Indebtedness in the Czech Republic and in some selected EU Countries

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Résumé: Nowadays we are witnessing an inconsistent approach to the question of where the critical level of indebtedness lies for each individual country and which economic and political changes can lead them to be classed as countries with serious problems [22]. Of increasing importance are the questions of what level of debt can be considered proper, whether it can be inferred using economic theories, or whether we need to concentrate on empirical data. In this article we would like to highlight the relativity of how indebtedness is assessed in the countries of Europe, especially those with a transitive economy, if the assessment is based on traditional indebtedness indicators. The Czech Republic, like most European countries, favours the principle of welfare. A growing number of households in the Czech Republic are linked to public finance. This trend increases fears about whether the private sphere will be able to sustain this principle in the future from its taxes [12]. From statistical data it is evident that households in the Czech Republic are saving less and consuming more. This therefore raises the question of risky this behaviour is in combination with the rapid rise in debt [11]. The aim of this article is to provide information about the conclusions of an analysis of debt in the Czech Republic in comparison with selected transitive EEU economies, then to compare the household debt of transitive economies with the level of debt in German households. The analysis focuses on identifying the specifics of household debt in the Czech Republic and the risks implied by the rising level of debt with regard to the preference of the welfare-market economic model and the greater openness of the economy. Comparison of the indebtedness of households in the countries in question is based on data from OECD, Eurostat, the European Commission, the European Central Bank, the Czech Statistical Office, the Czech National Bank, Transparency International, and the World Bank.

Key Words: Household Debt, Household Savings, Credit, Consumption, GDP, National Debt

1 Introduction
So far insufficient attention has been devoted in the Czech Republic to analysis of the factors which influence the financial potential of households in the process of debt. Attention is focused particularly on the macroeconomic aspects of the financial potential of households in the process of debt. A similar situation can also be seen on the international level. Testimony to this can be found in theoretical works focusing primarily on the macroeconomic aspects of the stability of the financial potential of the populace. Macroeconomic analysis in this field draws on a number of modern methods used to model the development trends of the financial potential of households [30,10,25,26]. Somewhat less favourable is the situation as regards research of the quality and effectiveness of the institutional framework and its influence on household debt. In the Czech Republic there has been a lack of adequate research into the influence of formal and informal institution on the financial potential of households. So far there have been theoretical works which analyse the quality of the institutional framework from the point of view of its relationship to economic growth in the Czech Republic [23,27,18,35]. These authors have based their work on the theoretical approaches of North [28] and Alston [2] in particular. More extensive analyses of the quality of the institutional environment and its impact on household debt have not yet been carried out. Research in this area is still in the early stages. One example of research that is under way is that of Bartošová [3]. In the Czech
Republic there is no adequate analytical and methodological apparatus which could clarify the developmental changes in the financial potential of households in the process of debt. This is due to the fact that, amongst other things, transitive EU countries have not yet gone through the corresponding development phase which would crystallise all the basic institutional pillars of the household loans market. We can therefore assume a certain special potential risk for households in transitive economies that fall into debt in comparison with those of developed economies. In this respect there are still a number of unanswered questions concerning the influence the institutional environment has on household debt. The need to concentrate both research and discussion of this topic amongst the professional public rises in relation to the impact of the global financial crisis on the economies of transitive countries and thus consequently also on the financial potential of the households in those countries.

Czech household debt is considered low in comparison with developed EU countries. The Czech Republic and selected transitive economies have not had time to accumulate the relative volume of loans that are common in the countries of Western Europe. We assume that the lower volume of loans in transitive economies can be attributed to the relatively short transition of those economies to a market economy, which in the future may also generate a series of other specific similarities in relation to household debt. We have therefore compared household debt in the Czech Republic with the willingness of households to accept loans in other transitive economies. We then compared selected macroeconomic and microeconomic development indicators over the last decade for the countries in question. We focused primarily on those indicators which can be expected to have a significant impact on household debt. We also took account of the fact that selected transitive economies show a number of the characteristics of the welfare market economy model. We compared indicators which have been confirmed as having a significant influence over indebtedness in transitive economies with the characteristics of household debt in Germany. We chose the German economy on the grounds that it represents a model of the welfare market economy and its development is affected by the economic development of the transitive economies in question. We may therefore assume that there is a higher level of economic dependence between Germany and transitive countries, including the Czech Republic.

