



Foundation Findings

Household
over-indebtedness in
the EU: The role of
informal debts

3rd
EQLS policy brief



European Foundation for the Improvement of Living and Working Conditions

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EQLS policy briefs

This policy brief highlights findings on a specific topic from Eurofound's European Quality of Life Survey (EQLS) that is of particular interest from a policy perspective. It brings results of the analysis of these data together with evidence from other Eurofound projects to formulate a number of policy pointers. The focus of this policy brief is household over-indebtedness – in particular, the role of informal debts. This policy brief has been prepared by Hans Dubois. For further information, contact hdu@eurofound.europa.eu.



Policy context



In its Europe 2020 strategy of 2010, the European Union set an objective to lift at least 20 million people out of poverty by 2020. This has proven challenging in the current economic environment. The recent Social Investment Package (European Commission, 2013a), for example, notes an increase in evictions and homelessness since the onset of the crisis. An increasingly prominent cause of poverty is over-indebtedness. Management of over-indebtedness is thus critical in the effective reduction of poverty.

Borrowing money may help people to exit, avoid or tackle poverty and deprivation. For example, it facilitates investments in schooling and housing; it allows people to cover the cost of an urgent, unexpected need for home repair. For those who are not poor, it may help them make an investment in housing and education that will enhance their quality of life.

Over half the population of the euro zone does not have debts with financial institutions (European Central Bank, 2013). Many of the 44% who do have debts have no financial difficulties. Over-indebtedness usually emerges only after an unexpected income shock – for example, caused by unemployment. Increased expenditure due to illness or over-consumption can also play a role. Life events such as a relationship break-up can cause both an income and an expenditure shock. Over the

course of the economic crisis, debt problems have become more common, especially because of unemployment and reduced working hours.

Over-indebtedness is a heterogeneous problem. Among the working poor and long-term unemployed, it usually arises from accumulated missed payments on utility and phone bills, and on rent. The crisis, with its lay-offs and reduced social benefits, has enlarged this group of poor people with debt problems, which has long formed a major part of the over-indebted cohort. However, much of the increase in over-indebtedness has come from a different group: people who were in well-paid employment, lost their jobs and are now left with large mortgages on their houses without the prospect of increasing their income anytime soon. Both between these groups and within them, there is great heterogeneity in the causes and consequences of over-indebtedness.

Over-indebted households – whether they are struggling with mortgage, rent and consumer credit arrears, unpaid utility and phone bills, or other forms of debt – may in the end face having their utilities cut off or being evicted from their dwellings. To make ends meet, they may economise on basic necessities such as food and clothes for themselves or their children, utilities and badly needed home repairs. Increasing the incomes of these households, although preferred, may be a less realistic strategy in the

short run. These households often experience health problems and stress, and feelings of insecurity mainly in terms of uncertain housing situations. Debt problems can furthermore be a factor in relationship break-up and tensions in the household, affecting children's well-being as well.

An effective policy response to household over-indebtedness is based on a balanced set of preventive, alleviative and rehabilitative measures (Eurofound, 2012b). The EU has contributed to this mainly in the area of prevention. In April 2013, the European Parliament and the Council of the European Union agreed on rules aiming to better protect consumers when they take out residential mortgages. These include the provision by the lender of a European Standardised Information Sheet to facilitate comparison of loan offers and the right of withdrawal from a loan agreement for up to seven days. The EU is also contributing by improving the information available on over-indebtedness; for example, it will release a report on household over-indebtedness later this year (European Commission, forthcoming).

Policy challenges and issues

The focus of policy discussion, data collection, research and service provision tends to be on 'formal debts'. These include debts with institutions such as financial service providers, utility companies and public authorities. Illegal money lending has also received attention. However, many people borrow from family, relatives or acquaintances when in need of money. Such debts are also of importance. This policy brief addresses the lack of attention to the informal sphere. In particular, it focuses on 'informal arrears': arrears on informal loans from friends or relatives outside the household.

Much financial support to relatives and friends is provided as gifts rather than loans, but there are signs that borrowing is common as well. A Portuguese study describes how loans are often provided free of interest and without any specific repayment schedule (Frade, 2003). Households repay them whenever they have a surplus. Such unconditionality may change

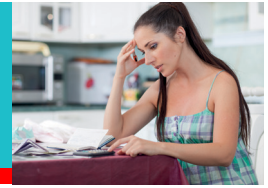
when the lending household itself is in urgent need of money, a situation that may have become more common during the crisis. There are indications that households have failed to make payments related to these debts, or at least feel that they failed to do so. For example, in the Romanian Quality of Life Diagnosis survey, in May 2010, 12% reported that they fell behind with what they owe to people around them (friends and relatives) during the previous month (Marginean and Precupetu, 2010).

When developing a common European definition of over-indebtedness, the European Commission recognised the importance of such informal commitments. Nevertheless, as this common definition was meant to be operational, informal debts were excluded 'as no data exists on them' (European Commission, 2008, p. 37). This has now changed. The 2011 EQLS provides for data on informal arrears for all 28 EU Member States.

Loans from friends or relatives tend to be quick and cheap. When someone is under financial stress, the preparedness to lend money signals support and trust from the lender in addition to the financial relief the loan provides to the borrower. Such psychological aspects are important for households that are struggling financially. Furthermore, defaults on informal debts may have less severe consequences than those on formal debts and on bills, which may eventually lead to eviction or disconnection from utilities. Nevertheless, there are also downsides to informal debts; three are described below.

1. Delayed detection of problems

When debt problems arise, financial support from family and friends provides immediate financial relief. Nevertheless, this support may not address the sources of debt problems. Sometimes formal services are in a better position to provide structural solutions and to prevent problems from spiralling out of control. Such services may include debt advisory services, welfare services, employment services, mental healthcare services and social housing services (Eurofound, 2012b). Informal



borrowing may discourage households from seeking help from such services and complicate early proactive detection of problems by service providers as defaults may go unobserved. When an informal loan resolves the situation effectively, delayed detection of problems may not matter. If it does not, however, and the household starts defaulting on its informal loans, formal loans and bills, delayed detection is an issue. Furthermore informal debts do not have the checks and balances that formal debts more often have, so detection of problems before the money is borrowed is unlikely.

2. Domino effect of defaults

It is not only a problem for the household itself when people cannot repay money that they have borrowed informally. It may also trigger financial problems among friends and family they have borrowed from, especially when those friends and family urgently need the

money back. This problem can be particularly prominent if there are only a few people in employment lending money to a larger social network. If such key people lose their income from work and urgently need their money back, a chain of defaults may follow.

