

Social Situation Monitor – Multidimensional poverty in the EU

Financial Resilience: measures, trends and policy options

Abigail McKnight
Centre for Analysis of Social Exclusion

Brussels, 12 March 2018

- Many individuals/households face periods of financial difficulty during the course of their lives, but while some are able to recover relatively quickly, others experience an elongated period of financial stress.
- We use the term **Financial Resilience** to describe the capacity to recover quickly from financial adversity (the ability to bounce back from financial shocks).
- From a policy perspective, it is important that policies are in place to bolster households' financial resilience to income and expenditure shocks – individuals' well-being (Gathergood and Guttman-Kenney, 2016) and wider economic stability/prosperity (Murtin and d'Ercole, OECD, 2015).

Determinants of Financial Resilience



- Income is not a good predictor of an individual's ability to respond well to financial shocks.
- Access to liquid assets and emergency savings is important.
- Ability to borrow at reasonable rates.
- So called 'soft measures' are also key: attitudes, family networks, financial capability (skills and knowledge, motivation, accessibility to financial services).
- The welfare state can both promote and exacerbate resilience.

Income and expenditure shocks



- Negative shocks to income: earnings from work; separation; death of a partner
- Expenditure shocks: birth of a baby; poor health; car repair bill; domestic appliances; increase in borrowing rates
- Not all types of shock are randomly distributed

Measuring Financial Resilience



- Tend to turn to measures of financial vulnerability:
 - Absence or low levels of liquid financial assets or emergency savings;
 - Overburdening levels of debt (objective and subjective measures);
 - Unsecured debt;
 - Arrears;
 - Debt servicing pressures;
- Profiling of individuals/households at risk:
 - Income level
 - Age group
 - Education level
 - Disability status
 - Employment status

Note: although debt can be a sign that households are in financial difficulty, borrowing can be an appropriate response to financial shocks

