Inequalities in financial resilience of European households on the eve of the Covid-19 pandemic: welfare regimes and household types

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Introduction

- Negative financial shocks are common, but while some households are able to recover relatively quickly, others experience protracted periods of financial hardship.
- Financial resilience is the ability to cope with negative income or expenditure shocks, or to recover quickly from periods of financial adversity.
- To cope, households need access to sufficient financial assets, or be able to borrow from institutions, wider family or friends.
- In the short-term, financial hardship has an immediate and direct effect on households' consumption and their ability to cover the cost of basic needs such as housing, food, utilities, transport, clothing, and essential consumables.
- For those who have to borrow, the effects will be longer lasting as debts need to be repaid, and borrowing from family and friends can put a strain on these relationships. Paying back any incurred debts will result in a fall in living standards over the period in which repayments are made, with some unable to return to the standard of living they enjoyed prior to the shock.

Background evidence

- Money Advice Service's Financial Capability survey in 2018 found that 11.5 million adults in UK (22%) had savings less than £100; Financial Conduct Authority's Financial Lives survey found that over half (57%) of UK adults had savings less than £5,000
- A 2009 study found that 43% of the lowest income households in the UK had no savings or assets (Kempson and Finney, 2009)
- Some forms of problem debt are much more common among low income households – arrears on debts or other payment obligations (eg utility bills) is highly concentrated in low income households (Hood et al., 2018)
- Problem debt is more persistent in low income households in the UK (Hood et al., 2018)
- Almost half of Americans (44%) are "liquid asset poor"- lacking any savings reserve that they could turn to in an emergency (Levin, 2016);
- High levels of household debt prior to the financial crisis meant that the UK recession was deeper and longer than would otherwise have been the case, due to over-indebted households cutting expenditure (Bunn and Rostom, 2015)

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This research

- Define and operationalise a number of indicators of household financial resilience (or lack of). Financial resilience is a latent construct – it cannot be measured directly
- Use harmonised data to provide estimates across European countries and North America (22 countries – HFCS/LWS. 2011-2015)
- Provide new estimates on how indicators of financial resilience vary across different household types
- Examine how household financial resilience varies between welfare regime types across Eurozone countries

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Indicators of financial resilience

- **Financial security** - financially secure households hold net financial assets (financial assets minus non-housing liabilities) worth more than the value of *three* months' household income
- **Over-indebtedness** - over-indebted households hold financial debts (non-housing liabilities) to the value of at least *three* months' household income
- **Severe lack of financial resilience** - households who hold both gross financial assets less than the value of three months' household income *and* gross financial debts to the value of at least three months' household income (financially insecure *and* over-indebted)

Welfare regime typology

Why are we interested in welfare regimes? Private financial circumstances provide a partial picture of how households cope with financial shocks. Welfare states also plays a key role but the extent to which they help insure households against financial shocks varies across different regime types.

Our starting point was the typology developed by Esping-Andersen (1990) in *The Three Worlds of Welfare Capitalism:*

- **Social-democratic** – high degree of generous, universal support
- **Corporatist** – social protection is tied to prior employment with a strong element of earnings replacement (social insurance)
- **Liberal** – welfare support is highly targeted through means-testing, modest transfers

As many other studies have done, we added a southern European regime type

- **Southern** - family support systems play a distinctive role, welfare support is patchy