3. Endangering social networks

When a household struggles to make ends meet, the stress involved poses a risk to relations within the household and to the mental well-being of its members. Social support from friends and family can ease the situation for the household involved. As long as the borrower can repay informal debts when required to, there is no need for informal debts to put a strain on these social relations. Nevertheless, when default is looming, this can break social bonds, and may lead to the social exclusion of the struggling household at a time when it is in particular need of social support.

Key findings

- The proportion of people unable to make payments related to utility bills and to their rent or mortgage increased between 2007 and 2011. Such arrears are still most common for renters, but the increase has mostly come from people who own their homes with a mortgage.
- Much of the policy debate and discussion about over-indebtedness has focused on formal arrears. Nevertheless, when in urgent need of money, most people in the EU would turn to relatives or friends, which suggests that problems may arise in making payments related to informal debts as well.
- In the EU, 8% report that their household has been unable to pay, as scheduled, payments related to informal loans from friends or relatives not living in their household. The prevalence of informal debts can be assumed to be even more common than that of informal arrears.
- Informal arrears are particularly common in the Czech Republic, Germany, Greece, Italy and Poland, but in all Member States significant proportions of people report having such arrears.
- Low-income groups, single parents and people living in social housing are most likely to report having informal arrears.
- Such payment problems may lead to delayed detection of debt problems by service providers who could help, loss of social support when most needed, and the domino effects of default.
- Most people with arrears in utility bills have informal arrears as well, so even when arrears observed in the formal sphere may look small, more financial problems may be unseen in the background.
- Conversely, most people with informal arrears have arrears in other areas as well. While it is not clear from the data which come first, it suggests early detection may be easier than one might expect.
- In general, feelings of absolute housing security have declined in the EU28. They are especially low for people with informal arrears, 13% of whom believe it likely that they will need to leave their accommodation because they cannot afford it; relatively few find it very unlikely.
- People with informal arrears experience difficulties accessing healthcare services relatively often because of cost, which is of particular concern because they have worse self-reported health.
- People with informal arrears are often confident that they can continue relying on relatives or friends when they need to borrow money. Nevertheless, they are also particularly likely to have nobody to turn to when they urgently need money.
- Social exclusion is high among people with informal arrears. For example, the EQLS asks whether households can afford having friends or family over for dinner once a month; this is particularly likely to be unaffordable for people with informal arrears. Those who have informal arrears and nobody to turn to when urgently in need of money are particularly excluded.
- Local government is distrusted to a greater extent by people with informal arrears than by those without. This holds across Member States and is of concern also because it is precisely this local government which often offers services aiming to help people in such circumstances.



Exploring the issue



Over-indebtedness and the EQLS

Eurofound has previously investigated the causes and consequences of household over-indebtedness (Eurofound, 2010) and has looked into how these can be addressed (Eurofound, 2012b). In particular, Eurofound examined how the quality of debt advisory services can be improved, adjusting to the changing patterns in demand during the recent crisis.

This earlier research drew upon evidence from country reports and case studies of debt advisory services. It is also based on analysis of European databases, particularly Eurostat's Survey on Income and Living Conditions (EU-SILC), which every year collects data on household arrears in the EU. In 2008, EU-SILC contained a more extensive module on household over-indebtedness. In addition, the European Central Bank's Eurosystem Household Finance and Consumption Survey collects detailed information in the euro zone countries on household mortgage debts and non-mortgage debts with financial institutions.

In the following sections, results from the EQLS are discussed. The survey was held in 2003,

2007 and 2011.¹ It includes questions on arrears in rent or mortgage payments, as well as in utility payments. Since 2011 it also asks about arrears on payments related to consumer loans, including credit card overdrafts. Furthermore, the survey includes questions about financial insecurity, such as the ability of households to make ends meet and the need to leave their accommodation because it has become unaffordable. The questions with regard to utility arrears and mortgage or rent arrears, in particular, are similar to those in EU-SILC. Nevertheless, the EQLS also collects data on issues related to quality of life. This allows for investigation of how household over-indebtedness relates to other quality of life issues.

This policy brief focuses on a type of arrears that is unique to the EQLS, included for the first time in 2011: arrears on debt repayments to friends or relatives outside the household. Descriptive data on the different types of arrears for the various Member States have already been provided in earlier Eurofound publications (Eurofound 2012a, b).

The survey's sample size differs among Member States and ranges between 1,000 (Bulgaria and

¹ The main fieldwork for the third EQLS was carried out in 2011, with some additional fieldwork in early 2012.

Slovakia) and 3,055 (Germany). This limits the potential for analysis especially within Member States; hence most analysis here is at the EU28 level.

Arrears in bill and debt repayments

Effects of the crisis

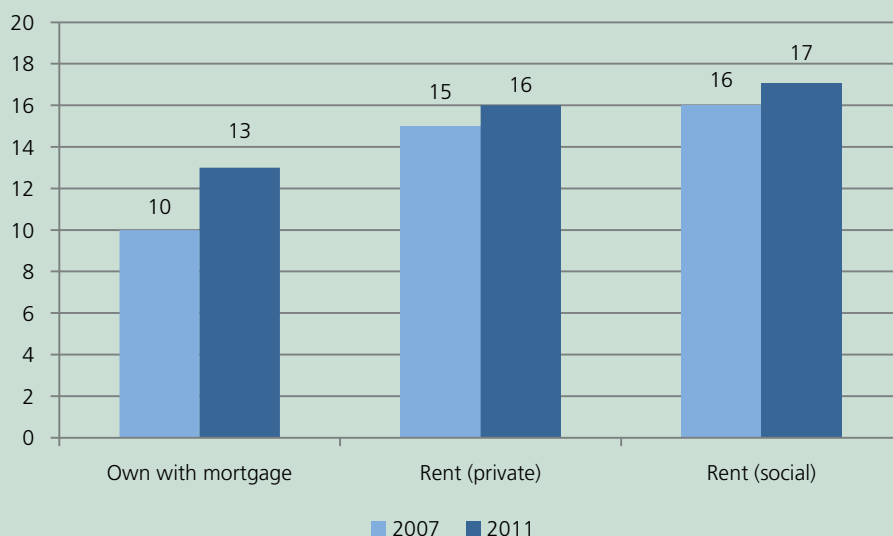
It has long been more common for people who rent their accommodation than for people who own their house with a mortgage to report problems in making rent or mortgage payments as scheduled. Between 2007 and 2011, such arrears went up for both renters and homeowners. However, the gap between the two has narrowed as this recent increase seems to have mostly come from mortgage arrears rather than rent arrears (see Figure 1).