Existing evidence

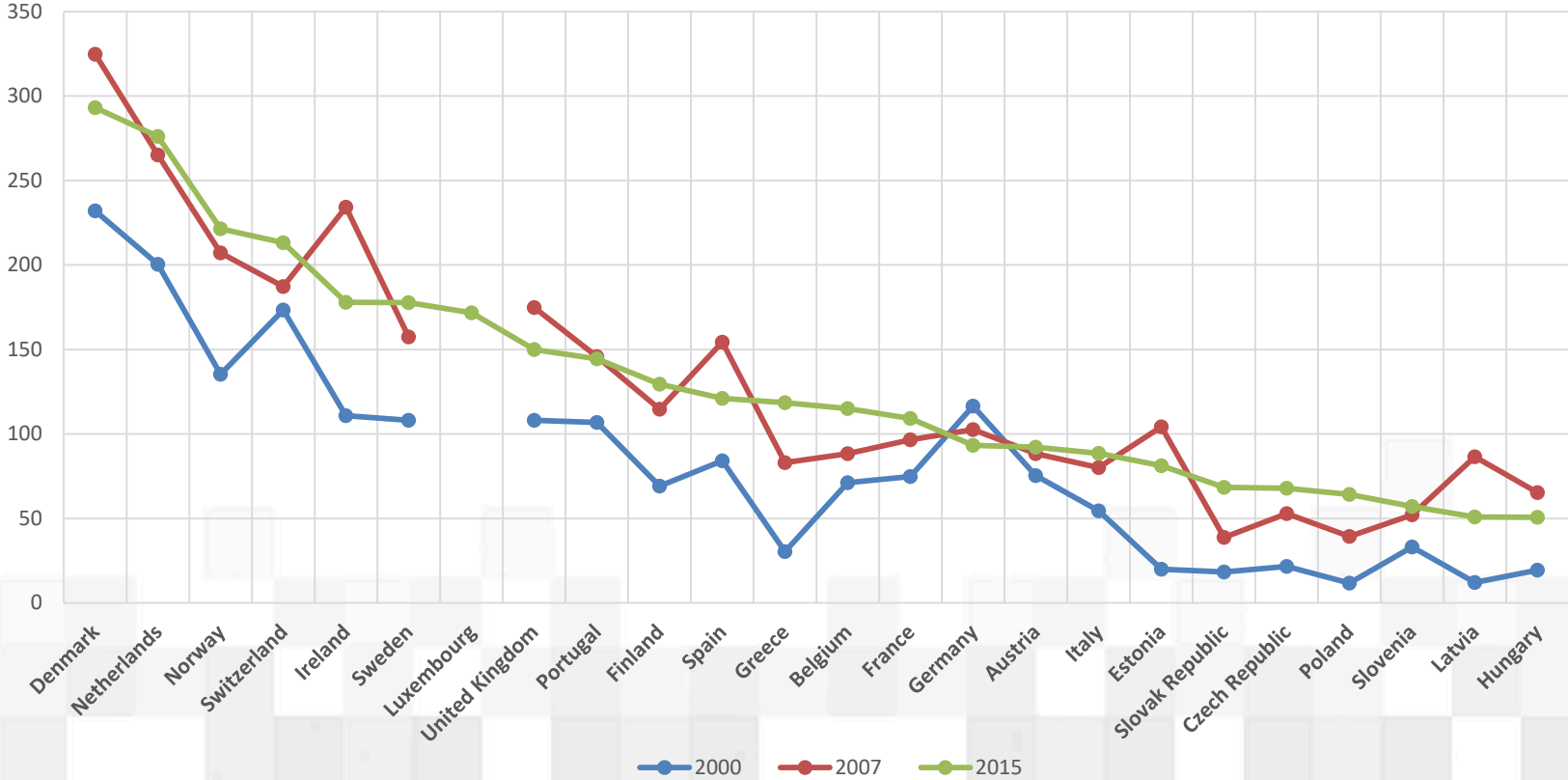


- Some forms of problem debt are much more common among low income households – being in arrears on debts or other payment obligations (eg utility bills) is highly concentrated among low income households as is having high debt-to-income ratios (Hood et al., 2018);
- Problem debt is more persistent in low income households in the UK [indicating a lack of financial resilience] (Hood et al., 2018);
- Almost half of Americans (44%) are “liquid asset poor”- lack any savings reserve that they could turn to in an emergency (Levin, 2016);
- Determinants of savings can explain more than half of the cross section variance in household saving rates across EU countries. However, large unobserved country fixed effects (e.g. because of institutional differences and measurement error) appear to be present (Rocher and Stierle, 2015).
- There is substantial heterogeneity in holding of components of assets and debt across Eurosystem countries (Bover et al., 2016).
- Financing negative saving out of informal loans plays a bigger role in Greece and Portugal than in Germany (Bover et al., 2016).

Country level indicators



Trends in household indebtedness: household debt as a percentage of net annual disposable income – 2000, 2007, 2015 (ranked)



