Debt management pays off!

A research on the cost and benefits of debt management in the Netherlands[*]

Prof. Nadja Jungmann[**] and Marc Anderson[***]

[*] This paper is based upon the research of Geuns van, R., Jungmann, N., Kruis, G., Calkoen, P., Anderson, M. (2011), *Schuldhulpverlening loont!* Regioplan Beleidsonderzoek/ Hogeschool Utrecht, Amsterdam.

[**] Prof. Nadja Jungmann is a law professor at the University of Applied Sciences Utrecht in the Netherlands and management consultant at Social Force

[***] Marc Anderson works as a researcher and teacher at the University of Applied Sciences Utrecht in the Netherlands.

Keywords
Cost-benefit analyses, debt management, municipalities, bankruptcy, social effects, employability, evictions

Abstract

The number of applications for debt management services in the Netherlands shows a steady increase of about 10 percent each year, over the last few years. Municipalities, responsible for these services, at the same need to cut back on expenditures. Our research shows that the (social) return on debt management is on average twice as high as the costs. These benefits are mainly found in the areas of social welfare and housing. Since debts are a reason for employers not to hire or not to continue employment, debt management increases the chance of (continued) employment and therefore helps reduce costs of unemployment and welfare benefits. Since housing corporations spend large sums of money on evictions, the prevention of evictions through debt management also reduces costs in that area.

The ratio between the costs and benefits is only partly influenced by the quality of execution. Social structure offers a better explanation, where a weaker social structure results in greater benefits. Our findings are based on extensive research of individual files combined with interviews with professionals. Only direct if-then relations were considered. This means that in reality the cost-benefit ratio may even be more favorable. Municipalities should therefore be careful in cutting back on debt management services. On the other hand, crosslinking debt management with welfare payments and co-operating with housing corporations could open up opportunities for co-financing debt management services.

The vast majority of municipalities in the Netherlands carry out private debt management. On the one hand this service is performed by municipalities them self, on the other hand municipalities purchase the service from privately owned organizations. The context in which debt management in the Netherlands takes place is dynamic.[1] In recent years, the number of applications for debt management in most municipalities increased by 10 percent each year. Besides the increasing number of applications, debt packages of debtors seeking help are becoming more complex and include multiple problems. It is in this context that municipalities currently decide whether and if so how much they are going to cut back on their debt management services. Councilors, directors of social services and other decision makers in policy search for an answer to the question: what is the return on debt management? Extensive research based on empirical data shows that debt management does pay off. The costs appear to be lower than the benefits thus a cut back will cost money rather than make money.

The return on debt management is on average twice as high as the cost

To determine whether the benefits of debt management outweigh its costs, we performed a local cost-benefit analysis in five carefully selected municipalities. Three out of the five selected municipal departments and/or organizations work for smaller regional municipalities. The results of the study are therefore representative of the Netherlands. The main conclusion of this research is that the return on debt management is on average twice as high as the costs spend by municipalities. On average the surveyed organizations spend 1.4 million euro per 100.000 residents on debt management. This resulted in an average saving in costs of 3.3 million on other policy areas. In the five separate cost-benefit analyses the return ranged from a ratio of 1:1,7 to 1:12,6 euro. This means that the municipality with the lowest cost-benefit ratio saved 1,70 euro for each euro spent on debt management on a number of other identifiable places and/or policy areas. In short, the costs of debt management are lower than the avoided costs on other areas. Table 1 summarizes the relationship between costs and benefits and the areas where there are benefits (read: costs avoided).

Summary costs and benefits of debt management in euro's per 100.000 residents in respect of which the average benefits are posted in descending amounts.

	On average	**Minimum**	**Maximum**
Costs	1.405.000	1.169.000	1.591.000
Benefits	3.260.000	2.727.000	3.864.000
Avoided costs welfare benefits	1.442.000	1.133.000	1.886.000
Avoided costs unemployment benefits	586.000	434.000	664.000
Avoided costs homelessness (health and safety)	509.000	279.000	913.000
Avoided costs evictions	396.000	215.000	811.000

[1] Within the period 2007-2010 members of the Nederlandse Vereniging voor Volkskrediet (NVVK) observed an increase of the average number of creditors per debt package from thirteen to sixteen, as well as an increase of the number of applications from 47.500 to 78.986 (taken from the annual statistics reports NVVK 2011 and 2008). The NVVK constitutes the professional organization for credit counseling and social lending in the Netherlands.