Arrears in utility payments have also increased since 2007, especially among people who own their house, both without a mortgage (from 11% to 14%) and with a mortgage (from 10% to 13%). Such arrears are still most common among people who live in privately rented accommodation (18%) or social housing (19%),

but again there has been hardly any increase in utility arrears among this group.

With the increase in arrears, an important aspect of quality of life has deteriorated: housing security. The EQLS quantifies this by showing a larger proportion of Europeans reporting that they are afraid of losing their home because they can no longer afford it, the proportion rising from 4% in 2007 to 6% in 2011. The increase has come from households living in larger, mortgaged accommodation (Eurofound, 2012a). While most people by far still believe it unlikely they will need to leave their accommodation, it is notable that absolute feelings of security have fallen. In 2007, 85% of people who owned their home with a mortgage felt secure, believing it very unlikely they might need to leave their home because they could no longer afford it. In 2011, this proportion decreased by 6 percentage points to 79%. Renters in the private market also less often felt very secure, with a decrease of 3 percentage points, from 68% to 65%. Other groups – social housing tenants and owners without mortgages – did not experience any decreases in this respect.

Figure 1: Arrears in mortgage and rent payments, by tenure, 2007 and 2011 (%)



Notes: Q60 Has your household been in arrears at any time during the past 12 months, that is, unable to pay as scheduled any of the following? a. Rent or mortgage payments for accommodation.
Q18 Which of the following best describes your accommodation? 2. Own with mortgage, 3. Tenant, paying rent to private landlord, 4. Tenant, paying rent in social/voluntary/municipal housing.



Households that own their dwelling with a mortgage generally live in better accommodation and are of higher social classes. In terms of educational background, absolute feelings of their household's housing security decreased most among people with tertiary education (by 3 percentage points) and among people in the second-highest income quartile (by 5 percentage points).

The findings detailed here provide support for the idea that a new group of people in vulnerable housing situations has emerged, often with debt problems, alongside a still-dominant group in a long-standing vulnerable situation (Eurofound, 2012b).

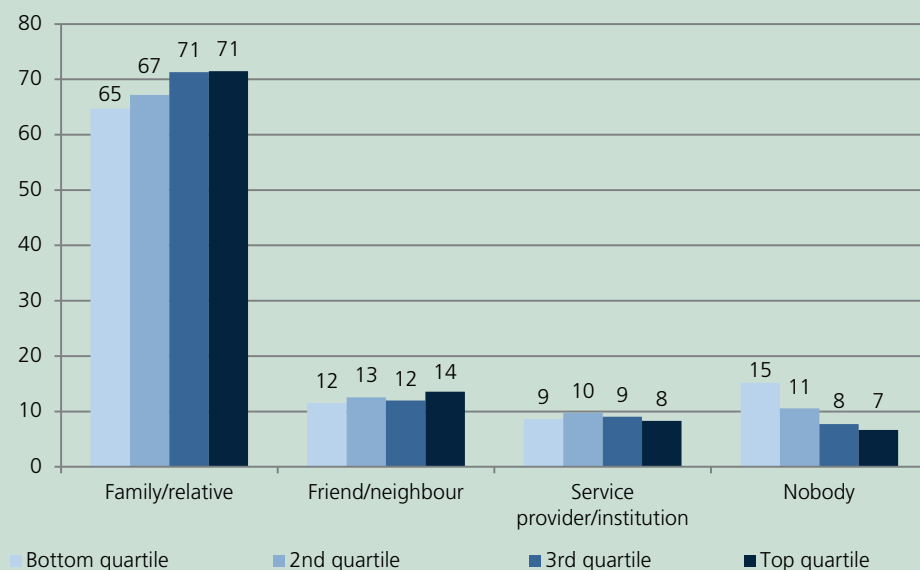
Informal borrowing and arrears

When urgently in need of money, people tend to turn to family or relatives (70% in 2011). Many also turn to friends or neighbours (12%); relatively few turn to institutions (8%). This low reliance on institutions holds regardless of income, but people in higher income quartiles more often say they would turn to family, while

people in lower income quartiles are more likely to have nobody to turn to (Figure 2). For some of those who report turning to family or relatives when urgently in need of money, it is to their partner they turn. In the 2007 EQLS, this question included 'Partner/spouse' as a response option, and that survey showed that 17% of people in the EU28 would turn to their partner.

Given this reliance on informal networks, it is not surprising that a considerable number of defaults happen in the informal sphere. Out of all people living in the EU28, 8% report their household has been unable to pay as scheduled payments related to informal loans from friends or relatives not living in their households at any time during 2011. Furthermore, it is interesting to observe that an additional 4% either said they did not know or refused to answer when asked whether they had such informal arrears. These respondents may not have understood the question or may not have wished to disclose their informal arrears, but may also have doubted whether they were expected to return the money they had borrowed.

Figure 2: Sources of emergency financial support, by income quartile (%)



Note: Q35 From whom would you get support in each of the following situations? For each situation, choose the most important source of support. e. If you needed to urgently raise [country-specific amount, around 1/12 of annual national at-risk-of poverty threshold] to face an emergency: 1. A member of your family/relative, 2. A friend, neighbour, or someone else, who does not belong to your family or relatives, 3. A service provider, institution or organisation, 4. Nobody.

Defaults on informal loans happen across the EU28. Italy and Greece top the list, with 14% reporting their household has been unable to make payments related to informal loans (Eurofound, 2012a). These two countries where informal arrears are particularly common are among those euro zone countries where it is least common for people to have formal debts (European Central Bank, 2013). Italy and Greece are closely followed by Germany (12%), the Czech Republic, Poland and Latvia (all at 10%), Bulgaria and the Netherlands (both at 9%) and Romania (8%). This constitutes a rather broad geographical spectrum of Member States. As with many other quality of life indicators (Eurofound, 2012a), it challenges the traditional split between the Member States that have joined since 2004 versus the Member States that joined prior to 2004.

