Washington University in St. Louis
Social Policy Institute

Strategies for Debt Reduction: Comparing Financial Tips and Financial Counseling

Sophia Fox-Dichter, Madi M. Ryan, Olga Kondratjeva, and Stephen Roll

Social Policy Institute at Washington Universityin St. Louis | Research Brief 20-04 | January 28, 2020

Introduction

U.S. households hold increasingly more debt, with almost 80% of adults holding debt of some form.[1] While ownership of debt is widespread, debt burdens can be particularly challenging for low-income households; debt-to-income ratios can be three times higher for these households compared to those with high-incomes.[2] Debt reduction has thus become an aim of initiatives to help lower-income Americans increase their financial well-being. This brief examines two different mechanisms for delivering debt management advice and describes the success of each method in helping individuals reduce their debt.

First, we examined the efficacy of simple debt-reduction "rules-of-thumb" provided to low-income TurboTax Freedom Edition[3] users immediately after they filed their taxes in 2018. Tax-time can potentially be an apt moment for providing financial advice because most Americans receive a tax refund, and this refund can be one of the single largest payments low-income households receive all year.[4] Financial interventions instituted at tax time thus far have generally focused on encouraging savings, so debt reduction is a novel aim for tax-time interventions.[5]

Using tax time as a moment to address debt reduction is particularly appropriate as most tax filers report using their refund to pay down their debts rather than for savings.[6] Thus, the intention behind providing these "rules-of-thumb" was to investigate whether simple tips could help filers reduce their debt, and to see which of the tips issued proved most effective in helping filers reduce their debts.[7]

Second, we looked at the efficacy of debt-reduction guidance provided via one-on-one financial counseling. The financial counseling program we study was provided to low- to moderate-income workers through their employers. Employees electively participated in financial counseling sessions, whether in-person or over the phone, and created financial action plans with their counselors. Based on their financial counseling sessions, some employees were prompted to address debt by their counselors. Counselors would offer tailored debt recommendations based on the employees' unique situations to help employees address their debt. Such recommendations included making a payment on a specific debt, contacting a creditor to negotiate better terms for the repayment of debt, and contacting a creditor to gather more information about their repayment plan.

Some employees had a more intensive level of engagement in the counseling program, attending more than one counseling session to further discuss their financial goals. We examined whether this heightened level of involvement in the program was predictive of better outcomes such as following the debt-related recommendations and reducing one's debt. Previous work on this program found that employees who began the program with low credit scores and who had more direct counseling sessions reported significant improvements in their credit scores, but no analysis has yet addressed the importance of increased counseling sessions in motivating debt reduction.[8]

Tax-Time Debt Tips

The simple debt tips were provided to low-income tax filers as part of a field experiment. In this experiment, tax filers were randomly assigned to one of six groups: A control group that received no debt management tip, one of four treatment groups that provided a specific tip, or a final treatment group in which filers could pick their own preferred tip to follow from a list of the four aforementioned tips. The groups in this experiment, as well as the tips provided to each group, are outlined in Table 1.

These tips were delivered immediately following tax filing as part of a survey that also asked a variety of questions about their debts, assets, and financial circumstances. To evaluate the efficacy of the tips on debt behaviors, we examined whether filers were more likely to follow any specific tip and, through a follow-up survey administered six months after the experiment, whether the tips had any impact on debt-related outcomes.

For all filers, regardless of which tip they received, none were significantly more likely to follow their assigned or chosen tip at a significance level of $p<0.05$. However, there were significant differences in the likelihood of holding debt six months after the experiment. At the time of follow-up, filers who were randomly assigned to see a specific debt-reduction tip were 4.8 percentage points significantly less likely to have unsecured debt ($p < 0.05$)—including credit card debt, payday loans, and negative balances in savings and checking accounts—relative to a control group that saw no tip. We found that these impacts were concentrated in filers who received a tax refund and had pre-existing debt at the time of tax filing. For filers who did not receive a refund, those who got a debt tip were no less likely than those in the control group to have unsecured debt at the time of the follow-up survey.

