). Reliance on borrowing from family is particularly likely

for those in poverty, and (particularly if extended families are also at greater risk of poverty) there can be repercussions of increased vulnerability on both the lending and receiving households.

At the same time, financial strain associated with household debt interacts with psychological strain (e.g. anxiety, worry or feelings of not coping, as well as debt-related stigma). **Psychological strain associated with household debt is linked to negative outcomes across a range of social exclusion-related domains**, from social relations and conflict with extended family or within the household, to employment outcomes and children's educational outcomes – thus reinforcing intergenerational transmission of disadvantage (French and Vigne, 2019; Hiilamo 2021; Bialowolski, et al., 2021; Collard, 2014).

There is strong evidence of the relationship between indebtedness and a range of physical and mental health problems (Richardson et al., 2013; Turunen and Hiilamo, 2014; French and McKillop, 2017; French and Vigne, 2019; Lea, 2021; Hiilamo and Grundy, 2020; Meltzer et al., 2011). This adverse impact on mental and physical well-being has been shown to erode self-esteem and confidence, reducing employment prospects not only by undermining the ability to seek employment but affecting job performance for those who are in work (Dearden, 2010; Hiilamo, 2021; CPEC, 2013). However, not all types of debt show a strong association with a negative psychological impact. For example, the association with negative effects on mental well-being is less clear for long-term secured debt such as mortgages and student loans (Hiilamo, 2020; McCloud and Bann, 2019).

Relationship to lived experience of poverty and social exclusion

Understanding people's experiences and the psychological aspects connected to debt is very important because they can be both determinants and consequences of indebtedness.

Indebtedness is often accompanied by experiences of shame and stress. For example, Bramley and Besemer (2018) suggest that being forced to rely on informal borrowing as a result of indebtedness is a painful reminder of financial stress and deprivation, and that reliance on informal borrowing is more likely for households in poverty. Lived experience evidence from Wales also highlights that informal borrowing can leave people reliant on frequent use of 'high-cost' credit, which can result in cycles of poverty and indebtedness (Young Foundation, 2016).

Evidence also shows that indebtedness is a highly emotional experience, and that repeated cycles both limit people's ability to escape debt and deplete the considerable emotional energy necessary to constantly juggle all the different demands on their incomes (Dearden et al., 2010). Despite determination and considerable skill in navigating complex circumstances, it is often the case that indebtedness ends up eroding earlier progress and ambition towards reducing debts (Dearden et al., 2010).

Debt-related benefit deductions, mentioned above, not only put further strain on already precarious financial circumstances, but contribute to the dynamics of psychological stress, depleting the motivation of those caught in this form of poverty trap (Fitzpatrick et al., 2018; 2020). These psychological dynamics are related to evidence of how financial insecurity can affect decision-making, with coping strategies focusing on short-term solutions to prevent stressful circumstances, often at the expense of future goals and greater risk-aversion, leading to lower self-esteem and a heightened sense of social exclusion (Sheehy-Skeffington and Rea, 2017; Hardy and Lane, 2018).

Evidence of policy effectiveness

Intervention	Strength of evidence	Effectiveness
Financial literacy	Strong	Effective - Financial literacy on financial behaviours Mixed - Financial education on literacy and behaviours
Asset-based welfare policies	Strong	Mixed
Debt advice services	Good	Effective
Debt relief services	Weak (Robust evaluations are scarce)	Effective
Access to credit opportunities	Weak evaluations of alternative financial products	Limited effectiveness (Able to reach a marginal portion of the population)

Financial literacy

Increasing financial literacy can provide the relevant skills to allow people to improve their budgeting and financial management, thus increasing the likelihood that they are able to increase savings to cope with financial shocks, manage existing debts, develop effective repayment plans, seek the best interest rates and avoid arrears. Financial literacy and financial capability programmes can be delivered through schools and further education establishments, as part of asset-based welfare policies (see following section), within active labour market policies, and as part of debt counselling services.

There is evidence that financial capability and literacy in Wales are low (Fincap, 2015) – as is the case internationally (OECD, 2020). Financial literacy and education are an integral part of the Financial Capability Strategy for Wales and of the Financial Inclusion Strategy for Wales more broadly (Welsh Government, 2016).

There is a vast international literature that paints a consistent picture regarding the **importance of financial literacy on a range of financial behaviours.** Low financial literacy is associated with debt accumulation, high-cost borrowing and higher fees transactions (Lusardi and Tufano, 2015). In contrast, financial literacy is associated with more effective financial planning (Goyal and Kumar, 2020) which in turn brings about an increase in wealth holdings (Lusardi and Mitchell, 2007). For example, Behrman et al. (2012) found a strong positive association between financial literacy and wealth accumulation. In relation to savings, financial literacy is significantly positively associated with propensity for precautionary saving (Blanc et al., 2015). Further to this, more financially literate savers on average achieve higher rates of return on their savings (Deuflhard, Georgarakos and Inderst, 2019). This is partly because more financially literate households are more likely to use new technologies (online banking and mobile payments) to identify higher interest accounts.

