Indebted societies: How private borrowing has become a substitute for social policy in rich democracies

When citizens encounter financial difficulties, they often turn to private borrowing on credit markets. As **Andreas Wiedemann** *explains, this form of borrowing now increasingly acts as a support mechanism that complements the welfare state in rich democracies. But while credit markets and welfare states appear to fulfil similar functions, they follow different underlying logics, each with their own socio-economic and political consequences that shape and amplify insecurities, inequalities, and social solidarity.*

When the Covid-19 pandemic hit people around the globe, many lost their jobs and incomes. Their debts, however, stayed on the books. In some countries, governments and private lenders have suspended debt repayments and imposed eviction moratoria, temporarily easing the financial pressures many people have experienced during the height of the pandemic. But as these policies and protections expire, people, societies, and governments have to deal with the root causes behind household debt and its political consequences.

In a recently published book, I argue that people's growing reliance on financial markets and rising levels of household debt reflect a fundamental transformation of social rights, responsibilities, and resource allocations. Credit markets provide opportunities that mitigate how social status, parental wealth, or skills affect socio-economic outcomes. But the emergence of financial markets as private alternatives to social policies and the public provision of goods and services has re-allocated responsibility for addressing social risks and seizing social opportunities from the broad shoulders of society onto individuals themselves.

Weakening social policies and a flexible knowledge economy have made incomes more volatile and increased costs for housing, education, and raising a family – forcing many people into debt. Combining a cross-national perspective and relying on a wide range of micro-level data, I show that people increasingly rely on financial markets and borrow money to fill gaps that arise between people's financial needs, for example to smooth income losses or pay for education, and the financial support and protection they receive from the welfare state.

It may seem surprising to suggest that credit markets can fulfil functions that resemble social policies, not least because welfare states were in part designed to respond to market failures and cushion against adverse market outcomes. Yet credit markets mirror welfare states' tasks in three crucial ways.

First, they too redistribute resources – although not across individuals but through time, moving resources from the borrower's future self into the present. Credit markets also provide financial liquidity through credit cards, bank loans, payday loans, and home equity loans, helping people address financial shortfalls or meet expenditures. And credit markets allow people to invest in both human capital (e.g. using student loans to finance their education) and financial assets (e.g. taking out mortgages to buy homes).

But not all countries share similar patterns of rising indebtedness; nor do only low-income people go into debt. Levels of debt vary considerably across countries and across different groups within countries. In the book, I show that the structure of social policies and the structure of what I call credit regimes together shape patterns of indebtedness. This framework helps explain why similar groups of people are more indebted in some countries than others.

Consider the welfare state first: paid sick and parental leave, subsidised childcare and education, and generous unemployment benefits reduce the financial costs of having children, help parents to reconcile family life and career choices, and provide a cushion against social risks. However, countries differ considerably in how much their social policies offer financial protection against social risks such as unemployment or sickness and social investments and opportunities through education and family policies. Countries also vary in which societal groups they protect the most. For example, financial support for low-income people is much more generous in Denmark than in the United States.

But whether households go into debt and borrow money to address income losses or finance social opportunities, instead of relying on other private means, depends on the structure of a country's credit regime. This concept describes the institutional and policy environment that shapes the breadth and depth of financial markets, the allocation of credit between businesses and households, and regulatory and fiscal policy incentives to borrow money.

Permissive credit regimes support open financial markets and have larger pools of capital and credit. Close institutional ties between banks and households, combined with political incentives to borrow money, make credit more easily accessible for households. Restrictive credit regimes, by contrast, are less open to global financial markets and have smaller pools of capital. Strong institutional links between banks and businesses tend to channel credit flows more toward the business sector. In a policy environment that incentivises saving instead of borrowing, households find it much harder to access credit.

The particular constellation of welfare state and credit regime structures shapes how individuals cope with social risks and harness social opportunities. When social policies protect economically disadvantaged groups against social risks and provide social opportunities, permissive credit regimes and welfare states complement each other in the provision of financial support, either privately through access to credit or publicly through government transfers. This is the case in Denmark.

By contrast, when social policies are weak and push the financial cost of addressing social risks and financing social investments to a much wider range of people, including the economically vulnerable, permissive credit regimes substitute for welfare states as more people borrow money to address financial shortfalls. This is the case in the United States. In restrictive regimes such as Germany's, people find it much more difficult to access credit and draw instead on savings, utilise family support, or cut expenditures because the borrowing option is precluded. Credit has limited, if any, social policy functions.

> Credit is a risk mediator for high-income individuals, who buffer income fluctuations over time, but a source of risk contagion for low-income people, whose reliance on credit to cover income shocks in one arena can lead to great exposure to risk in other areas.

This framework helps us understand that welfare states and the regulatory and fiscal environment behind credit markets shape patterns of indebtedness. But why should we care about these patterns and developments? The reason we should care is that the growing influence of financial markets and rising household debt have important consequences for individuals' economic insecurity, social policy preferences, and the future of the welfare state.

In delegating responsibility from the state to the individual, this process also shifts social rights, accountability, and eligibility from democratically legitimised institutions such as the welfare state to private, largely unaccountable lenders. Welfare states are based on politically and democratically set eligibility criteria that grant access, define conditions under which claims can be made, and constitute legally enforceable rights. Credit markets, by contrast, determine access to loans based on creditworthiness, charge different costs based on people's income, wealth, and employment status, and can exclude and discriminate against specific groups.

This transformation has also increased individuals' dependence on market participation instead of protecting them and limiting their exposure to adverse market outcomes. Credit only appears to fulfil social policy functions: credit is *not* an insurance. Whereas the welfare state sought to de-commodify individuals, *credit re-commodifies* because it increases dependence on market income for debt repayment.

As I have argued elsewhere, weak social policies amplify risks that can spread from one domain into another in ways that can cause individuals to spiral into precarity and poverty. While the financial impact of job loss is relatively contained in a country like Denmark with generous social support, unemployment in the United States not only results in a loss of net income given weak unemployment benefits but also a potential loss of health insurance coverage and more debt to compensate for income losses.

Credit is a risk mediator for high-income individuals, who buffer income fluctuations over time, but a source of risk contagion for low-income people, whose reliance on credit to cover income shocks in one arena can lead to great exposure to risk in other areas. This is something that the pandemic has brought painfully to light, where individuals who lost their jobs still had to make debt repayments.

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Finally, the growing reliance on credit markets has bolstered opportunity hoarders in a winner-takes-all economy and created new political cleavages. Those who can reap the benefits of easy access to credit and private goods and services will get ahead; those who don't will find themselves in increasingly precarious situations.

This opens up new political conflicts between creditors and debtors – and between different types of debtors: those who rely on financial markets for upward social mobility (e.g. for access to education or housing markets) and those who use credit to smooth income losses and make ends meet. Credit markets, in other words, privatise opportunities, allowing borrowers to take full ownership over the fruits of their investments, but also privatise risks, which pushes the burden of debt repayment onto borrowers and increases their downstream economic insecurity. With household debt rising in many rich democracies, its political consequences are likely to become more relevant in the future.

For more information, see the author's recent book, Indebted Societies: Credit and Welfare in Rich Democracies (Cambridge University Press, 2021)

Note: This article gives the views of the author, not the position of EUROPP – European Politics and Policy or the London School of Economics. Featured image credit: Claudio Schwarz on Unsplash

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