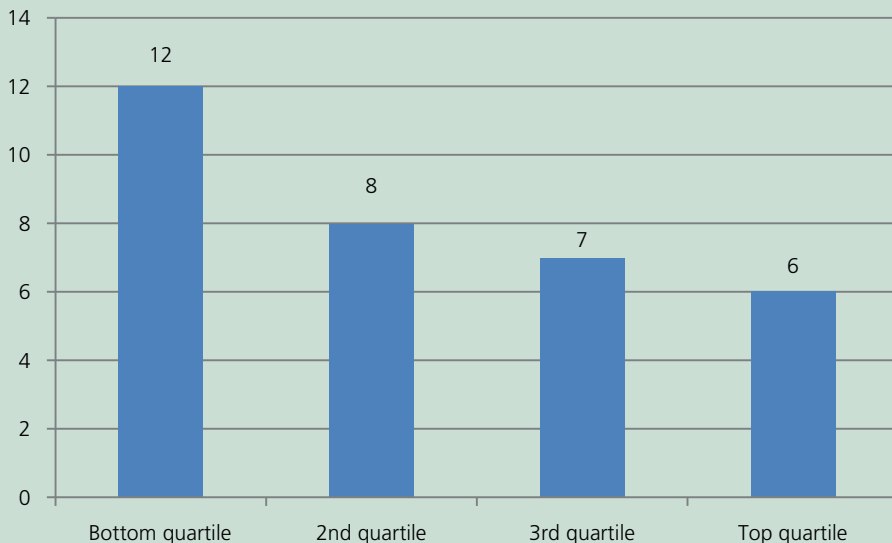
Who has problems repaying informal debts?

In all Member States where informal arrears are relatively common, it is particularly people in the lowest income quartile who report them (Figure 3), except in Italy where arrears on payments related to informal debts are spread more equally across income quartiles. Overall,

in the EU28, the proportion of people with informal arrears is similar in the upper three income quartiles in the different countries, but the 25% with the lowest incomes are twice as likely as the top quartile to have informal arrears. On the one hand, this high proportion of informal arrears may reflect the fact that the lowest-income earners have limited access to the financial markets for formal loans. On the other hand, formal borrowing is relatively easy for people with higher socioeconomic status, so they may less often be in need of informal loans; and if they have such loans, they may less often be unable to make payments related to them.

Among all income groups, single parents are most likely to report that they have been unable to make payments related to informal debts: over 10% in each income group and almost one in five (19%) in the bottom income group. For the top two income groups, however, single households (without any child) also experience such arrears relatively often: 8% for the top half of income earners overall. In contrast, among the bottom two income groups, couples with children relatively often experience such defaults: 12% among the bottom half of income earners.

Figure 3: Inability to repay informal debts as scheduled, by income quartile (%)



Note: Q60 Has your household been in arrears at any time during the past 12 months, that is, unable to pay as scheduled any of the following? d. Payments related to informal loans from friends or relatives not living in your household.



In terms of tenure, formal arrears are most common among households in the bottom income quartile who live in social housing (17%). For the middle two income groups, they are more common among people who live in private rented accommodation (12% and 11% for the second and third quartiles respectively). Regardless of income, it is relatively uncommon for homeowners to have informal arrears, whether they are homeowners with a mortgage (8% overall) or without a mortgage (7% overall). People with a mortgage are likely to have had good access to banks, otherwise they would not have obtained the mortgage. With this access to formal lenders, it is not surprising they have less often informal arrears than people who rent, regardless of income. People who own their house without a mortgage are older, on average, and less likely to borrow. If they do, they may have easier access to formal loans because they have an asset.

Coping strategies

In trying to make ends meet, people apply various coping strategies. They draw on savings and economise, but may also turn for help to family, friends, service providers and financial institutions (Figure 2). People also cope by prioritising which bills to pay. They may postpone a utility or rent payment, especially if this does not have immediate consequences, in order to be able to buy food for their households. Exchanging goods and growing food are also important for many in the EU.

People go to great lengths not to lose the roof over their heads. They are thus unlikely to default on rent or mortgage payments systematically before defaulting on other payments – even more so if there are children in the household (Eurofound 2010; 2012). They might miss a rent or mortgage payment once or twice, but avoid more structural defaults by borrowing from friends and family, relying on credit cards and defaulting on utility payments. Among Europeans who have defaulted both on payments related to informal debts and on consumer credit and utility bills, 12% have still not missed rent or mortgage payments. In contrast, only 3% of people who have defaulted on consumer credit, informal debts and rent or

mortgage payments have not defaulted yet on utility payments.

Just over one in ten (12%) people with informal arrears have no other arrears. Overall, this amounts to 1% of all residents in the EU28. They are mostly single people on low incomes and are relatively young. All other people with informal arrears (88%) also have arrears in utility bills, consumer credit, or in rent or mortgage payments. The majority of people with informal arrears (61%) also reports having the other three types of arrears simultaneously. This amounts to 5% of all residents in the EU28. The majority (63%) of people who have arrears on payments related to consumer loans and of those with rent or mortgage arrears (55%) have informal arrears as well (Figure 4). Among the large group of people with arrears in utility bills, almost one in two (46%) has informal arrears.

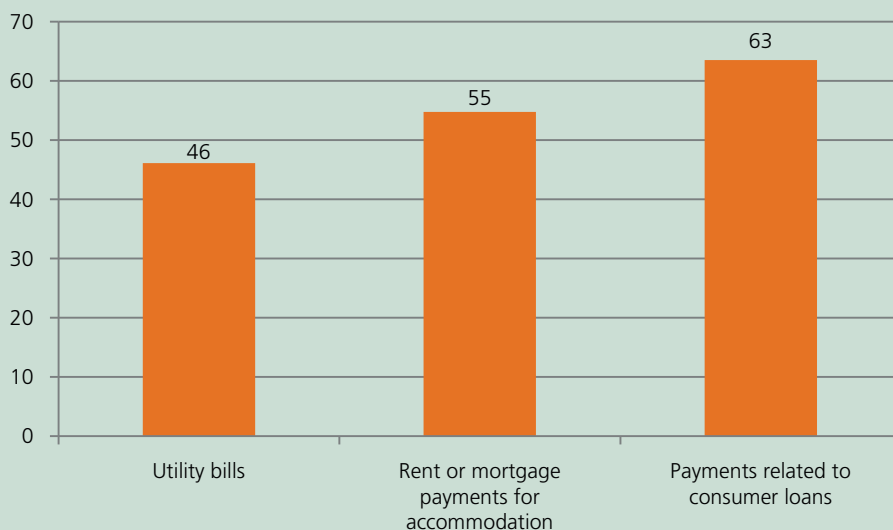
Not everybody who has arrears in formal debts or who has missed formal bill payments has defaulted on informal debts. In fact, 12% of Europeans report arrears in at least one of the three types of debts or bills, but not in payments related to informal debts. They may not have such informal debts, may not feel required to make payments related to them, or may prioritise informal debt payments above formal debts.

Informal debts and quality of life

There is a complex relationship between quality of life and over-indebtedness; causes and consequences are often hard to disentangle (Eurofound, 2010). Nevertheless, over-indebtedness does impact quality of life – in particular, in how it affects living standards and housing security, health and social relations. The relationship between informal debts and these three variables is examined in this section.