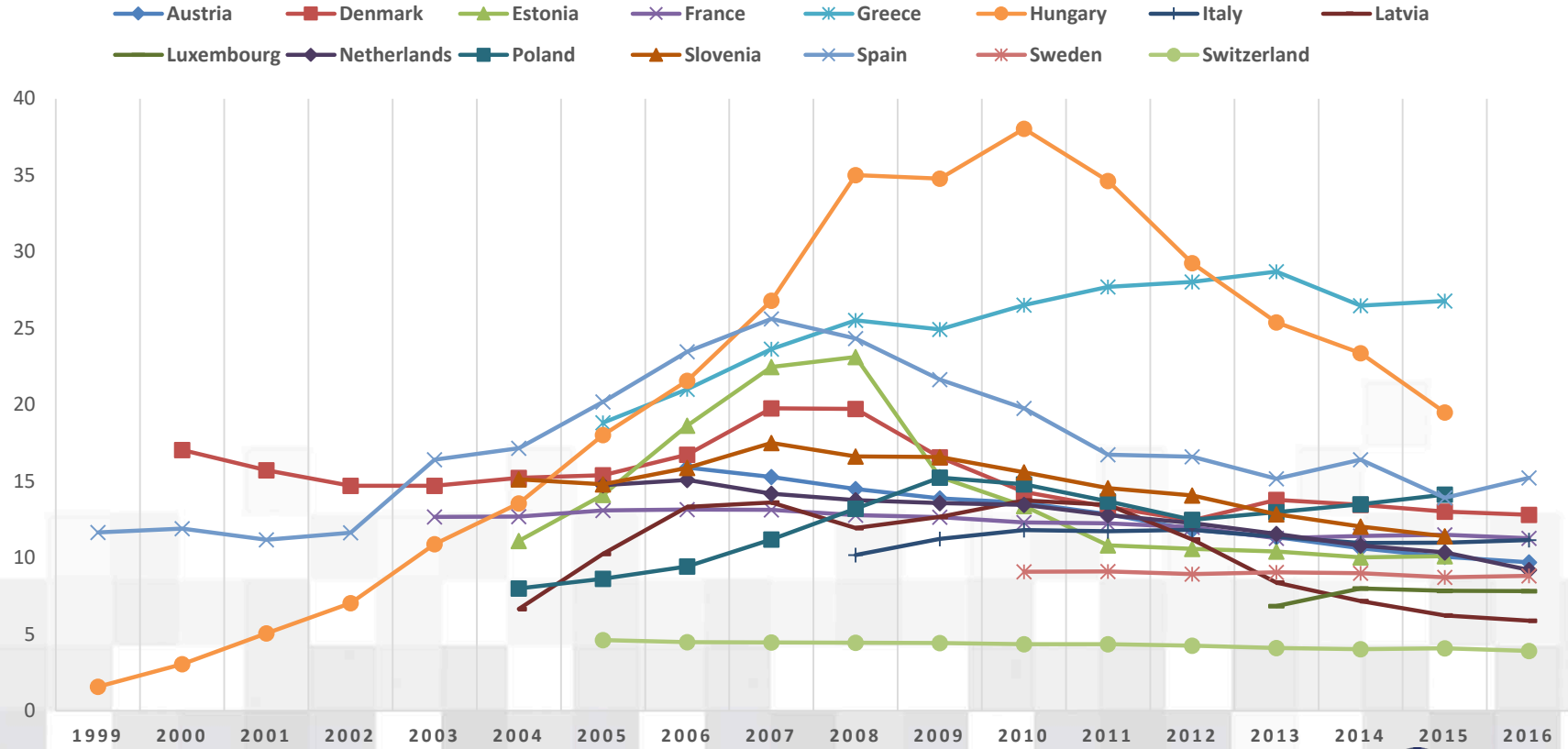
Data source: OECD.Stat

Note: housing bubbles impact on debt and consumption/credit

Country level indicators



Trends in consumer credit-to-income ratios within European countries between 1999 and 2016



Data source: OECD.Stat

Measuring financial resilience using micro-data



Using micro-data from the Luxembourg Wealth Study (LWS) and the Eurosystem Household Finance and Consumption Survey (HFCS) we will compute various measures

- Lack of emergency savings or liquid financial assets;
- Measures of problem debt (unsecured debt; high debt-to-income ratios; evidence of debt-servicing pressures (eg spending more than a quarter of income servicing debts);
- Profiling
- Difficult to get measures of dynamics – resilience is the capability to recover quickly from shocks

Building Financial Resilience through Asset-based Welfare Policies



- In contrast to most traditional forms of welfare policy, Asset-Based Welfare Policies are designed to boost individual's asset holdings rather than income;
- In the decade leading up to the financial crisis, a number of countries were experimenting with different ways in which to incentivise saving and asset accumulation among low income households;
- Most forms of state subsidised saving schemes offer tax exemptions on savings and therefore benefit the all-ready well-off (many low income households are not liable to tax or the incentives available are so low that they are ineffective);
- Asset-based welfare policies targeted at low income households involved direct transfers in the form of lump-sums or matched savings schemes (with various matching rates).

Asset-Based Welfare Policies designed to increase financial assets – pilots and programmes (examples)



- Individual Development Accounts in Massachusetts, USA;
 - learn\$save in Canada;
 - Savings Gateway and Child Trust Fund, UK;
 - Family Development Accounts, Taiwan;
 - Child Development Accounts (Baby Bonus scheme)/EduSave/Post secondary accounts/MediSave accounts, Singapore;
- Many included compulsory financial education

- Evaluation evidence suggests that asset-based welfare policies can be effective at increasing savings among low income households;
- No evaluation of whether asset-based welfare policies increase individuals/families' financial resilience;
- Many policies were axed as part of austerity measures following the financial crisis;
- A strong case has to be made to demonstrate that these policies are cost-effective – boosting financial resilience may result in long term cost savings (cash transfers, health services, etc.) but there maybe lower cost alternatives – and politicians will require electoral support.

Boosting Financial Resilience: alternative policy options



- Building financial capability – financial education, regulation of financial services to improve accessibility and reduce financial exclusion;
- Debt advice and counselling services;
- Adequate welfare system;
- Revisit asset thresholds in eligibility criteria for cash transfers;
- Regulation of short-term, high cost lenders;
- Crisis grants and loans.

Boosting Financial Resilience: alternative policy options



- Building financial capability – financial education, regulation of financial services to improve accessibility and reduce financial exclusion;
- Debt advice and counselling services;
- Adequate welfare system;
- Revisit asset thresholds in eligibility criteria for cash transfers;
- Regulation of short-term, high cost lenders;
- Crisis grants and loans.

Remaining challenges



- Measuring resilience rather than distress;
- How to treat housing assets and debts;
- Institutional differences across countries;
- How to evaluate most effective policy response;