The evidence on the effectiveness of financial education on financial literacy and related behaviours is mixed (Hastings, 2013; Beshears et al., 2018). This is a rich area of research internationally and some high-quality meta-analyses are available covering both high- and low-income countries. The overall effects are small and are shown to depreciate rapidly with time (Fernandez et al. 2014, Beshears et al., 2018). Fernandez et al. (2014) found that interventions to improve financial literacy explain only 0.1% of the variance in financial behaviours, with even weaker effects for low-income groups. Even studies reporting a positive impact find that effects depend on the target population and the type of financial behaviour (Miller et al., 2015; Kaiser et al., 2017).

Importantly for this review, it appears that **the effects of financial education on financial literacy are weaker for those on low income and in relation to debt in comparison to savings**. For example, Kaiser et al. (2017) found weak and particularly shorter-lived effects in relation to low-income groups, and also showed that affecting financial behaviours in terms of retirement savings and budgeting may be easier compared to borrowing behaviour, as improving debt-related behaviour is, on average, hardly successful. Similarly, Miller et al. (2015) found positive effects in relation to savings and record keeping but not in relation to credit defaults.[2]

This literature does however shed some light on what makes interventions more or less effective:

1. It appears that positive effects are associated with providing financial education at a **teachable moment** – when teaching is directly linked to decisions of immediate relevance, thus allowing people to apply their knowledge in a concrete case of interest to them (Kaiser et al. 2017; Goyal and Kumar, 2020; Fernandez et al., 2014).
2. Rather than one-size-fits all, **interventions which are tailored to a target group are also more effective** (Lusardi and Mitchel, 2014; Goyal and Kumar, 2020).
3. Some studies also find that while financial education alone is largely ineffective in changing financial behaviours, **combining interventions (e.g. financial education, goal setting, and counselling)** can strengthen the link between education and outcomes (Carpena et al. 2015).
4. Evidence on the role played by the intensity of a programme is more mixed – some studies find a positive relationship, albeit not in relation to debt or for low-income groups, as noted above (Kaiser et al., 2017), while others do not (Fernandez, 2014).
5. **Making financial education mandatory is associated with deflated effect sizes** – this can point to challenges in achieving desired positive effects on those who do not self-select into education measures (Kaiser et al., 2017).
6. Recently, attention has been paid to structural aspects, such as **digital inclusion**, to boost financial literacy and capability (Bavafa et al. 2019). Since 2017 there has been a reduction in adults having low financial capability in the UK and this can be attributed to a reduction in the number of (especially older) people who are digitally excluded (FCA, 2021).

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[2] It should also be noted that this literature emphasises that positive effects may be related to the type of study conducted: correlational studies find stronger associations than experimental and quasi-experimental studies, which are more robust in identifying causal effects.

Asset-based welfare policies

Asset-based welfare policies (ABWPs) have attracted particular interest because of their potential in producing 'asset-effects': holding financial assets, even of relatively low value, appears to produce both monetary and non-monetary benefits, for instance in relation to family stability, physical health and psychological well-being (Bynner and Paxton, 2001; Sherraden, 2003; McKnight, 2011). For instance, there is evidence that asset holding contributes to later outcomes for employment, earnings, general health, and psychological well-being (McKnight, 2011; Lerman and McKernan, 2008). Encouraging savings-related behaviours can be an important element of promoting social mobility: for instance, there is evidence that children of low-income, high-saving parents are more likely to experience upward income mobility (Cramer et al., 2009).

In a review of UK and international evidence, Searle and Köppe. (2014) found that **match funding for savings; auto-enrolment; government backing; and benefit guarantees are key ways to increase coverage and to support low-income households to save**. Linking asset policies to financial education and social services – e.g. through additional support and financial advice – also has positive effects. Conversely, tax incentives are of little benefit to people experiencing poverty, which instead benefit those who pay higher taxes and can have overall strong regressive effects.

In the US, there is a body of literature (Schreiner and Scherraden, 2007; Sherraden, 2009) exploring the effectiveness of Individual Development Accounts (IDAs), which are a type of matched savings accounts. Such accounts have demonstrated positive short-term effects, including on level of assets and experiences of financial hardship (Mills et al., 2019). However, debt emerged as a barrier to saving: participants with debt were less likely to make account contributions, and made lower average monthly deposits to their IDA (Schreiner et al., 2002). Moreover, in the longer term (six years after the programme ended), no impact of the intervention could be found in relation to homeownership, business ownership, retirement saving or overall net worth. Connectedly, as the intended impact on asset accrual did not materialise, positive psychological outcomes also could not be found ten years after the start of the programme.