We also observed that certain tips worked better than others. Filers who received a tip to pay their smallest debts off first or a tip to pay down their highest-cost debt were 6 percentage points less likely ($p < 0.1$) to have unsecured debt six months after tax filing. Filers who received the other two pre-specified tips or had a chance to choose their own preferred tip, however, were no more likely to eliminate their unsecured debt at follow-up relative to the control group. (Figure 1)

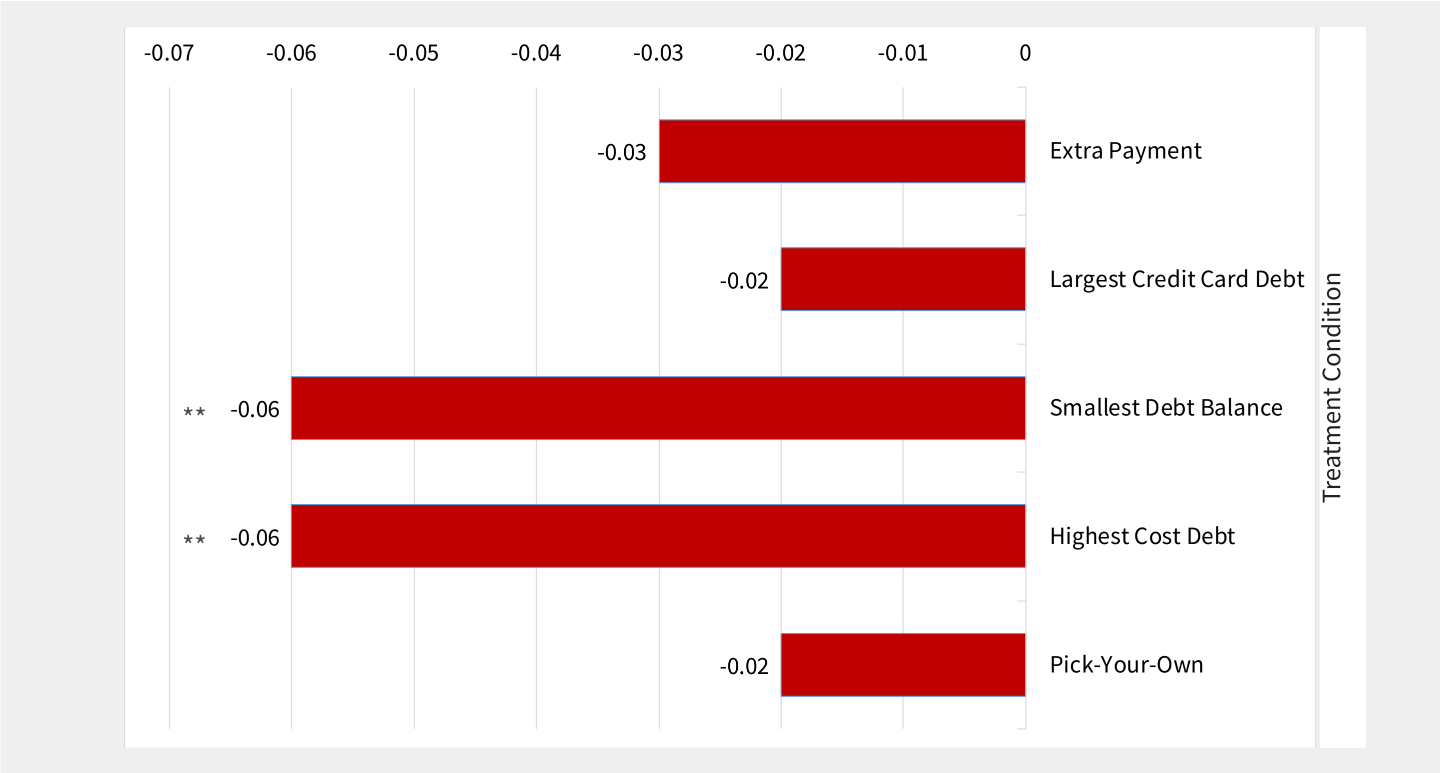
Debt Advice through Financial Counseling

Employees who engaged in financial counseling received specific action-oriented recommendations on how to improve their financial situations. For this study, we examined whether employees who received debt-related recommendations followed them and

Table 1: Experimental Groups and Description of Financial Tips

Experimental group	Treatment description	
	Received tax refund	**Did not receive tax refund**
Control group	Did not receive any financial tip	Did not receive any financial tip
Extra payment	“Get ahead on your debt! When you get your tax refund, use it to make at least one extra payment on one of your debts.”	”Get ahead on your debt! When you have extra money, use it to make at least one extra payment on one of your debts.”
Largest credit card debt	“Higher debts can lead to lower credit! When you get your tax refund, use it to pay down your largest credit card debts first.”	“Higher debts can lead to lower credit! When you have extra money, use it to pay down your largest credit card debts first.”
Smallest debt balance	“Build momentum toward being debt free! When you get your tax refund, use it to pay off your smallest debts first.”	“Build momentum toward being debt free! When you have extra money, use it to pay off your smallest debts first.”
Highest cost debt	“Dig yourself out from expensive debts! When you get your tax refund, use it to pay off your highest cost debt first.”	“Dig yourself out from expensive debts! When you have extra money, use it to pay off your highest cost debt first.”
Pick-your-own	Picked a financial tip from the list above	Picked a financial tip from the list above