In addition, a fourth aspect of quality of life, not usually considered when discussing the causes and consequences of over-indebtedness, will be examined. Comparison of the 2007 and 2011 EQLS has produced few unequivocal observations, as there is much variation in dimensions of quality of life among Member States. Nevertheless, for some variables clear changes occurred, valid across Member States;

Figure 4: Informal arrears among people with other forms of arrears (%)



Note: Q60 Has your household been in arrears at any time during the past 12 months, that is, unable to pay as scheduled any of the following? a. Rent or mortgage payments for accommodation, b. Utility bills, such as electricity, water, gas, c. Payments related to consumer loans, including credit card overdrafts (to buy electrical appliances, a car, furniture, etc.).

a decrease in trust in institutions is one of these (Eurofound, 2012a). This decline occurred both in Member States where trust has traditionally been high, and in Member States where trust was at such low levels that it would have been hard to imagine it could deteriorate any further. As this is an important and worrying development, and because it is financial difficulties rather than, for example, income that contributes to low trust in institutions, this aspect of quality of society, and with it quality of life, will be examined as a fourth variable.

Living standards and housing security

In the EU28 Member States, among the bottom half of income earners without informal arrears, 14% report that their households cannot afford a meal with meat or fish every second day. People with informal arrears are twice as likely to report that their households cannot afford this (28%). The bottom half of income earners without informal arrears report in 16% of cases that they cannot afford to keep their homes adequately warm. The proportion is again double (32%) for those lowest-income earners experiencing informal arrears. Half (50%) of the bottom half of income earners without informal arrears report that they

cannot replace worn-out furniture. For those with informal arrears, this is true for 70%.

For the top half of income earners in the different Member States, the proportions of people reporting they cannot afford any of these three items are considerably lower. Furthermore, the difference between people with informal arrears and those without is less marked. Nevertheless, a quarter (25%) of top income earners with informal arrears report not being able to afford to replace worn-out furniture, compared to one-fifth (20%) of those without informal arrears. It is uncommon among top income earners to report inability to afford a meal with meat or fish every second day if desired (4%). Nevertheless, it is more common among those with informal arrears (7%). Almost one out of ten (9%) top income earners with informal arrears reports that they cannot afford to keep their home adequately warm, compared to 6% of those without informal arrears.

People with informal arrears often experience housing insecurity. Of all EU28 residents with informal arrears, 13% feel it likely or very likely they will need to leave their accommodation



within the next six months because they can no longer afford it. This compares to 5% among people without informal arrears. Moreover, feelings of absolute security are relatively rare, with 69% of people with informal arrears believing it very unlikely they will have to leave their accommodation, compared to 83% for people without informal arrears.

Social relations

Some people report having nobody to turn to if they urgently need money. This is particularly common among those who are unemployed for over a year (21%), unable to work due to illness or disability (17%) or retired (14%). People in the bottom income quartile frequently have nobody to turn to (15%), even if employed or self-employed (12%). It is about half as common for people in the top income quartile (7%) to have nobody to turn to.

When people have arrears in payments related to debts with someone outside the household, it implies that the borrowers had connections outside the household that are strong enough to have relied upon to borrow money. These and other connections are likely to also serve when people need advice, psychological support or more money. Indeed, people with arrears on informal payments are more likely than others to

rely on a friend, neighbour or someone else who is not a relative for help in the following situations:

- urgent financial support (19% of people with informal arrears compared to 12% of people without);
- support when feeling depressed (40% compared to 35%);
- advice about a serious personal matter (30% compared to 23%).

One reason for asking someone outside the household for money is likely to be that relatives or family are not sufficiently affluent. Nevertheless, the fact that people who are likely to turn to friends or neighbours for money also turn to them when feeling a bit depressed (65%) suggests this is not the only reason why people do not turn to relatives or family. They may find more support for confidential matters outside the family circle. On the other hand, more than half of those who would ask friends or neighbours for support when feeling depressed (59%) would instead ask a relative or family member for money in an emergency. This may be because their friends do not have the means to support them, but also because they might find asking for money humiliating, as a step too far in testing their friendships, or as spoiling their friendship with colder, financial matters.

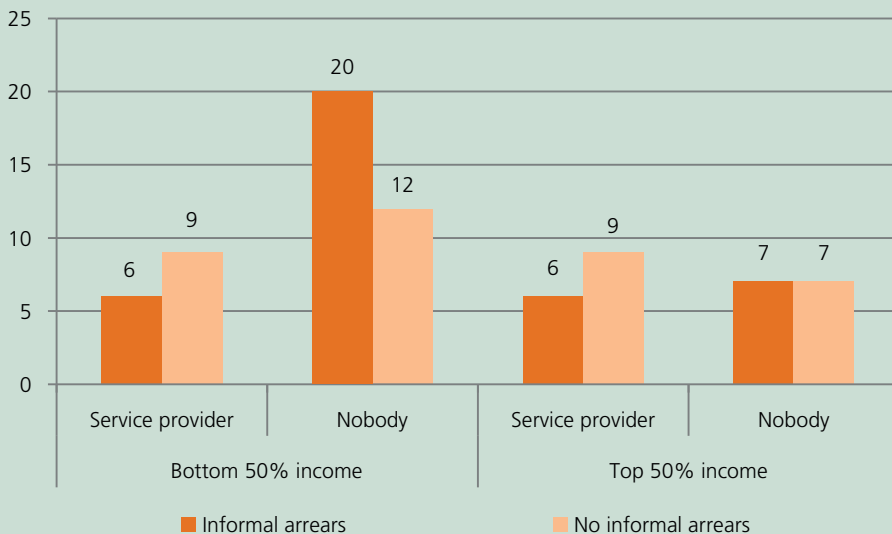
People in arrears with informal debts often continue to be confident in relying on their network for additional financial assistance. However, there are also signs that borrowing money from friends, when unable to pay the money back as scheduled, harms these social bonds, further isolating people who are in financial difficulties. In particular, among people with informal arrears, a larger proportion reports having nobody to turn to when urgently in need of money (14%) than among those without informal arrears (9%). Nevertheless, this difference is only apparent among low-income earners with informal arrears, not among higher-income earners (Figure 5). For low-income earners, and probably for their networks, the amounts asked for are relatively larger than for higher-income earners.