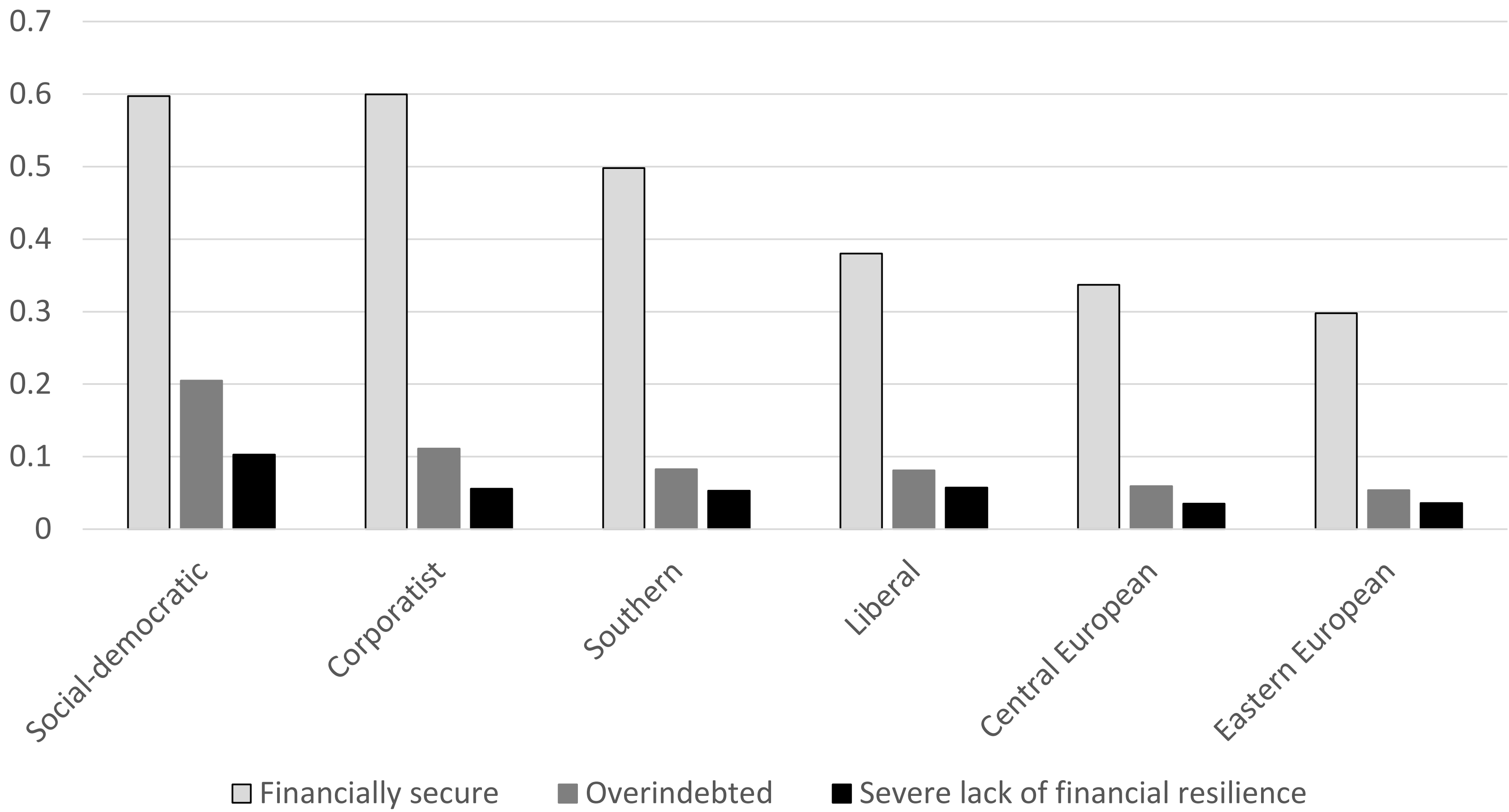
And two further regime types for Central and Eastern Europe:

- **Eastern European** – social protection is low and patchy ('very different')
- **Central European** – social protection is low (not as low as Eastern), has some similarities to Southern