2 Formulation of the problem

2.1 Macroeconomic factors

a) One of the most commonly monitored factors affecting the level of household debt is economic growth. After accession to the EU, transitive countries show a clear trend of narrowing the economic gap in comparison with more developed member states, which can be attributed primarily to the increasing speed of the growth of GDP per inhabitant. This trend can be ascribed to the obligation to meet convergence criteria, but also to strengthening economic cooperation and the development of foreign trade. From the point of view of household debt, we are interested in what factors condition the growth of gross domestic product, especially the impact of growth on employment and work productivity. The growth of gross domestic product in the transitive countries in question must also be considered with respect to their greater degree of openness and strong dependence on the growth of their trading partners, with the corresponding consequences [36]. Economic growth and how it ties in with government debt is different in comparison with household economy. The difference lies in the fact that the rise in household debt has no effect on the wage incomes of the members of that household, while rising indebtedness in the economy as a whole may considerably increase gross domestic product, the general level of wages, and the tax incomes of the state. Every healthy economy is expected to require a certain level of debt, particularly private debt. Problems occur when low productivity requires debt to rise at a higher rate than that at which the economy is growing. This situation may mean that the rising number of loans are not “dissolved” in economic growth, but actually accumulate.

b) Household debt is also significantly influenced by the balance of payments deficit. This is treacherous for household debt, as it can maintained for a long time, although not forever. In general, the extension of the balance of payments deficit
leads to a persistent imbalance between economies, thus increasing the likelihood of serious consequences resulting from that imbalance. The most serious consequences include the loss of international competitiveness, job losses, loss of income to the state budget, and loss of innovation potential and capital, which then moves abroad, outside the national economy.

c) It is not only the consequences of the crisis in the balance of payments that have a bearing on household debt, but also the way in which the national debt is understood and used as an instrument for policies of stabilisation. National debt has become a direct source of welfare. Indebted states and their national debt are pushing private investment and capital to the business sector. This leads to job losses, which requires ever more funds to be spent on welfare. This causes additional demand for public expenses and increases the level of debt. Increased issuance of government debenture bonds stimulates greater interest on the part of commercial banks in these securities, which may lead to a reduction in trade for private lenders. And as there is a potential market with these clients, non-banking subjects appear which are able to urge consumers on to even more irrational behaviour. So it is not about finding a solution to how to slow down national debts. If savings measures and the modernisation of the welfare system have an impact on households, it can be assumed that there is a strong link between national debt and household debt [17]. This may result in a major reduction in salaries, pensions and public expenses across the board. To express the size of the government debt, as an indicator we will be using the size of the government debt in proportion to the gross domestic product of the country in question.

The overwhelming majority of EU countries have debts and these debts rise in proportion to GDP, while none of the countries we are looking at has a long-term budget surplus, with the exception of Estonia, which is trying to keep a balanced state budget. The question is how far the governments of transitive economies will in the future manage to eliminate inefficient state expenses and costs relating to the formation of the fundamental pillars of the institutional environment of the market economy. Although nowadays the Czech Republic is not one of the most indebted countries in the EU, the current situation cannot be simplified or overestimated for these reasons.

d) Besides public debt, private debt can also play a crucial role in household debt. In certain circumstances private debt may have more serious consequences than excessive public debt. In the Czech Republic and in other transitive economies, banks are of key importance for the business owing to the lack of developed capital markets. Although the Czech banking market is considered stable and is not affected by a credit bubble, we should not underestimate the fact that bank credit is a factor that influences the volume of private investments and household consumption [4].

2.2 Microeconomic factors
While from a macroeconomic viewpoint household lending in the Czech Republic is not considered a crisis factor, at the micro-level we can see a whole range of problems which testify to the uneven development of the individual aspects of the institutional environment at the microeconomic level.

a) Household consumption / debt
The level of household consumption in transitive countries is close to that in developed countries. Nowadays, for example, in the Czech Republic almost half of gross domestic product is made up of household consumption [7]. The question is to what extent the rise in household consumption is accompanied by household debt, and how proportionate household loans are to their incomes. Debt in Czech households and the households of other transitive economies is still low in proportion to the level of household debt in developed EU countries. On the other hand, households’ willingness to accept credit and the structure of loans received in selected transitive economies generally have much in common with the households of developed EU countries [15]. The potential risks of household debt in transitive economies may lie in the rate at which those countries fall into debt and in the higher level of indebtedness in comparison with the increase in their spendable incomes. This trend can be seen as problematic when there is not sufficient income to pay off the
debt. This means that even apparently high nominal household debt is not necessarily fatal, provided that the spendable income of households increases faster in proportion to that debt.

b) Household savings/debts
Looking at the consumption expenditure of households in developed countries it is evident that it is on the increase, together with the spendable incomes of those households. The problem occurs when expenditure exceeds spendable incomes. Households in most Western European countries finance part of their expenditure from their savings. The consequences of this may vary, depending on what the expenses go on, i.e. whether they are spent on standard necessities or luxury goods.

c) Household debt
Transitive economies are characterised by a sharp rise in household debt, which is motivated by consumption. Transitive economies are at great risk from the sharp rate at which their debts increase; if that rate is motivated by consumption and established practices, the bank allows loans to be paid off with other loans. Another risk factor is the development of the structure of household indebtedness and the structure of the people who draw loans and whether their debts are motivated by consumption and not long-term investment, as well as whether loans are drawn by people with below-average to low incomes.

d) Quality of the institutional environment.
Experience so far has shown that the household loans market of transitive economies is still immature in comparison with more developed EU countries. This makes it more vulnerable, which may result in unexpected and sharp deviations from the trend. If consumer habits, the institutional structure of the loans market and the pattern of creditor and debtor behaviour as expressed by the population’s level of financial literacy are taken into consideration, the dynamics of household debt in transitive countries can be seen as risky [24].