People with informal arrears not only seem to have lost some of their financial support network, but also more often have nobody to turn to when feeling depressed (7% compared to 5% of those without informal arrears) or when in need of advice (5% versus 3%). In contrast to financial support, these differences hold both for the bottom and top half of income earners. This could indicate that there is some loss in the

intensity of social ties for high-income earners when they start defaulting on informal debts, but this is not always expressed in relation to financial issues as they may be of somewhat lesser importance to affluent friends.

Another piece of evidence for such weakening of social support networks lies in the degree of perceived social exclusion. The Social Exclusion Index measures how excluded people feel from society, on a scale from 1 to 5. Figure 6 shows that people who have been unable to make payments related to loans from friends or others outside their household have a higher Social Exclusion Index score (2.6) than those who report not having such arrears (2.1). This is true for both the bottom half of income earners (2.7 compared to 2.3) and the top half (2.3 as against 2.0). People who report they have nobody to turn to when they urgently need money have a similar Social Exclusion Index score (2.5) as the partly overlapping group of people with informal arrears. This is true for both the bottom half (2.7) and top half (2.2) of income earners. Nevertheless, people who have informal arrears and in addition have nobody to turn to have a particularly elevated Social Exclusion Index score (3.0), both those in the

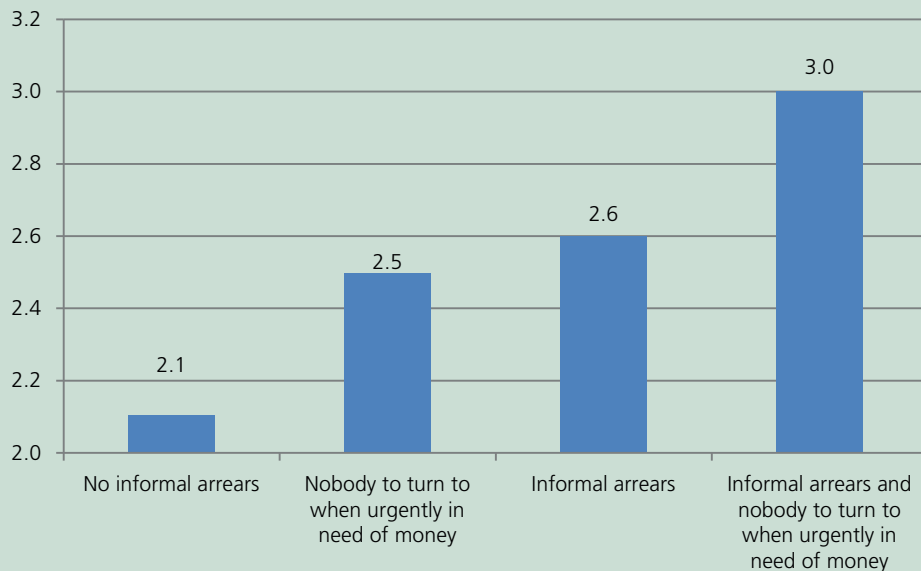
Figure 5: Sources of emergency financial support, by informal arrears status and income group (%)



Note: Q35e (see Figure 2 for wording), Q60d (see Figure 3 for wording).



Figure 6: Social Exclusion Index score, by informal arrears status and financial support



Note: The Social Exclusion Index refers to the overall average score from responses to four statements in Q29: 'I feel left out of society', 'Life has become so complicated today that I almost can't find my way', 'I don't feel that the value of what I do is recognised by others', and 'Some people look down on me because of my job situation or income'. Responses are scored on a 1–5 scale, where 1 = 'strongly disagree' and 5 = 'strongly agree'.

bottom half of income earners (3.2) and the top half (2.6).

People may become more socially excluded because they default on debts to friends, challenging the limits of compassion and potentially eroding trust. Nevertheless, the struggle to make ends meet in itself may also have a negative impact on someone's psyche and on their financial ability to participate in social activities. For example, in the EQLS people are asked whether their households can afford having friends or family for a drink or meal at least once a month. In the EU28, there are large differences between income groups, with 31% in the bottom income quartiles and 5% in the top income quartiles reporting they cannot afford it. However, inability to afford this item is consistently higher for people who experience any of the four types of arrears.

In particular, 46% of people in households in the bottom income quartile with utility arrears report they cannot afford having someone over for a drink or dinner, against 27% among those without such arrears. Nevertheless, the difference is even more pronounced for people in households experiencing arrears in informal debts, with over half of them (52%) reporting they cannot afford such social activities, compared to 28% among those without such arrears. The ability to participate in social activities thus seems to be particularly reduced for this group.

Mental and physical health

The EQLS measures well-being using the World Health Organization's WHO-5 Index; scores range from 0 to 100, where 0 is the lowest well-being score and 100 is the highest.²

² The index is calculated from responses to five items such as 'My daily life has been filled with things that interest me' on a six-point scale (0–5) ranging from 'all of the time' to 'at no time'. The scores to these five questions can amount to a maximum raw score of 25, which is then multiplied by 4 to get to a maximum of 100.

Mental well-being is lower among people who have informal arrears (a score of 58 out of 100) than among those who do not (a score of 63). This is particularly true for low-income earners. People in the bottom income quartile with informal arrears have a mental well-being index score 13% below that of people whose households have no informal arrears. In contrast, for the top income quartile this difference is almost three times smaller at 4% (Figure 7).

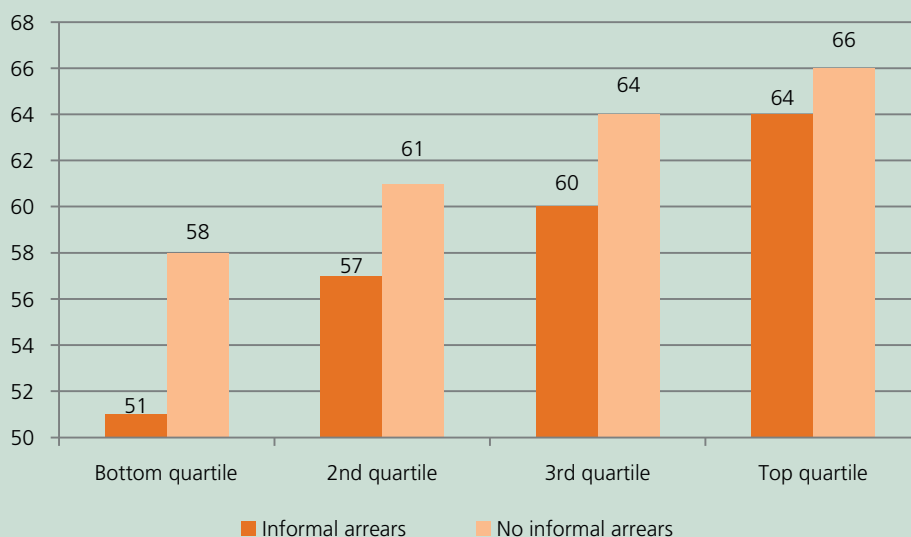
People’s mental health is considered to be at risk if their WHO-5 score is 48 or below. Among the bottom quartile of income earners, 47% of those with informal arrears score 48 or below as against 34% for those without informal arrears. For the three higher income quartiles, mental health is less often at risk, but always 8 or 9 percentage points more so for households with informal arrears than for those without.