Welfare regime types

Welfare regime	Country	Financially secure	Over-indebted	Severe lack of financial resilience
Social-democratic	Finland	0.46	0.17	0.11
	Netherlands	0.64	0.22	0.10
Corporatist	Austria	0.63	0.05	0.03
	Belgium	0.68	0.08	0.03
	France	0.58	0.12	0.06
Southern	Cyprus	0.55	0.21	0.10
	Spain	0.55	0.12	0.07
	Greece	0.25	0.06	0.06
	Italy	0.50	0.06	0.04
	Malta	0.80	0.08	0.02
	Portugal	0.51	0.09	0.06
Liberal	Ireland	0.38	0.08	0.06
Eastern European	Estonia	0.42	0.03	0.02
	Latvia	0.13	0.05	0.04
	Lithuania	0.62	0.11	0.05
Central European	Hungary	0.52	0.10	0.03
	Poland	0.28	0.04	0.03
	Slovakia	0.39	0.08	0.06
	Slovenia	0.33	0.12	0.09

Proportion of households within welfare regime types: financially secure, over-indebted or having a severe lack of financial resilience



Probit regression estimates: financially secure and over-indebted, 17 European countries

	Financially secure			Over-indebted		
	Coef.		SE	Coef.		SE
Income quintile						
Q1 (ref)						
Q2	0.057	**	0.029	0.011		0.038
Q3	0.113	***	0.033	-0.003		0.046
Q4	0.185	***	0.035	-0.182	***	0.047
Q5	0.242	***	0.036	-0.403	***	0.057
Welfare regime						
Social-democratic	0.015		0.043	0.418	***	0.042
Corporatist (ref)						
Southern	-0.335	***	0.023	-0.199	***	0.031
Central European	-0.870	***	0.026	-0.355	***	0.034
Eastern European	-0.944	***	0.029	-0.442	***	0.056
N	72,894			72,894		
F-statistic	148			40.01		
Prob > F	0.000			0.000		

Notes: Malta and Ireland are excluded; estimates take into account HFCS complex survey design and multiple-imputation; HFCS data weighted using cross-sectional weights and 1,000 replicate weights; bootstrapped standard errors; *p<0.1; **p<0.05;***p<0.01

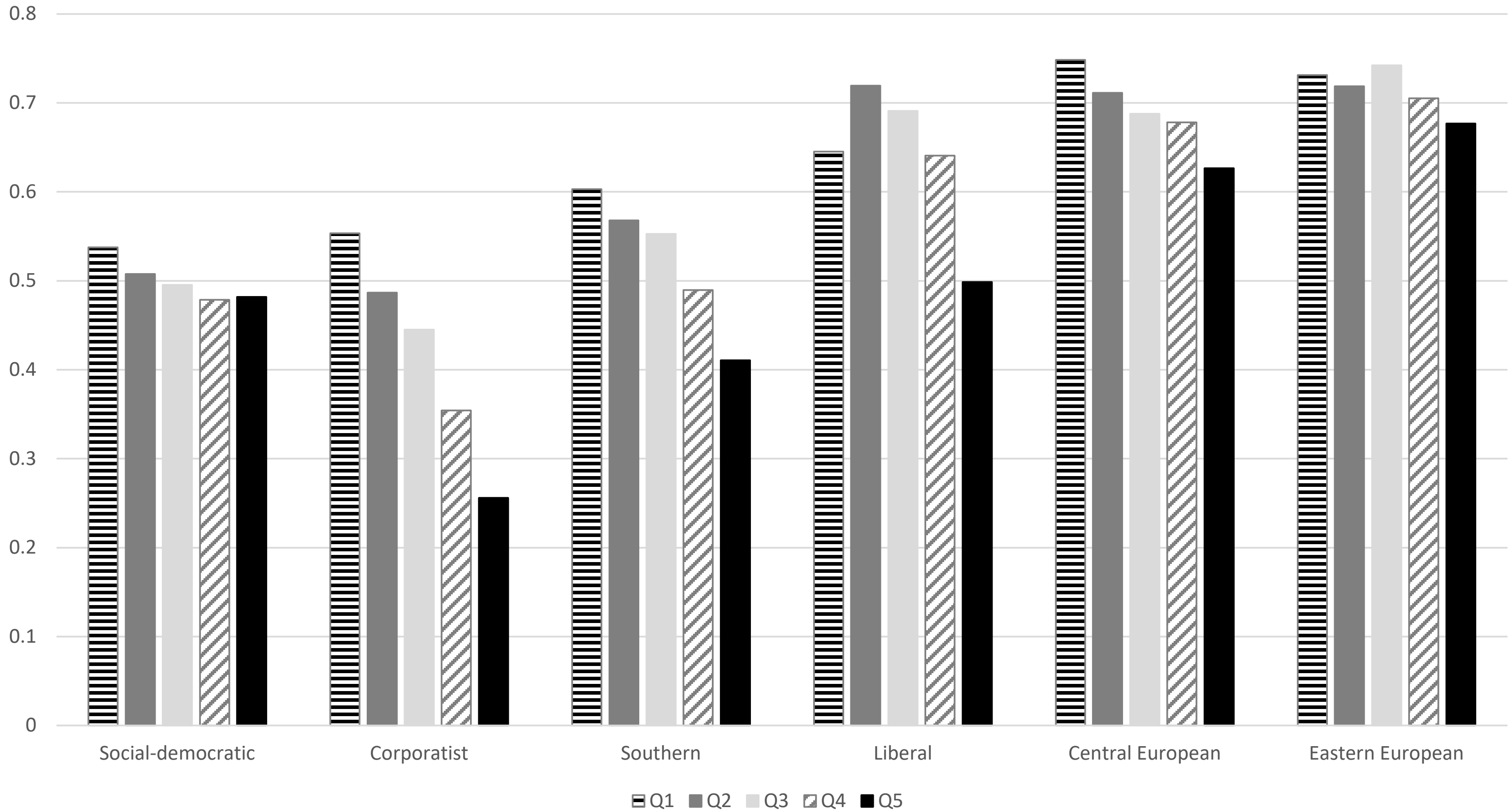
Other household characteristics included: gender, age, education, economic activity status.

