

Broke, ill, and obese: The causal effect of household debts on health

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Abstract

Overindebtedness and debt-related financial distress have become a common phenomenon in many countries. This paper analyzes the effect of household indebtedness on different health outcomes using data from the German Socio-Economic Panel from 2002-2008. Several findings in the literature suggest that a precarious financial situation coincides frequently with health problems. However, the causal effect of household debt on health is widely unexplored. The econometric challenge in finding causal effects of indebtedness on health is in controlling for unobservable factors that coincide with financial problems and bad health. Furthermore, the possible effect of health on debts, i.e., reversed causality, has to be taken into account. We address this issue extensively in this paper: to consistently estimate the effect of debts on health, we use fixed-effects methods (to rule out omitted variable bias due to unobserved heterogeneity) and a subsample of constantly employed individuals to rule out problems of reversed causality. Our dependent variables are three different health measures: self-rated overall health, mental health, and being overweight. Our main explanatory variables are two different measures of household indebtedness: consumer debt repayments divided by household income and a binary variable for being overindebted; this latter variable measures whether the household budget after debt repayments lies below the social assistance level. We find that, on average, indebted individuals report

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more frequently a bad health status, have a worse mental health, and are more likely to be overweight. Controlling for unobserved heterogeneity and ruling out reversed causality, we find indeed evidence for a causal impact of debt repayments on self-rated overall health and mental health. In contrast, the likelihood of being overweight is not significantly affected by debt. Our findings are similar for debt measures that concentrate on consumer credit as well as for those that include mortgage debt. However, we find no causal effect of debt on being overweight. We conclude that policy makers should strengthen debt-counselling and improve financial literacy to avoid downward spirals of debt, illness, and unemployment. Furthermore, the spreading credit culture in industrialized countries should give rise to serious concern and, consequently, should draw policy makers' attention.

Keywords: debt, self-rated health, mental health, overweight, fixed-effects

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