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Household repayment behavior: The role of social capital and institutional, political, and religious beliefs

Dimitris Georgarakos [a,b,c,*], Sven Fürth [a]

[a] Department of Finance, Goethe University Frankfurt, Grueneburgplatz 1, 60323 Frankfurt am Main, Germany
[b] Department of Economics, University of Leicester, Leicester, UK
[c] CFS, Frankfurt am Main, Germany

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ABSTRACT

We examine the influence of social capital and various prevailing beliefs on household repayment behavior in Europe, after accounting for household-specific characteristics and country differences in institutions. Arrears are more common among households living in regions with dense corruption beliefs, low confidence in institutions and authorities, and a low fraction of religious people. Moreover, high stocks of social capital reduce the likelihood of arrears, net of the influence of various potentially relevant factors. Households in these communities face a higher hazard of losing standing in the group and access to the positive externalities of social capital.

1. Introduction

Household repayment behavior and the likelihood to fall into arrears have attracted considerable research attention. Existing literature has stressed the role of various factors that are demand and/or supply side related: adverse events experienced by households, such as unemployment, health shocks, and divorce (e.g., Duygan-Bump and Grant, 2009); cross country differences in institutions and their efficiency of collecting overdue debts (e.g., Jappelli et al., 2013); changes over time in the credit environment due to changes in regulation, transaction costs, lending competition and supply of credit (e.g., Livshits et al., 2010); legal adjustments, such as a more generous benefit structure for those filing for bankruptcy in the US compared to the past (see Fay et al., 2002); social stigma considerations that diminish in importance due to the fact that an increasing number of community members files for bankruptcy (e.g., Gross and Souleles, 2002).

Our aim is to examine the extent to which prevailing social capital has an independent influence on household arrears, over and above those factors that existing literature has identified as important. In this context, we also explore the role of beliefs about corruption in general and with respect to specific institutions and authorities, public perceptions about the justice system, and religiosity.

* Corresponding author at: Department of Finance, Goethe University Frankfurt, Grueneburgplatz 1, 60323 Frankfurt am Main, Germany. Tel.: +49 69 798 34033; fax: +49 69 798 33912.
E-mail addresses: georgarakos@hof.uni-frankfurt.de (D. Georgarakos), fuerth@wiwi.uni-frankfurt.de (S. Fürth).

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Understanding the links between social capital and household arrears can be of interest to policy makers, given, especially, the recent credit crunch in many European economies and the need for institutions to price fairly their loan products.

We use internationally comparable survey data from the European Community Household Panel (ECHP) that offers information on whether households fail to meet various payment obligations (utility bills, rents, mortgage, and credit installments), their income sources, and a range of demographics. Data from the ECHP has been recently used to examine the contribution of household characteristics into the likelihood to fall into arrears (Duygan-Bump and Grant, 2009) and to associate such incidents with country-specific institutional indicators, like information sharing arrangements, judicial efficiency, and individual bankruptcy regulation (Jappelli et al., 2013).

Our aim is quite different. Arrears may not be only influenced by household demographics, economic fundamentals and the institutional environment, but also by social factors and prevailing beliefs. In order to shed light on such factors, we supplement the ECHP data with information on social capital and the density of various beliefs that prevail in each household's region of residence. We recover the relevant information from the World Value Survey (WVS) and Eurobarometer, which are specially designed surveys in measuring household values and norms. As we discuss below, these data are well-suited for the purposes of our analysis, given the prevailing heterogeneity in social capital and the historical disparities in the quality of political institutions across European regions.

Our analysis consists of two parts. The first part is descriptive and presents associations between household arrears and one regional indicator of social capital or prevailing beliefs at a time, while taking into account various household socio-economic characteristics and country wide differences in institutions and development. We find that, other things equal, households living in regions with more dense beliefs about corruption in the country or in executive bodies (e.g., police) are more likely to fall in arrears. Furthermore, we estimate a proportionally stronger association between arrears and views about corruption regarding more local institutions (i.e., European vs. national vs. regional). In addition, missing payments occur more frequently in regions with a lower fraction of religious people or in regions where people think that it is easy to win a legal dispute against an institution. We also estimate a particularly strong correlation between arrears and living in regions with low stocks of social capital, as this is approximated by low prevailing generalized trust and limited participation in voluntary organizations.

In the second part of the paper, we attempt to identify a causal role for these two social capital indicators and to shed light on the mechanism through which social capital can influence household repayment behavior. To that effect, we follow two different identification strategies. First, we exploit historical variation across European regions in the quality of political institutions over the 17th to 19th centuries, and literacy rates at the 19th century to instrument for the potentially endogenous social capital indicators. Tabellini (2010) has recently used these historical instruments to support a causal effect of prevailing regional norms on regional disparities in contemporaneous economic development across Europe. In our context, we find that such historical variation affects household arrears through prevailing social capital, while taking into account household heterogeneity in incomes, country fixed effects, and, importantly, the contemporaneous regional disparities in economic development and in education.

Second, we augment our baseline model, which takes into account regional variation in social capital, various demographics, and country fixed effects, to incorporate regional heterogeneity in those factors that have been shown by the extant literature to be associated with social capital. That is, we take into account indicators of the prevalence of informal borrowing, of beliefs about corruption and the legal environment, of religiosity, of economic growth, and of social stigma related to the observed repayment behavior of other households in the region.

Following both strategies we estimate statistically and economically significant effects of our social capital indicators on household arrears that can be consistent with one or more of the following explanations. First, in high social capital communities, meeting payment obligations complies with socially acceptable behavior. Due to dense social networks, which allow faster information sharing, arrears are more likely to be identified and punished.[1] In turn, loss of standing in the group can have several consequences that range from loss in social status to limiting employment prospects. Second, social exclusion is costlier in areas with high stocks of social capital given that the socially excluded lose access to the positive externalities created by social capital (e.g., information sharing, receipt of informal care, and social support).[2] Third, the fact that members of high social capital communities are typically treated as trustworthy induces them to behave in a way that reciprocates trustworthiness.[3] Thus, such moral considerations can exercise an additional pressure to meet timely any payment obligations.

In the light of the recent financial crisis there is a growing empirical research that focuses on the effect of social factors on delinquencies or defaults in the US mortgage market. Guiso et al. (2013) use US survey data with a series of hypothetical questions that ask individuals to assess the possibility of strategic default at different thresholds of negative housing equity. They find that those who think that it is immoral to default would be less willing to do so, while those who know someone who defaulted would be more inclined to default. Cohen-Cole and Duygan-Bump (2010) argue that the overall increase in bankruptcy rates in the US cannot be explained by a decline in social stigma and they mainly attribute the effect to the lower information costs that the poor and less educated face.

[1] On the other hand, information sharing through formal channels, like credit bureaus, is organized at the country level and has been absorbed by country fixed effects.

[2] The notion that social punishment costs, that are more severe in societies with strong ties, can improve the repayment behavior of borrowers has been addressed in a theoretical framework by Besley and Coate (1995).

[3] Many studies have found evidence in favor of reciprocity in trust or gift exchange games and have stressed the importance of reciprocity in various economic domains (see for example Fehr and Gachter, 2000).