Overall, mixed results of ABWPs suggest that 'many don't address the fundamental problem that low-income households live financially precarious lives and simply don't have spare income to save' (McKnight and Rucci, 2020, p.54). These policies should thus be seen as complementary rather than alternative to strong welfare states (McKnight and Rucci, 2020). Critics have argued that the shift towards ABWPs in the late 1990s and 2000s, including incentives to increase

home ownership, is in fact a form of welfare state retrenchment and effectively moves the burden of risk onto the individual and away from the state (Ansell, 2014; Ronald et al., 2015; Lennartz and Ronald, 2017). Given the positive effects of financial assets (both monetary and non-monetary), it is essential to assess the overall policy context. For instance, at the bottom of the income distribution, savings may be discouraged by the design of taxes and transfers (OECD, 2018). Programmes conditional on low assets may tend to benefit the chronically low-income more than addressing volatility and mobility risks – in the UK, asset limits in relation to Universal Credit eligibility are an example of this.

Debt advice services

Debt advice services have been adopted in several countries and there is evidence that they have a positive impact in relation to managing finances, reducing debts and preventing further debts, both in the short- and longer-term (Civic Consulting, 2014; Eurofound, 2020; Hartfree and Collard, 2014; Orton, 2010; YouGov, 2012). It should be noted that studies often rely on subjective measures of financial stress to explore debt resolution and alleviation (Brackertz, 2014), and that participants often self-select for receiving advice (Stamp, 2012). However, while the literature suggests that debt advice can have a positive effect, especially for low-income debtors, these measures are more likely to alleviate, rather than resolve, financial difficulties (Stamp, 2012). Debt advice will not tackle the structural causes of debt for low-income households but can help to mitigate immediate crises, forestall further consequences of debt and provide information and skills assisting people to develop longer-term financial management strategies. **Effective debt advice services have also been found to have a direct, beneficial impact on mental health, social well-being and quality of life** (Europe Economics, 2018).

Eurofound (2020) offers an in-depth overview of debt advice services in the EU. The review identifies barriers to access, such as lack of capacity affecting waiting times and quality of service provision; non-public advisors charging user fees; and non-take up due to lack of awareness or social stigma. **Effective programmes were shown to provide customised advice, are grounded in the establishment of trusted relationships with customers but also with creditors and authorities, and rely on registered, professional, trained advisors.**

Particularly in relation to people in poverty, it is important to consider how debt advisory services can support people by helping them to access a tailored range of other social services (e.g. mental healthcare, employment and welfare services). Debt advice services can thus **serve as a point of contact and trigger a range of referrals to appropriate services**, resulting in a holistic approach which can be

considered a key aspect of service quality (Eurofound, 2020; Dubois, 2012; Stamp, 2012).

Debt relief services

Robust evaluations of the impact of various debt relief and settlement solutions is still scarce. US quasi-experimental evidence finds that bankruptcy protection leads to strong increases in income (measured as the increase in the recipient's marginal annual earnings) and decreases in mortality and foreclosure (Dobbie and Song, 2015). Mortgage debt relief programmes, when used with sufficient intensity, are shown to have a positive impact on foreclosure rates and consumer debt delinquencies (Agarwal, 2017).

Looking beyond financial effects of debt relief, Ong et al. (2019) used quasi-experimental evidence to explore the impact of debt relief on psychological dimensions connected to debt, and in particular the type of mental effects that, as discussed above, risk severely depleting people's cognitive and emotional energy and contribute to stress and reduced overall well-being. They found that debt relief has positive and significant effects on cognitive functioning and reduces the likelihood of exhibiting anxiety and bias.

In relation to debt settlement procedures, Eurofound (2020) identified **barriers to access related to strict application of criteria or administrative/procedural costs.** These are crucial issues for the UK system too (Collard et al., 2018). Eurofound (2020) found that overall, across the EU, procedures have become simpler and shorter, but the **extent to which these measures represent a fresh start for debtors depends on a range of factors, such as:**

- **The types of debts excluded.** Across Europe, the types of debt which are most important for low-income households include debts to public authorities (e.g. rent, utilities and tax arrears, fines, healthcare costs),[3] or debts resulting from informal borrowing. The exclusion of these debts in many countries thus prevents a fresh start even for those people for whom debt relief procedures are successful. While some countries (e.g. Norway, Greece) have been reforming exclusion criteria, no assessment of their impacts could be found.

[3] This is unlikely to be the case in relation to healthcare and income taxes in the UK, but is relevant for local taxes such as the Council Tax.

- **Timing** is also essential because if debt relief is granted too late there can be devastating physical, mental and social consequences for the debtors, undermining the rehabilitative potential of these measures.
- In order to have a lasting effect on people's financial resilience **it is important that settlement procedures provide, or are at least consistent with, incentives for people to maximise their income and seek work during the settlement period.** In order to increase incentives, people need to notice the difference straight away, not after a few years, or after a certain proportion of the debt is repaid. Payment plan setting or income thresholds also need to consider a range of factors, including access to services such as childcare, education, transport, housing, healthcare and long-term care.

Taken together, this suggests debt solutions should be considered in the context of social security arrangements, in line with the issues faced by low-income households in the UK in relation to public service debt and benefit repayments. Examples of innovative debt relief and settlement initiatives for at-risk groups are provided in Case Study 1.

