in brief...
The long-term effects of financial distress in childhood

Is there a relationship between childhood circumstances and outcomes later in life? Andrew Clark and colleagues consider the cognitive and non-cognitive consequences for young adults whose families experienced major financial problems when they were children.

The Great Recession of 2008-09 and the eurozone’s sovereign debt crisis of 2011-13 put many families at risk of poverty and social exclusion. One particular feature of this double-dip downturn is that it has affected not only the poorest but also a far broader swathe of the population.

The European Commission’s February 2018 quarterly review of employment and social development records that the number of families who experienced financial distress – there defined as the need to draw on savings or run into debt to cover current expenditure – is at about 14% of the population. This figure is far above that of a decade earlier, and only slightly below its highest ever value of 17% at the end of 2013. Along similar lines, 63% of Americans have no emergency savings for a $1,000 emergency room visit or a $500 car repair.

There is a very large body of evidence on the relationship between income and financial resources, on the one hand, and adult outcomes on the other. The question we address in our research is whether income suffices to describe parents’ financial difficulties and, if not, what we can do to improve our understanding of these intergenerational transmissions.

In general, we need to know both the level of financial resources and the demands that are made on them in order to measure financial distress. Knowing whether households have difficulty paying bills or have had financial problems may provide information over and above the income they received.

We then ask whether the trace of parents’ financial problems, conditional on their income, can be found in the adolescent cognitive and non-cognitive outcomes of their children many...
The number of family financial problems is a far better predictor of children’s later life behaviour and emotional health than average family income in childhood years later. We are interested in children’s outcomes both in their own right as measures of how well young people are doing, and because these are known to predict outcomes throughout adult life.

Knowing about financial distress will not advance our knowledge much if this is almost entirely determined by income. But if the former reflects both economic resources and the demands that are made on them, income on its own may tell only half of the story. Financial distress may pick up not only income but also health problems, housing problems, the job loss of a family member, divorce, falling housing equity and so on.

Some supportive evidence on this point comes from the British Household Panel Survey, which has collected data on a representative sample of 5,500 households since 1991. Respondents are asked ‘Would you say that you yourself are better off or worse off financially than you were a year ago?’ Around a quarter say better off, another quarter say worse off and almost exactly one half say about the same. Respondents who report being better or worse off are then asked ‘Why is that?’, with the answers being reported verbatim.

Three response categories dominate for those whose financial position has worsened: a rise in expenses for almost exactly 50% of respondents, followed by a fall in income (28%) and ‘Other’ (11%). These figures are very similar for those who have any children in the household, and for those who have children under age 12 in the household. In these cases, financial problems are more often caused by increased expenses than by lower income.

We analyse data from the Avon Longitudinal Study of Parents and Children to see how parents’ financial distress is related to children’s outcomes many years later. This large-scale birth cohort survey, which began with a population of 14,000 pregnant mothers in and around the city of Bristol in the early 1990s, has now followed the ‘Children of the 90s’ for over two decades. For the children’s first 11 years, mothers were asked whether they had had a ‘major financial problem’ over the past year.

Just under a half of the children grew up in households with at least one major financial problem during the child’s first 11 years, and around one in eight had three or more such episodes. We then relate this childhood financial problem count to child outcomes at age 16 or 18. These outcomes are both cognitive (exam scores) and non-cognitive (behaviour and emotional health).

Our striking finding is that the number of financial problems is a far better predictor of behaviour and emotional health than average family income during childhood. (Indeed, the latter is mostly unimportant). It is also as good a predictor of exam scores as income.

It may be countered that we are not showing an effect of financial distress on child outcomes, but merely a correlation, in the sense that parents who have trouble managing their money may also have trouble bringing up their children.

To investigate, we carry out what is sometimes called a ‘value-added’ analysis. Given children’s outcomes at age 5 (where any effect of poor parenting should already be evident), do financial problems over the period when children are aged 6-11 continue to be correlated with their adolescent outcomes? The answer is yes.

We conclude that our understanding of how well families are doing financially requires information on both income and financial distress. This financial distress is not just the preserve of those at the bottom of the income distribution, and the shadow that it casts is likely to be very long. Financial problems in childhood lead to significantly poorer outcomes for young adults, and it is known that these continue to affect life satisfaction throughout adult life.

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