Probit regression estimates: severe lack of financial resilience, 17 European countries

	Severe lack		
	Coef.		SE
Income quintile			
Q1 (ref)			
Q2	-0.064	**	0.029
Q3	-0.120	***	0.031
Q4	-0.215	***	0.035
Q5	-0.317	***	0.035
Welfare regime			
Social-democratic	0.108	***	0.038
Corporatist (ref)			
Southern	0.248	***	0.023
Central European	0.766	***	0.026
Eastern European	0.828	***	0.029
N	72,894		
F-statistic	125.33		
Prob > F	0.000		

Notes: Malta and Ireland are excluded; estimates take into account HFCS complex survey design and multiple-imputation; HFCS data weighted using cross-sectional weights and 1,000 replicate weights; bootstrapped standard errors; *p<0.1; **p<0.05;***p<0.01

Proportion of households classified as facing a lack of financial resilience (over-indebted *or* lacking sufficient financial assets) across income quintiles



Summary of results

- The proportion of households with inadequate financial assets or over-indebted varies between welfare regimes and while there are inequalities between different types of household, differences in household characteristics do not account for differences between regimes.
- Households most likely to be financially secure are in Corporatist and Social-democratic welfare regimes where the state already plays an active role in helping households insure against financial shocks.
- In other welfare regime types with lower coverage and less generous welfare support, high proportions of households lack financial resilience due to inadequate financial assets, over-indebtedness or both.
- Differences between welfare regimes are not always in line with welfare regime theory predictions as households in regimes characterised by lower decommodification have a greater need to privately hold assets to insure against shocks, but the reverse is found.
- One factor affecting incentives for lower income households to accumulate savings is the inclusion of capital limits in eligibility for means-tested cash transfers. In addition, where social security is inadequate households quickly deplete any savings.
- Although in general lower income households are less likely to be financially secure, inequalities in resilience vary between welfare regimes with big differences between income groups in Corporatist and Liberal regimes and smaller differences in Social-democratic and Eastern European regimes. In the Eastern European regime there are very low levels of financial resilience in all income groups.