Work on debt management in relation to tax debt, for instance by the OECD (2019), has produced cross-country comparisons to highlight best practices and successful strategies. Largely, recommendations revolve around an enhanced use of technology such as data mining and predictive models to segment debtors based on their payment history and a number of risk criteria. At different stages of debt management this can help:

- Identify and proactively engage those who are most at risk of getting into debt;
- Direct cases to the appropriate recovery phase;
- Develop personalised payment plans; and
- Account for taxpayer segments and risk categories to inform multi-channel communication strategies.

However, this type of study focuses on providing a guide to developing successful debt management strategies, with no assessment of how proposed actions bear on household debt reduction or on poverty and social exclusion more broadly.

Recent studies have addressed a shift towards 'market-based debt resolutions' in many countries (Gray et al., 2020). These 'privatised solutions' envisage the completion of long-term plans with repayment obligations which exceed those under debt relief procedures – the Individual Voluntary Arrangements (IVAs) in England and Wales would fall under this category. These solutions can be problematic because they reduce the re-allocative effect of debt relief, undermining its beneficial economic effects (Möser, 2020). These issues are connected to funding models for debt

advice, as providers have incentives to stir debtors into income-generating long-term repayments, rather than statutory debt relief solutions.

This literature underscores that there is an **important social protection role for relief policies and personal insolvency law to play, and that alternative debt solutions are important for vulnerable households for whom bankruptcy processes are often financially unaffordable and bureaucratically complex**. Nevertheless, the decline of bankruptcy and Debt Relief Order procedures witnessed in the UK, accompanied by the rise of Individual Voluntary Arrangements and Debt Management Plans, can be seen as a shift towards privatisation of personal insolvency. This shift understands debt relief less in terms of its protective role and more as a tool that seeks to avoid threats to financial stability (Spooner, 2019; 2020).

Case Study 1: Debt solutions – recent developments

Debt relief and settlement initiatives have seen a range of developments, but some promising policies have not yet been robustly evaluated. Eurofound (2020) identified some innovative approaches relating to arrangements for particular at-risk groups which may be relevant in light of the drivers of household debt in Wales.

Some countries have attempted to combine debt settlement procedures with stronger protection of children in the household. The 2016 Debt Reconstructing Act in Sweden, for instance, adjusts the payment schedule in favour of households with children, including two months of free instalments. Other initiatives use proactive systems that can help with early intervention and address widespread lack of awareness with available debt solutions – for instance through public service referrals or through collaboration with social partners (e.g. trade unions, employers) who can share knowledge of imminent redundancies. There are examples of advisory services who proactively contact potential clients once they are alerted that people are in arrears, for instance, with utility bills or social housing rent (Netherlands), or when there is a court case for an eviction (Austria).

Access to credit opportunities

Financial deregulation and inadequate social safety nets are often recognised as providing structural conditions that increase the likelihood of financial difficulties (Ferretti, 2016). Especially following the 2008 financial crisis, regulatory measures have been at the forefront of attempts to address externalities and market failures (Cerutti et al., 2018). This has resulted in both macro- and micro-prudential policies

which saw regulatory measures applied to, for instance, interest rates, the provision of information and assessment of creditworthiness.

Regulation of credit is now widely recognised as an essential preventive measure for consumer protection (Eurofound, 2020). Regulation can thus play an important redistributive and inclusive role, for instance by shifting risks from consumers to suppliers (Ferretti and Vandone, 2019). Formal and regulated credit opportunities are essential to avoid the increased risks and vulnerabilities associated with informal borrowing (Eurofound, 2013). At the same time, **access to financial services is a key component of economic participation and regulation and there is evidence that borrowing restrictions can have negative consequences on the overall household financial situation and on financial inclusion** (Badarinza, 2016; Zinman, 2010).

Interest rate caps are a tool to protect vulnerable clients from predatory lending practices – as already noted, people with low incomes and poor access to credit often rely on relatively small loans with high interest rates. Caps, varying in scope and type, have been used widely around the world (Maimbo et al., 2014) and recent years have seen many tightening restrictions (Ferrari et al., 2018). However, there is evidence that interest rate caps often result in limiting access to finance, particularly for younger and poorer segments of the population, as high-risk borrowers end up being excluded from the formal financial system (Ellison and Forster, 2006; Madeira, 2019, Ferrari, 2018). This reflects the UK experience with caps on high-cost, short-term credit (FCA, 2017). Other side-effects reported in the international literature include increases in non-interest fees and commissions (which in turn reduce price transparency, complicating the system and thus entrenching disadvantages resulting from disparities in financial literacy), lower number of institutions and reduced branch density.

The high-cost credit market is adapting and evolving –despite substantial regulation coming in force in relation to the sector in the UK since 2014, high-cost credit products have adapted around the regulation introduced while also leveraging on the opportunities afforded by digital technologies, thus remaining a major source of indebtedness (Aldhoni, 2021). Some US evidence shows that even outright bans of high-cost credit solutions appear not to be effective for those on low-income customers, who shifted to using other, non-prohibited alternatives (Friedline et al., 2017).

