The impact of welfare on household debt

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After the Second World War, lives in Europe and North America followed a typical pattern—after secondary education, it was common to get a job and to keep it for life. It was a time when industrial jobs offered that kind of stable and full-time employment. European welfare developed during this period and had to deal with two main social problems: unemployment and old age. Most of the welfare "services" for kids and the elderly were assigned to outside of the formal job market.

With globalization intensifying in the 1990s, many of those stable industrial jobs moved away because they became less profitable. While global inequality decreased—driven by the rise of China and India—it rose sharply in the industrialized west and primarily impacted the middle classes.

As a reaction, policymakers tried to make the labor market flexible, hoping that it would make it easier to create and find new jobs. However, this only weakened, fragmented, and deskilled labor. Since a large share of productive industrial jobs were offshored, job creation has been concentrated in the service sector. This is more unstable than the industrial sector and has a marked tendency to depress wages—especially at the lower end of the spectrum in jobs related to personal services, food, and care.

At the same time, the traditional family has become more unstable. Earlier, the family was not just a social union, but served as a redistribution device and economic unit where a breadwinner redistributed market income and a caregiver created welfare. While intergenerational redistribution still occurs within the family (vertical redistribution from parents to kids), traditional familial roles are less common. As women received better education and were more integrated into the formal—but unstable—labor market, families became less stable.

Welfare systems have tried to adapt to this brave new world and face new social problems that have appeared alongside the old ones. In addition to facing unemployment and old age, societies must now deal with new forms of precarity: low-quality employment; low wages and working poverty; difficult reconciliation of work and family time; low fertility rates and the postponement of childbirth; family instability; the need for formal childcare and eldercare; little or discontinuous contribution to social welfare, pension, or unemployment programs (social security rewards long careers); and decreased savings rates—to name a few.

These labor market and family dynamics created an unstable situation in western countries, where, for the first time since the Second World War, new generations can expect to have a lower standard of living than the previous generations. In this scenario, finance plays a large part. Financial markets were seen as a substitute for low labor productivity and a decaying social security system. The role of social policy has also been oriented more towards the concept of "financial inclusion", with the idea that if people with modest revenue are integrated into financial markets, then they would get a share of the wealth. In many countries, pensions were restructured into pension funds to be capitalized on by financial markets—linking worker savings to market fates. Housing is increasingly seen as a security asset that will allow higher welfare in an "asset-based welfare" system. This new exposure to financial markets also exposes households to financial crises.

This new form of inequality, stemming from labor, family, and financial instability, acts as generational cleavage, as the liberalization in the labor market and the reform of the social security system disproportionately target younger generations, while older workers keep their privileges. Policymakers had little interest in unsettling the rights of the current voters and found it easier to shift the effects of those reforms onto people who could not yet vote. While the age and generational dimensions of those transitions are significant, social policy has been mostly blind to the age-orientation of welfare, perhaps because most of the welfare spending was (and is) primarily focused on retirement and pensions. These new social risks suggest that the age-orientation of welfare is an important dimension of how welfare works. Given their universalist nature, some systems—like social-democratic welfare regimes—were more prepared to adapt to this new world than others. The Christian-democratic system, for example, remained anchored to the idea of job stability and the traditional family and struggled to adapt to new changes. However, internal variability within clusters is large, and some traditionally Christian-democratic countries now focus their spending and generosity on younger generations as well.

In my paper “The impact of welfare on household debt”, I study the impact of the age-orientation of welfare on the larger macroeconomic context, focusing specifically on household debt. I explain how different tiers of household financialization have appeared due to how welfare states redistribute services among the active and elder populations. Household debt is part of the wave of household financialization and has increased significantly in the last 30 years, along with the rise of financialization and the assetification of housing. However, the rise in household debt varies intensely between OECD countries. Many scholars have pointed out that a trade-off might exist between household debt levels and welfare generosity—debt has increased because of a lack of welfare provision.

Rather than take this direction, I start by showing that household debt is traditional and is mainly a feature of the middle-upper class—banks do not usually lend to poor people. Contrary to the trade-off hypothesis, I find that countries that spend more on their active population tend to have higher levels of aggregate indebtedness, but very low levels of consumer credit. This shows how strong social protection can make people more confident in their financial decisions. However, if mortgages are a marker of privilege, then another common type of debt, consumer credit, is often a marker of need. If we break down debt, we see that the debt in Nordic countries is made of mortgages—in other words, long-term investments—and the use of consumer credit is essentially absent. Welfare makes people less risk-averse and empowers them to make financial decisions that will affect them for several years.

Conversely, in continental European countries, debt is low in general. This is because the cost of failure is higher—there are fewer safety nets. This is especially true for young people with unstable jobs who commit to long-term investments more cautiously. Where social protection focuses on “traditional” pensioners and the unemployed, indebtment remains the prerogative of the wealthy and is mainly avoided. Those seeking to access credit must first obtain job stability, and that can take a while. This is also shown by the high rate of young people who are not in education, employment, or training (NEET). Decomposing debt, we see that mortgages are low and consumer credit is minimal, with the partial exception of Central-Eastern European countries, where the use of consumer credit is a bit higher.

The United States, Canada, and the UK—usually depicted as heavily indebted societies—are not more indebted than Nordic countries. A noticeable difference between the two clusters is found in the composition of debt. In liberal countries, in addition to having a large number of mortgages in the higher strata of the population, consumer credit is more present overall. Since an underdeveloped welfare state is present, people tend to use credit cards or other forms of consumer credit to deal with life’s necessities, which creates a trade-off between welfare and consumer credit where credit is used as a substitute for social policy.

Further studies are needed to fully grasp the consequences of the age orientation of welfare in the economy and how it might have an impact on countries’ economic performance or financial stability or instability. With regards to the study of the varieties of capitalism, welfare and the state are often marginalized, as this field focuses more on intra-firm relations. However, the state is a central structuring force for different varieties and growth strategies. In this case, it is apparent that two clusters of countries (social democratic and liberal) have a lot of debt, but for very different reasons. This has created consequences in terms of financial stability, inequality, and growth potential. The full extent of those consequences is still to be explored.

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