Figure 1: Average Treatment Effects, Probability of Having Unsecured Debt



Note: N=2,971. Statistical significance: ** $p<0.05$

whether or not these employees were able to decrease their debt. The amount of debt employees held was measured by self-report. Every employee had one initial meeting with a financial counselor in which they established their financial goals, such as managing their debt, and could then subsequently engage with their counselor via follow-up appointments and/or through the use of text messaging, phone calls, and an online platform. Each time an employee used one of these methods of following up, they were marked as having one additional "engagement" with the financial counseling program.

In examining whether employees were able to follow debt reduction recommendations and decrease their debt, we looked at the number of engagements employees had and the number of formal counseling appointments they participated in.

The number of engagements employees had was not predictive of a difference in achieving their debt-management goals; however, employees who had more than one counseling session had greater odds of completing a debt-related recommendation (Table 2).

We also found that for participants who attended two rather than one counseling session, the odds of achieving their debt-related recommendation were 3.16 times higher ($p < 0.05$). The odds of achieving their debt-related recommendation were 12.89 times higher for participants who attended three counseling sessions than for those who attended only one session ($p < 0.001$).

While increased counseling sessions were significantly predictive of following a debt-related recommendation, we found no evidence that having more than one counseling session enabled employees to reduce their debt nor that a greater number of engagements was significantly related to debt reduction. These findings are limited by the self-reported nature of the data regarding total debt.

Table 2: Odds of Debt Action Completion

	Odds	Std. Err.	P>|z|	95% Confidence Interval	
Odds of Following a Debt-Related Recommendation					
Number of Engagements	1.05	0.02	0.01	1.01	1.08
Number of Sessions					
2	3.16	1.68	0.03	1.12	8.94
3	12.89	9.43	0.00	3.07	54.11
Odds of Reducing Debt from First Appointment to Follow-Up					
Number of Engagements	1.01	0.01	0.26	1.00	1.02
Number of Sessions					
2	1.03	0.26	0.91	0.63	1.68
3	0.93	0.30	0.82	0.49	1.76

Note: In this logistic regression controls included, race/ethnicity, gender, preferred language, education level, marital status, and number of dependents. The reference group for number of sessions is 1.

Conclusion

In examining these two approaches to helping households reduce their debt, we found mixed evidence on the roles that debt-management guidance can play in improving debt outcomes. With regard to providing financial tips, we observe that a very low-touch intervention—in which tax filers saw a simple tip immediately after tax filing—led, in some cases, to significant reductions in the incidence of unsecured debt held six months later for those filers who received a refund and held some debt at tax time. However, we only observed these significant reductions for tax filers who received two out of the four different debt-reduction tips provided.

While we do find that the number of financial counseling session an individual had increased the odds that they would achieve their debt management action items, we also found that completing more financial counseling sessions was not significantly related to reducing debt. Thus, both of these debt-reduction interventions have their limitations. Since these two types of debt-reduction recommendations were provided in different contexts, to different groups of people, and through different study designs, we cannot directly compare the efficacy of the two approaches to one another. However, one thing we can conclude from this comparison is that the problem of how to aid low- to moderate-income households in managing their debt remains a challenge.

Though counseling and coaching models have been shown to be effective at improving debt outcomes in certain contexts , we do not find evidence that incorporating debt-management goals into the workplace-based financial counseling model we studied can improve debt outcomes.

At the same time, the findings of the tip study reinforce those of other studies[9] showing that low-touch behavioral approaches like the ones tested here have the potential to help households reduce their debt burden, particularly for households receiving tips at the same time as an additional source of income, such as a tax refund.

End Notes

1. Urban, E. (2018, September).
2. Urban, E. (2018, September).
3. TurboTax Freedom Edition is offered as part of the IRS' Free File Program.
4. Internal Revenue Service Data Book, 2018 (2019); Roll, S. P., Russell, B. D., Perantie, D. C., & Grinstein-Weiss, M. (2019).
5. Roll, Davison, Grinstein-Weiss, Despard, & Bufe (2018); Bronchetti, Dee, Hufman, & Magenheim (2013).
6. Mendenhall, R., Edin, K., Crowley, S., Sykes, J., Tach, L., Kriz, K, & Kling, J., R. (2012); Grinstein-Weiss, M., Perantie, D. C., Russell, B. D., Comer, K.,

Taylor, S. H., Luo, L., Key, C., & Ariely, D. (2015).