This literature overall stresses that **a key issue with these measures is that they do not address systematic causes of the demand for high-cost products** (Ferrari, 2018; Maimbo, 2014). Demand for high-cost products reflects key drivers already explored in this review such as financial insecurity and precarity, or the

inadequacy of state welfare provision; but also increasing financialisaton creating a two-tier system of credit (Rowlingson et al., 2016; Dearden, 2010; Ferretti, 2016). In order to understand the demand for these services, insights into the lived experience of borrowers are particularly important. Rowlingson et al. (2016) explore borrowers' perspectives through qualitative methods and find that these products have characteristics that borrowers appreciate – the online application process is simple and anonymous (in line with their desire to maintain dignity and avoid the shame associated with debt); access to credit is quick, and matching their everyday expenditure needs and repayment can equally be quick, in line with the desire not to have debt hanging over them. These experiences also highlight negative experiences with face-to-face retail lenders, the inadequacy of alternative products (e.g. because they may offer *more* credit than needed) but also the desire to be responsible and not to become a burden on family or friends.

The provision of adequate alternatives in relation to these needs has prompted interest in credit union loans, community finance and no-interest credit schemes (see Case Study 2). Community/social finance and credit unions have been growing in several parts of the world, including Europe (EC, 2020). The core financial products offered are personal microloans and savings products but also non-financial services (e.g. financial education and advice). Particularly in Western Europe, governments have been promoting their expansion in a push to improve the financial inclusion of disadvantaged groups (EC, 2020). The UK has seen attempts to expand access to potentially suitable alternatives such as credit union loans (DWP, 2012; FCA, 2019).

Case Study 2: No interest loan schemes in Australia

The No Interest Loan Scheme (NILS) is the largest microfinance programme in Australia and offers no interest loans (up to $1,200) to people on low incomes for the purchase of essential household goods and services. This is in line with the need for essential household goods being a key driver of the need for credit that leads low-income households to turn to high-cost credit products (FCA, 2019). NILS constitutes a network of more than 600 community-based organisations (e.g. youth centres, shelters, churches etc.). NILS is an example of circular community credit: every time a repayment is received, funds are made available to someone else in the community.

The Centre for Social Impact conducted an evaluation of NILS which showed positive outcomes in terms of improved financial capabilities as well as reduced stress and anxiety levels, improved self-confidence, self-esteem, physical health, personal relationships and participation in society (CSI, 2014). Clients reported to have reduced or decreased their use of payday loans and fringe providers as a result of NILS.

Pilot programmes have since been conducted to reach specific excluded populations, especially in remote areas (Cain and Eccles, 2017) and were developed through partnerships with community organisations already operating in these locations. The programmes attempted to expand NILS in a variety of ways: for instance, through outreach initiatives or delivering NILS within credit unions. Positive outcomes echo those found in the prior evaluation.

CSI's evaluation however was based on self-reported assessment and no comparison group was included. Results varied in different locations, which pointed to some key success criteria:

- **A focus on clients' needs and cultural awareness;**
- **Investment in developing trusting relationships;**
- **Flexible loan assessments;**
- **A holistic approach connected to a range of social services;**
- **A tailored approach to arranging item delivery into very remote locations; and**
- **A tailored approach to adapting NILS to the specific context, fostering strong client relationships.**

Critics have emphasised that the Australian government has significantly invested in these forms of microfinance solutions despite little robust evidence of their effectiveness around the world and in the Australian context (Gerard and Johnston, 2019).[4] Subsidies and favourable regulation have supported the sector's growth while key elements of social security have been weakened (Kelly and Johnston, 2019).

It is risky to think of 'social investment' in the form of support for these affordable credit solutions as a substitute to adequate social protection, particularly because the inadequacy of the safety net is a key driver of poverty and hence of the high demand for credit – and, as noted, these kinds of solutions, similarly to other forms of community finance, do not address the issue of demand.

[4] It should be noted that this is a complex field of the literature, which largely focuses on the use of microfinance in developing countries and questions its effectiveness in reducing poverty (Awawryi, 2014). At the same time more positive results have been found in studies focusing on quality of life, and particularly employing capabilities (Chilova et al., 2015; Anand et al., 2019).

Evaluating these alternatives is also important because there is considerable space for intervention at the local level. While the sector has expanded, awareness has remained low (Rowlingson et al., 2016; FCA, 2019) and there is paucity of evidence supporting the efficacy of such policies, particularly in relation to reaching low-income households (Mosedale et al., 2018). There are a series of constraints that undermine their efficacy as a poverty reduction tool: strict constitutions and financial lending regulations, insufficient credit, and lack of capacity and expertise that thwart scaling up efforts.[5] In relation to credit unions in particular, their potential is also undermined by tensions in relation to the very scope of these institutions: for instance between those who embrace the government expansion and modernisation programme (with the potential of increasing access to credit among low-income households), and those who wish to retain a more traditional members-oriented function (Sinclair, 2014). Moreover, reliance on largely face-to-face interactions (FCA, 2019) not only affects the reach of community finance solutions and credit unions, but also clashes with some of the evidence explored above on consumers' preferences.