For more general health measures, the picture is similar in that it is more common for low-income earners with informal arrears to report being in bad or very bad health (19%) than for those without informal arrears (16%). Moving

up the income quartiles, the difference becomes progressively smaller, with no difference in the top income quartile. These top income earners with and without informal arrears rarely report being in bad health (both 4%). Debt problems may not only lead to mental health problems, but also to worse physical health – for example, through unhealthy eating habits triggered by relationship break-up (Rueger et al, 2011). Causation can also be reverse, with bad health leading to over-indebtedness, in particular because of healthcare expenditure and reduced income from work. Research among people in Germany who have sought debt advice revealed that health has become a more common cause of over-indebtedness, from 5% in 2005 to 10% in 2011, making it one of the top five causes (Knobloch et al, 2012). Such results may also be true for other Member States – in particular, for those that have experienced cuts in public expenditure and decreased financial coverage of healthcare (Eurofound, forthcoming).

For average health satisfaction, the difference between people with informal arrears and those without is more stable across income groups.

Figure 7: WHO-5 score, by informal arrears status and income quartile



Note: The WHO-5 Index is calculated from the overall average score from responses to five statements in Q45: ‘I have felt cheerful and in good spirits’, ‘I have felt calm and relaxed’, ‘I have felt active and vigorous’, ‘I woke up feeling fresh and rested’, and ‘My daily life has been filled with things that interest me’. Responses are scored on a 0–5 scale, where 0 = ‘At no time’ and 5 = ‘All of the time’.



People with informal arrears in the top income quartile have a mean health satisfaction score of 7.5, while for people without such arrears in the same income quartile it is 7.9. Average health satisfaction is lower in the bottom income quartile; for people with informal arrears it is 6.4, compared to 6.7 for those without. This association between informal debts and health satisfaction remains negative and significant even after controlling for the ability to make ends meet and for arrears in utility payments, mortgage or rent payments, and consumer loans, in addition to income quartile.

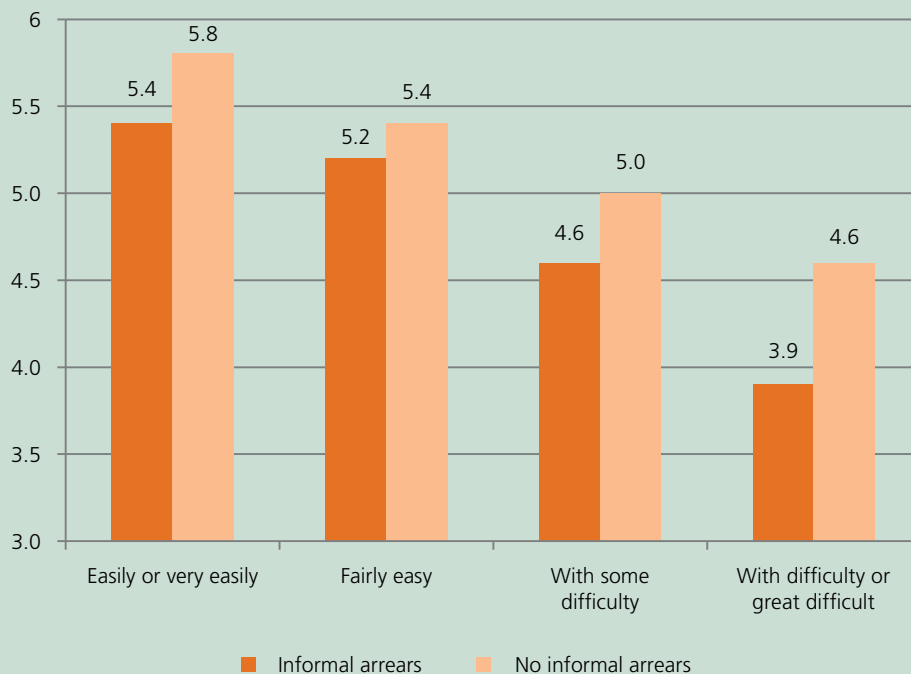
Healthcare services have the potential to mitigate these health inequalities. It is thus of concern that 43% of people with informal arrears experience difficulty in seeing a doctor because of costs, compared with 29% of people

without informal arrears. This difficulty is accentuated for the bottom half of income earners. Among them, almost half (49%) of those with informal arrears report difficulties in accessing these healthcare services because of cost, compared to just under a third (31%) of those without informal arrears. Among the top half of income earners, costs make it difficult to see a doctor for one in every three (33%) with informal arrears, compared to one in every four (25%) without informal arrears.

Trust in public institutions

Trust in institutions depends less on people's income than on whether a household is able to make ends meet. Generally, local government is better trusted than parliament or national governments. Nevertheless, people with informal arrears show less trust in local government (4.6

Figure 8: Trust in local government, by informal arrears status and ability to make ends meet



Note: Q28 Please tell me how much you personally trust each of the following institutions. Please tell me on a scale of 1 to 10, where 1 means that you do not trust at all, and 10 means that you trust completely: f. The local (municipal) authorities. Q58 A household may have different sources of income and more than one household member may contribute to it. Thinking of your household's total monthly income: is your household able to make ends meet ...? 1. Very easily, 2. Easily, 3. Fairly easily, 4. With some difficulty, 5. With difficulty, 6. With great difficulty.

on a 10-point scale) compared to those without informal arrears (5.3). This difference holds true across Member States but is most pronounced for Denmark (5.1 versus 6.6) and Bulgaria (2.7 versus 4.1). In particular, for those who are in the bottom income quartile in their country, trust in local government is lower among those with informal arrears (4.3) than among those without informal arrears (5.3). However, regardless of having a low or a high income, those who have difficulties making ends meet and have informal arrears report especially low levels of trust in local government (3.9) (Figure 8).