7. Findings in this section are derived from a study by Kondratjeva, Roll, Bufe Grinstein-Weiss, and Chun (2019).
8. Despard, M., Zeng, Y., & Fox-Dichter, S. (2019).
9. Roll & Moulton (2019); Elliehausen, Lundquist, & Staten (2007); Theodos et al. (2019); Wiedrich, Gons, Collins, & Drever, A. (2014); x Theodos, B., Stacy, C. P., Simms, M., Abazajian, K., Daniels, R., Hanson, D., … Smith-Ramani, J. (2016).

References

Bronchetti, E. T., Dee, T. S., Hufman, D. B., & Magenheim, E. (2013). When a Nudge Isn't Enough: Defaults and Saving Among Low-Income Tax Filers. *National Tax Journal*, 66(3), 609-634.

Despard, M., Zeng, Y., & Fox-Dichter, S. (2019). Financial counseling for low- to moderate-income employees: An assessment of engagement and outcomes. (SPI Research Brief No. 19-03). St. Louis, MO: Washington University, Social Policy Institute.

Elliehausen, Gregory, E. Christopher Lundquist, and Michael E. Staten. 2007. The Impact of Credit Counseling on Subsequent Borrower Behavior. *Journal of Consumer Affairs*, 41 (1): 1–28.

Grinstein-Weiss, M., Perantie, D. C., Russell, B. D., Comer, K., Taylor, S. H., Luo, L., Key, C., & Ariely, D. (2015). Refund to Savings 2013: Comprehensive report on a large-scale tax-time saving program (CSD Research Report 15-06). St. Louis, MO: Washington University, Center for Social Development.

Internal Revenue Service Data Book, 2018 (2019). Publication 55B. Washington, DC.

Kondratjeva, O., Roll, S., Bufe, S., Grinstein-Weiss, M., & Chun, Y. (2019). Designing effective financial tips to guide debt repayment: Experimental evidence from lower-income tax refund recipients. Panel Paper, Association for Public Policy Analysis and Management.

Mendenhall, R., Edin, K., Crowley, S., Sykes, J., Tach, L., Kriz, K, & Kling , J., R. (2012). The Role of Earned Income Tax Credit in the Budgets of Low-Income Households. *Social Service Review*, 86(3), 367-400.

Pew Charitable Trusts. (2015). The Complex Story of American Debt: Liabilities in Family Balance Sheets.

Roll, S. P., Davison, G., Grinstein-Weiss, M., Despard, M. R., & Bufe, S. (2018). Refund to Savings 2015–2016: Field experiments to promote tax-time saving in low- and moderate-income households (CSD Research Report No. 18-28). St. Louis, MO: Washington University, Center for Social Development.

Roll, S. P., & Moulton, S. (2019). The Impact of Automated Reminders on Credit Outcomes: Results from an Experimental Pilot Program. *Journal of Consumer Affairs*, 53(4), 1693-1724.

Roll, S. P., Russell, B. D., Perantie, D. C., & Grinstein-Weiss, M. (2019). Encouraging Tax-Time Savings with a Low-Touch, Large-Scale Intervention: Evidence from the Refund to Savings Experiment. *Journal of Consumer Affairs*, 53(1), 87-125.

Theodos, B., Stacy, C. P., Simms, M., Abazajian, K., Daniels, R., Hanson, D., … Smith-Ramani, J. (2016). Don't swipe the small stuff: An evaluation of the impacts of two "rules of thumb" for credit card revolvers (Research Report). Retrieved from Urban Institute website: https://www.urban.org/sites/default/files/publication/83986/an-evaluation-of-the-impacts-of-two-rules-of-thumb-for-credit-card-revolvers-1_1.pdf

Urban, E. (2018, September). Five Charts that Illustrate the Size and Scope of Consumer Debt. The Aspen Institute. Retrieved from https://www.aspeninstitute.org/blog-posts/size-and-scope-of-consumer-debt/

Wiedrich, K., Gons, N., Collins, J.M., & Drever, A. (2014). "Financial Counseling & Access for the Financially Vulnerable: Findings from the Assessing Financial Capability Outcomes (AFCO) Adult Pilot" (Washington, DC: CFED, 2014).

Suggested Citation

Fox-Dichter, S., Ryan, M., Kondratjeva, O., & Roll, S. (2020). Strategies for debt reduction: Comparing financial tips and financial counseling (SPI Research Brief No. 20-03). Social Policy Institute at Washington University in St. Louis.