Overall, these localised solutions are only able to reach a marginal portion of the population. It is also generally important to note that, especially where demand is driven by daily challenges in making ends meet, alternative routes to credit can mitigate but not eradicate the causes of financial insecurity.

Challenges and facilitating factors

An overarching challenge in this area is the mutually reinforcing relationship between debt and poverty. This is why governments attempting to tackle the root causes of indebtedness would need to focus on current drivers of poverty, including the role of the social security system. This emerges strongly in the literature (Lea, 2021; Atfield, 2016). Austerity reforms have severely reduced the safety net role of social security in Wales and in the UK and reverting some of these is essential to tackle household debt (Gardner et al. 2020). Beyond aspects related to the generosity of the system, there is a strong case to change aspects of the design of Universal Credit and its system of payment in arrears and repayment of advances (Cooper and Hills, 2020). Other reforms which are already being considered by the Welsh Government and are not covered in this review, for instance council tax reform, are particularly important in light of the regressive characteristics of the current system and the key role played

[5] See ABCUL (2019) in relation to the Credit Union Expansion Project.

by this type of arrears in indebtedness. A summary of the challenges and facilitating factors relating to household debt and policies and programmes to address the issue is provided in Table 1.

Table 1: Challenges and facilitating factors

Challenges	Facilitating factors
• The mutually reinforcing relationship between poverty and problem debt is a key challenge: tackling the root causes of indebtedness requires focusing on addressing drivers of poverty, including those related to the social security system. • Lack of awareness of services and of suitable debt solutions as well as negative experiences of shame and stigma, compounded by aggressive and coercive debt collection practices, erode trust and hinder access to affordable debt services and products. • Digital exclusion contributes to financial exclusion. Despite efforts to boost financial literacy there remain challenges in fully leveraging technological advances in favour of affordable credit solutions. • Privatisation of debt advice services and debt resolution mechanisms hinders people's access to the most suitable and beneficial types of debt solution.	• A holistic approach that understands debtors' needs and addresses their specific circumstances, fostering collaboration with other social services, facilitates take-up and the effectiveness of debt solutions and affordable credit products. • A focus on early intervention facilitates reducing household debt and its impact – this means identifying 'trigger points', adopting early referral strategies and proactive approaches to reach vulnerable households. • Strong partnerships with local and civil society actors boost the reach and timeliness of interventions and increase trust and awareness of services among debtors. • Debts to public authorities (including council tax arrears) are particularly significant for households experiencing poverty and destitution. This is an area where the Welsh Government can have significant influence.

Conclusion

Action on household debt alleviation, prevention and rehabilitation is important in light of recent increases in problem debt among low-income households, and the role of debt in entrenching poverty and affecting several dimensions of social exclusion. Common approaches to addressing household debt (e.g. debt advice and debt relief, regulation and improved access to low-cost credit opportunities, the boosting of financial literacy and capability, and asset-based welfare policies) largely do not tackle the root causes driving demand for borrowing among low-income households (namely low income). As such, they cannot be considered silver bullets to reverse these trends. However, a holistic, integrated financial inclusion strategy will need to include all these elements and consider them in conjunction with other elements bearing on households' financial resources, and their interaction with the social security system.

Transferability to Wales

Financial inclusion is an area in which the Welsh Government can make use of its devolved powers. The Welsh Government has long **acknowledged the need to facilitate a holistic and coordinated joint-agency response to financial inclusion**.

As per the recent Financial Inclusion Strategy for Wales, and the introduction of the Discretionary Assistance Fund (DAF) for urgent assistance, the Welsh Government has been active in several of the policy areas covered in this report, including:

- Improving access to affordable credit (including support for the expansion of credit unions);
- Direct investment in advice services and the development of quality assurance system standards – devolved debt advice funding allows Wales to develop its own integrated approach to the commissioning of debt advice services; and
- Commitment to boost financial literacy and capability.

Other activities undertaken by the Welsh Government, especially in relation to council tax reform are particularly important, in light of the identified drivers of debt among low-income families.

Promising actions

This section concludes with **promising actions** to consider in the Welsh context as emerging from the analysis of the international literature.

1. An **approach that tackles the causes of household debt** should be based on an understanding of the mutually reinforcing relationship between poverty and debt.
   - Strategies to increase disposable income and reduce expenditure (e.g. cost of childcare, food, fuel, transport, housing) should be considered to **increase households' resources**.
   - **Council tax reform** is particularly important in light of the regressive characteristics of the current system and the key role played by this type of arrears as a cause of indebtedness.
   - While beyond the remit of the Welsh Government's devolved powers, there is a strong case to call for **changes to the design of Universal Credit and its system of payment in arrears and repayment of advances.**
2. **Alleviating and rehabilitating measures** are important to provide a fresh start and mitigate the negative effects of debt on health and well-being.
   - **Greater coordination between debt advice services and other agencies and services** can help identify households at risk of indebtedness and facilitate early intervention. Debt advice services can also serve as a point of contact and trigger a range of referrals to appropriate services. Data-sharing opportunities should be evaluated.
   - **Improved links between debt advice and debt relief services** can tackle lack of awareness of debt solutions. This can strengthen consumer protection and prevent debtors making unsuitable arrangements.