Informal arrears show an independent negative relationship to trust in local government even after controlling for income quartile, for the ability to make ends meet, and for having arrears

related to consumer loans, rent or mortgage payments, and utility bills. This independent impact of informal arrears is not as clear for trust in parliament or national government. One reason may be that some of the payments these people are struggling with concern local government bills or institutions they associate with local government, such as utility companies and social housing associations. Another factor could be that people with informal arrears are particularly disappointed with government and see the local government as closest to them and most responsible for failing to support them in their situation. Or the fact that they rely on informal loans may also reflect their scepticism or inability to access services that are (or appear to them to be) the responsibility of local government.



Policy pointers



The EQLS shows that arrears on debts with friends and families occur among households in all Member States in the European Union. A considerable proportion of Europeans (8%) reported having had such informal arrears in 2011. Many others may have had informal debts but did not report they defaulted on payments related to them. Consequently, it is important to take the following steps:

- ➔ take informal debts into account when considering policies;
- ➔ raise awareness that, while informal debts can be an important support to the person in need, when repayment problems arise, these debts may put both social relationships and the financial situation of other households at risk;
- ➔ consider facilitating access to service providers with whom borrowers can discuss their informal debt problems at an early stage, and with whom informal lenders likewise can discuss their debtor problems;
- ➔ discuss affordable, low-barrier alternatives for emergency loans; in particular, those with early-warning systems that get in motion as soon as a payment is missed,

combined with proactive support services and effective referral.

An effective policy approach to household over-indebtedness includes preventive, alleviative and rehabilitative measures (Eurofound, 2012b). While prevention is the preferred option, it is unrealistic to assume that debt problems can always be avoided – in particular, when people have the option to borrow informally. Nevertheless, when problems emerge, it is important to detect them as early as possible, to avoid escalation. When defaults start in the informal sphere, such early detection is complicated. However, results from the EQLS show that most people with informal arrears actually also have other arrears. This finding suggests the following policy pointers.

- ➔ Even when minor arrears are observed in the formal sphere, they may be a symptom of larger debt problems, including arrears in the informal sphere. For this reason, it is important to react promptly to early warnings, and to take very seriously even the smallest problems that come to light in the formal sphere.
- ➔ It is often hard for service providers to get a full picture of the household's situation

when they have been contacted for assistance. People are usually reluctant to speak about an issue that comes with stigma and embarrassment. This is particularly problematic when there is no formal evidence of debts, as social service providers need to rely wholly on the story of the client. Service providers therefore need to make sure that informal debts come to the surface by developing trust and guaranteeing confidentiality, and providing anonymous contact options.

As most people with informal arrears have formal arrears as well, one may be inclined to focus policies only on those with formal arrears. The data do not reveal, however, whether households' informal arrears preceded the missed payments on formal debts and bills. It may be that people started off only with informal arrears before they began accumulating formal arrears. In any case, there is a significant proportion of Europeans who have informal arrears and no arrears yet in the formal sphere. It is further likely that there are people who have no informal *arrears* yet, but do have informal *debts* that may lead to informal arrears.

When people are struggling with informal debts, it is particularly important that they seek help themselves, because it is hard to provide proactive help when debt problems are in the informal sphere and hidden from outsiders. In many Member States, local government services generally play an important role in providing debt advice and other social services. Even non-governmental services are sometimes perceived to be associated with local government. It is therefore worrying that trust in local government is particularly low among people with informal debts, who might be hesitant as a result to ask for help from services they associate with the authorities. The reasons for low trust in local government in different Member States among this group of people need to be further investigated. Nevertheless, help to these households can be facilitated notwithstanding their persistent low levels of trust, and there are ways to enhance trust.

→ Cooperation with, or the support of, civil-society organisations dealing with

disadvantaged groups could be enhanced, and with organisations that are in closer contact with citizens more generally than local governments may be. These organisations can serve as a first contact point, facilitating referral to service providers that may be government provided or to outreach services.

→ Trust in local government can be increased by enhancing the quality of specific services for this group (Eurofound, 2012b) and by effectively providing information about these services. As soon as services are being used and people benefit from them, satisfaction is likely to increase (Eurofound, 2012a).

When someone has arrears on payments related to bills and formal debts, it is important to be aware that they are likely to be indebted to friends and relatives. It may not be because of these informal debts that they experience a reduced quality of life, but because of the dire financial situation they are in. Debt problems rarely develop in isolation. While the causal network is complex (Eurofound, 2010), unemployment, social exclusion, health problems, poverty and low levels of trust in public institutions are all aspects of quality of life that are particularly common among people who are unable to pay their bills and debts. It is important to be aware of the multidimensionality of the problems over-indebted households face. Many of these issues can be self-reinforcing. For example, when people are in financial difficulties, they need their social network for psychological support. However, their financial difficulties, especially when they concern informal arrears, put a strain on their social relations, further aggravating the situation. Over-indebtedness also triggers health problems, which in turn can worsen debt problems, through loss of income, for example, or increased healthcare costs.

→ Policymakers and service providers alike should be aware of the multidimensionality of problems that may accompany informal arrears. A long-term solution to causes and consequences may not be found if support focuses only on the financial aspects of the problems.



- The importance of integrated service delivery cannot be stressed strongly enough – in particular, mutual referral and cooperation in service delivery among debt-advisory services, welfare offices, employment services, healthcare services and community associations, regardless of whether they are public or private.
- Services can mitigate the negative impact of over-indebtedness on quality of life and can contribute to providing solutions. Nevertheless, people who turn to friends or relatives rather than to service providers for money are also less likely to contact service providers for non-financial support. Furthermore, they more often face access problems in terms of cost – for example,

in accessing healthcare services. It is important to guarantee access at least at one entry point in the network of services, followed by effective referral.

The 2011 EQLS has filled an important gap in the data on problems related to loans from friends and relatives. Based on analysis of that data, some pointers for policy action by service providers and governments have been identified. Nevertheless, in order to get a full understanding of this prevalent and important issue, more research and data are needed. In particular, little is still known about the prevalence of informal borrowing, magnitude of loans, identity of lenders, and borrowers' and lenders' expectations about repayment.

Further reading

All Eurofound publications are available at www.eurofound.europa.eu

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'A sustained recovery is now within reach, but only if we persevere on all fronts of our crisis response: keep up the pace of economic reform, regain control over our mountain of debt, both public and private, and build the pillars of a genuine economic and monetary union.'

Olli Rehn, European Commissioner for Economic and Monetary Affairs, 'Recovery is within reach' (blog on Commission website), 14 August 2013

Foundation Findings provide pertinent background information and policy pointers for all actors and interested parties engaged in the current European debate on the future of social policy. The contents are based on Eurofound research and reflect its autonomous and tripartite structure.



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