Avoided costs social care	169.000	92.000	317.000
Avoided costs disconnecting gas, water and electricity	94.000	47.000	179.000
Avoided costs social work	31.000	18.000	47.000
Avoided costs mental health care	24.000	15.000	39.000
Avoided costs housing corporations deferred payment	9.000	5.000	12.000

Social welfare expenditures and housing are the main areas who benefit

An analysis of the benefits of debt management shows a significant saving of costs on social welfare expenditures (for example unemployment benefits and welfare) and housing. The saving in costs on welfare constitutes the largest saving. Adverting these costs has an immediate positive effect on the municipal budget. There are also benefits that are not directly related to the municipal budget. The department of employment and housing corporations benefit most from the activities of municipal debt management.

Social welfare benefits significantly

Through file analyses, in which we connected data from clients of social security services and debt management agencies, we examined whether an offer of debt management affected the average duration of social welfare. This appears to be the case. The benefit period of unemployed who used debt management appeared four to twelve months shorter. Given that an unemployment benefit costs a municipality 17.800 euro per year (including execution costs) and on average 36 percent of debtors seeking help receive such a benefit, the avoided costs of debt management on social welfare are high. Our calculations assume the most conservative estimates (four months). This results in an average benefit of 1.285.000 euro per 100.000 residents for each of the five municipalities. If we had assumed an average reduction of the duration of social welfare benefits by twelve months, than this would have led to savings up to a stunning 3.854.000 euro per 100.000 residents.

A substantial group among the applicants for debt management have earned income. In this group debt management also contributes to the prevention of costs. Employers often find it unpleasant when creditors hold an attachment of earnings order against their employees. An attachment means more work and sometimes it even is the reason for not renewing a temporary contract. Also, the psychological pressure of having a debt could lead to loss of one's job. The prevention of further escalation of debt and loss of jobs through debt management constitutes a benefit of 705.000 euro per 100.000 residents. This number is based on the estimates of the consultants involved in the debtors whose files we examined. Eighty percent of these benefits will accrue to the employment office associated with less granting of unemployment benefits. The remaining twenty percent covers welfare benefits.

Housing also benefits significantly

A second important benefit of debt management is that it saves costs in the field of housing. 77 percent of the applicants for debt management in the Netherlands live in social housing. More than half of this group are behind on their rent payments. The first thing housing corporations do in cases of rent arrears is negotiating a payment arrangement. If there is not only a rent arrears, but also many other debts, such an arrangement often does not have the desired effect. Through debt management, payment problems can be solved, which leads to less payment arrangements. The cost of a paying arrangement averages some 45 euro, resulting in an avoided cost of around 9.000 euro per 100.000 residents.

If tenants are unable to repay arrears, housing corporations can carry out an eviction. The costs housing corporations make for executing an eviction, ranges from about 5.000 to 7.000 euro. Debt management organizations perform crisis interventions to prevent evictions. In certain municipalities these organizations come to an agreement (covenant) with housing corporations to avoid eviction. In 2010 639 evictions were prevented in the five municipalities surveyed. This yields an average of 396.000 euro per 100.000 residents in benefits. This relates only to costs spend by housing corporations. Expenditures for police and municipal spending are not included in these figures. The amount includes enforcement costs, collection fees and legal costs, the costs for booking, evictors, changing the locks, moving and storage fees and costs for notices of default.

What does this cost-benefit analyses of debt management teaches us?

The most important lesson is that debt management pays off. The costs are lower than the benefits, which induces us to reflect on cutbacks in debt management services. By explicitly examining those benefits of debt management related to the municipal budget and those that are not, municipalities can draw two conclusions. First, they can conclude that a cutback in their budget will not lead to the intended reduction in expenditure. Furthermore, it seems meaningful to examine the possibilities for co-financing by those that derive considerable benefit from municipal debt management services.

On a less abstract level, the results lead to two different conclusions. First, it seems advisable to crosslink the execution of unemployment benefits, and in particular welfare payment, to that of debt management services. Forcing people who receive unemployment- or welfare benefits to tackle their burden of debt, contributes to a faster outflow from welfare. This happens partly because dissolved debt is considered an incentive for people to work (again) or to work more. But also because employers do not want employees that involve a great deal of work, due to seizure of wages or high absentee rates caused by psychosocial problems. In most debt situations in which debtors receive unemployment benefit or social welfare a closer cooperation between paying agencies and organizations providing debt management is possible (and desired). If it appears that debt problems leads to a longer average duration of benefit payments (which this research indicates), then it is obvious that we should try to affect the behavior of beneficiaries in a way that leads to an active and effective job search as well as the changing of their spending habits and paying off debt.