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Annex: Methodology

Definition of poverty and social exclusion

For the purposes of this project it was agreed that a multidimensional concept of disadvantage, including social as well as economic dimensions, would be adopted. The Bristol Social Exclusion Matrix (B-SEM) (Levitas et al., 2007) provides the theoretical structure that underpins the selection of policy areas. The B-SEM uses the following working definition of social exclusion:

> **"Social exclusion is a complex and multi-dimensional process. It involves the lack or denial of resources, rights, goods and services, and the inability to participate in the normal relationships and activities, available to the majority of people in a society, whether in economic, social, cultural or political arenas. It affects both the quality of life of individuals and the equity and cohesion of society as a whole."** (Levitas et al., 2007, p.9).

It is structured around three main domains and ten sub-domains (see Table 1).

Table 1: B-SEM domains and sub-domains

A. Resources:	
A1: Material/ economic resources	Includes exclusion in relation to income, basic necessities (such as food), assets, debt and financial exclusion.
A2: Access to public and private services	Relates to exclusion from public and private services due to service inadequacy, unavailability or unaffordability. The range of services encompass public services, utilities, transport, and private services (including financial services).
A3: Social resources	Reflects an increasing awareness of the importance of social networks and social support for individual well-being. A key aspect relates to people who are separated from their family and those who are institutionalised.

B. Participation:	
B1: Economic participation	Includes participation in employment – which is not only important for generating resources but is also an aspect of social inclusion in its own right. Whether work is a positive, inclusionary experience depends partly on the financial rewards it brings, and partly on the nature and quality of work. Work is understood broadly and includes caring activities and unpaid work.
B2: Social participation	Comprises participation in common social activities as well as recognising the importance of carrying out meaningful roles (e.g. as parents, grandparents, children).
B3: Culture, education and skills	Covers cultural capital and cultural participation. It includes the acquisition of formal qualifications, skills and access to knowledge more broadly, for instance digital literacy inclusion. It also covers cultural and leisure activities.
B4: Political and civic participation	Includes both participation in formal political processes as well as types of unstructured and informal political activity, including civic engagement and community participation.
C. Quality of life:	
C1: Health and well-being	Covers aspects of health. It also includes other aspects central to individual well-being such as life satisfaction, personal development, self-esteem, and vulnerability to stigma.
C2: Living environment	Focuses on the characteristics of the ‘indoor’ living environment, with indicators of housing quality, inadequate housing and exclusion in the form of homelessness; and the ‘outdoor’ living environment, which includes neighbourhood characteristics.
C3: Crime, harm and criminalisation	Covers exposure to harm, objective/ subjective safety and both crime and criminalisation. This reflects the potentially exclusionary nature of being the object of harm, as well as the exclusion, stigmatisation and criminalisation of the perpetrators.

Notes: the descriptions of the sub-domains are the authors’ understanding of what each sub-domain includes based on Levitas et al. (2007).