Secondly, the results of this study prompts municipalities to have a dialogue with, among others, housing corporations. It seems worthwhile to examine the possibilities for co-financing debt management, now it appears that besides the municipality also others greatly benefit from it.

Are municipalities with higher benefits doing a better job?

For this study, we performed a local cost-benefit analysis in five municipalities. In addition to the preceding conclusions, this research also leads to the insight that there are considerable local differences in the cost-benefit ratio. The fact that the ratio between the costs and benefits within a municipality is favorable, does not automatically mean that the municipality performs the 'best' debt management service. The ratio between the costs and benefits is in fact only partly influenced by the quality of execution. In addition to variables such as the extent to which a municipality provides customized debt management, the quality of debt counselors and the type of products and services executed, there are other important variables that influence the cost-benefit ratio. Consider in this context for example, the social structure. Generally speaking, a weaker social structure leads to a higher ratio between the costs and benefits (think of the percentage of benefit claimants, poorly skilled, lone parent families and/or single persons etc.). Other key variables are the degree to which a municipality bet on early detection of debt problems and invest in good cooperation with chain partners and creditors.

In short, municipalities themselves have a significant impact on their local cost-benefit ratio of debt management, but the municipality with the 'best' value for money does not necessarily perform the best!

An approach based on empirical data leads to reliable results

The risk of a cost-benefit analysis is that the results are based on rough estimates at the expense of reliability. The value of such an analysis therefore depends on the accuracy of the individual cost and benefit estimates. By adding an approach in which only empirical-based information was used, the risk of an over-estimation was limited to a minimum. As a cost-benefit analysis requires a thoughtful approach, we explain in this last section the most characteristic elements of this approach. These are important pillars of the reliability of our results.

Combining extensive file research with interviews

Through an extensive chart review, and combining it with interviews, we have a good picture of the effect of debt management; not in the sense of the number of debt arrangements, but in the sense of its added value. If tomorrow all debt counselors were to be sent home, there are basically three distinct groups of debtors:

1. Debtors who nevertheless succeed in solving their debt situation
2. Debtors wherein the situation does not improve, but also not deteriorates, and
3. Debtors whose problems grow bigger.

There is a correlation between the magnitude of the problem and how a debt situation develops. However, not every debt situation automatically escalates from a certain amount of debt. To prevent the assumption that severe debt problems automatically lead to costs in other places and situations concerning light debt problems never escalate, we conducted interviews with debt counselors. By asking them for their expectations in individual files, we could examine how these situations may develop. By combining data on, for example the amount of debt or the source of income, with experiences debt counselors had with these debtors, we were able to draw a well-considered prediction. We where thus able to reckon with an expectation, in which both the magnitude of the debt problem, as well as the ability of the debtor and the quality of their social network et cetera were taken into account.

Only direct if-then connections

Financial problems and intangible issues are often related. To ensure a pure estimate of the costs and benefits we have only considered direct if-then relationships. For example, if debt management leads to an agreement with a housing corporation that intends to evict someone due to arrears, the eviction is identifiable prevented by the intervention of debt management. The complex causalities that we know exist are not included. This helps us to keep our calculations pure and ensures that the benefits we designate are real. The above approach also means that the expected benefits can be considered as minimal benefits.

We only considered areas with benefits for which we could collect empirically (and therefore reliable) material. In the analysis we have worked with the following benefit areas: social care, execution of unemployment benefits and welfare benefits, housing corporations, energy companies, effects of homelessness in respect of care and safety, social work and mental health care. Working with this selection of areas has led us to ignoring a number of places with (possible) benefits. We had several reasons for this. Sometimes we knew in advance that we could not find factual information. In other cases we knew it was only a minor benefit and instead we judged that the effort to map out these benefits would not outweigh the research effort. Important municipal/ public benefit areas that we deliberately not included in this study are the domain of policing and justice, health, school dropout and absenteeism at work and all benefits in the market such as the cost for creditors due to unresolved debt situations and inefficient collection costs. Thus, it is important to note that the above definition also leads to a minimum cost-benefit ratio. In reality, the benefits are greater.

Computational tool for municipalities

In addition to the above research a computational tool was developed to give municipalities the opportunity to calculate their local cost-benefit ratio of debt management.