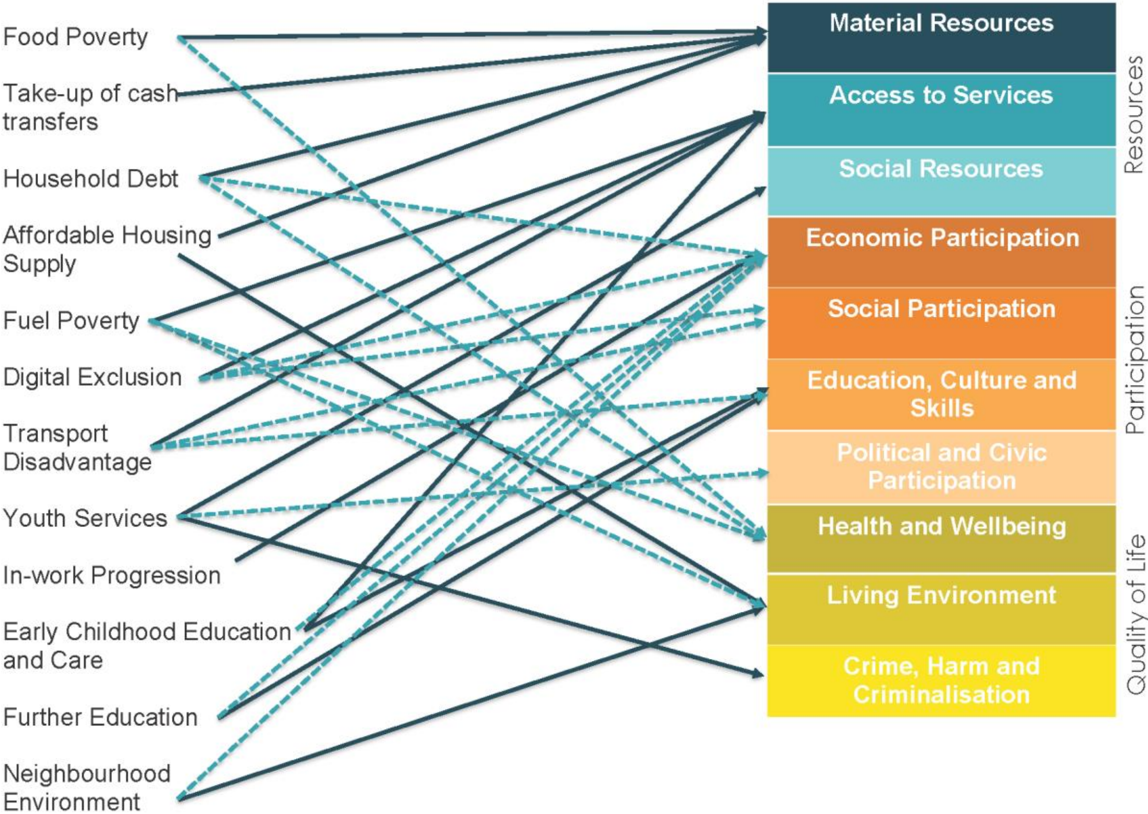
Selection of policy areas

The first step involved the research team identifying a long list of 40 policy areas with reference to the domains and sub-domains of the B-SEM. The long list was, in part, informed by a review of key trends in poverty and social exclusion in Wales, across the ten sub-domains, conducted by WCPP (Carter, 2022a); a consideration of the Welsh Government's devolved powers across policy areas; and meetings with experts. From this long list a shortlist of 12 policy areas was agreed. The shortlisting process took into account advice on priority areas identified by a focus group of experts, but ultimately the final list of 12 policies was selected by the Welsh Government.

The final set of 12 policy areas covers a broad spectrum within the B-SEM, and most are related to more than one sub-domain within the B-SEM (Figure A1). However, the final selection should not be considered exhaustive from a poverty and social exclusion policy perspective. This is because some important policy areas are not devolved to the Welsh Government and, therefore, were not included. For example, while adequacy of social security is a key driver of poverty the Welsh Government currently has no powers to set key elements of social security policy (e.g. rates and eligibility criteria for the main in-work and out of work benefits) and this is the reason why we focus on one aspect of social security, take-up of cash transfers, that the Welsh Government has power to influence.

Another factor was the project's scope and timescales, which limited the selection to 12 policy areas and meant that other important areas had to be excluded (for instance, social care, healthcare and crime). To make the reviews manageable, it was also necessary to identify a focus for each of the 12 policy areas. The research team identified a focus for each of the reviews on the basis of a brief initial scope of the research evidence and consultation with WCPP who, where relevant, consulted sector and policy experts. This means that there are likely to be additional policies which could be included in a poverty and social exclusion strategy by the Welsh Government *within* the 12 policy areas and *in addition to* the 12 policy areas reviewed.

Figure A1. The selected policy areas mapped to relevant B-SEM sub-domains



Source: prepared by the authors

Notes: The figure outlines the mapping of the 12 selected policy areas to the B-SEM matrix: bold lines show the relationship between each policy area and main B-SEM sub-domain(s), light dotted lines identify selected secondary B-SEM sub-domains the policies are related to (a full list of these 'secondary subdomains' is included in the specific reviews).

Review stages

In the 'evidence of policy effectiveness' section, while it was not possible to produce a full systematic review (although evidence from existing systematic reviews and meta-level analyses were included where available), a structured approach was adopted. This first involved an evaluation of the state of the relevant literature, focusing on whether effectiveness was assessed via methods standardly considered better suited to establish causality (e.g. on the basis of hierarchical grading schemes such as the Maryland Scientific Method Scale (Sherman et al., 1997) or the Oxford Centre for Evidence-Based Medicine's (OCEBM) levels of evidence (Howick et al., 2011) such as randomised controlled trials (RCTs), meta-analyses of RCTs and other quasi-experimental studies. While RCTs are particularly powerful in identifying whether a certain intervention has had an impact in a given context, other forms of evidence, such as quasi-experimental and observational studies with appropriate

controls may be better suited, depending on the type of intervention, to establish the range of outcomes achieved as well as providing an understanding of distributional effects and allowing sub-group analysis (i.e. 'for whom' did the intervention work). In the process of assessing evidence, case studies were selected to further elaborate some of the key findings resulting from the review and to identify specific examples of promising policy interventions.

In a few areas, the literature review highlighted a lack of robust evaluations – the reviews underscore this and present the best available evidence found along with an assessment of the strength of the evidence. Where possible, an evaluation of the underlying mechanisms of change was also considered, allowing an explanation of not just whether, but why a certain intervention works, thus also facilitating the identification of challenges and facilitating factors, which is crucial in thinking about not just 'what' should be done but also 'how' it can best be implemented.

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