The low financial literacy amongst inhabitants of the Czech Republic and those of other transitive economies is poor in comparison with the financial literacy of people living in more developed EU countries [19]. Consumers’ lack of financial literacy when making decisions is reflected in their poor ability to objectively judge their financial situation [34].

e) Quality of the institutional market environment for the household loans market.
If we base our assumptions on the assessment of institutional quality as carried out by Žák [35], we find that the indices of institutional quality in the Czech Republic show particularly low enforceability of the law and a high level of corruption [23]. They also highlight the inconsistency between formal and informal institutions, i.e. the situation whereby formal institutions either do not arise from informal institutions, or are not properly supported by them. The adverse impact of this inconsistency is evident, for example, when households are deciding on a loan and when they are exercising their contractual rights.

One positive finding is that the quality of the institutional market environment as regards insolvency is increasing both in the Czech Republic and in the other countries concerned. This can be seen in the published database Doing Business, administered by the World Bank [33], and from the assessment of the bankruptcy law of the Czech Republic, published by EBRD [21]. Although the results of these assessments are generally favourable, this area is also affected by persistent inconsistency between formal bankruptcy institutions and informal institutions. This is due to the fact, amongst others, that the people in transitive countries do not yet have the experience or established rules of conduct required for the exercising of ownership rights in market conditions, which is also true of the exercising of ownership rights through insolvency. This problem becomes more serious [32] particularly in the case of resolving household debt. So far there have been no analyses of the institutional prerequisites for the effective enforcement of personal bankruptcy and other state regulatory instruments. The situation is similar in cases where legal rights are enforced through execution [34, 20] or out of court.

3 Selected economic indicators
For the quantitative analysis in the context of household debt we have chosen selected macroeconomic indicators which could indicate certain links.
The GDP per Capita indicator expresses the economic standard of the country. In the period in question there is a clear tendency towards rising wealth in the economies in question. Unlike the pure GDP indicator, where there is no evident slump as a result of the economic crisis. The highest figures are achieved by Germany, which from our point of view is taken as the benchmark. In analogous terms this also corresponds to the level of spendable income.

Convergence criteria cover the rules governing public debt. Nevertheless, nowadays these criteria are met by a mere 13 EU countries. Member states show a great degree of variability in their level of indebtedness. Those with the highest debt are Greece and Italy, while countries with good debt discipline are Estonia, Latvia, and Luxemburg [13]. In comparison with the GDP per Capita indicator it might seems as though debt has a positive effect on economic growth. This is evident in the case of Germany. However, other countries manage to maintain their debt or even reduce it despite unfavourable economic conditions, such as Slovenia. The situation is also interesting from the point of view of a country’s wealth. Less developed countries do not reach the same levels of debt as developed countries. The question may be to what extent a country’s indebtedness is essential to its economic growth, or what economical level a country needs to be at in order to require debt for economic growth.

Public debt of course needs to be managed in a responsible manner, as exceeding sustainable limits results in a range of adverse consequences. High public debt places a burden on future generations, forcing them to pay higher taxes and reducing their chances of acquiring state benefits. A high level of indebtedness is a threat to the domestic economy. Investors lose trust in the domestic market, meaning that capital is transferred abroad, making lending less available and more expensive.

It is evident that in comparison with developed countries such as Germany, consumption is lagging behind in transforming economies. The consumer has not yet reached the saturation point. We can also see a tendency towards changes in consumer behaviour which copy the pattern of behaviour in developed countries [16,5]. The “harmonisation” of consumption is also directly affected by the efforts of the EU, where there is an evident tendency to stimulate consumers in their shopping habits [14]. For the
individual final consumption as well as for the GDP per Head we used the data in current prices, because the data at constant prices was not available in the same currency euro.

![Graph](image1.png)

Fig. 4. Debt to Income Ratio - Households.
Source: Eurostat [15]

The indicator debt to income ratio implies that German households are making an effort to clear their debts. It is clear that the disposable pension of German consumers is considerably higher in comparison to the economies we are looking at, but even Germany shows a clear tendency in comparison with other countries. In the countries concerned, with the exception of Germany, debt is increasing at a faster rate than the disposable pension. The situation in Estonia is striking, where although it did not have any debt in relation to public finance, since 2004 there has been a sharp rise in the proportion of household debt to incomes, which has eventually even surpassed the indicator for German households.

It can be assumed that these tendencies have become even stronger after accession to the EU, as consumers have not had to adequately react to the range of new loan products which sprang up on the market after joining the EU. This, coupled with poor financial literacy and rationality on the part of consumers, may make this a high-risk situation.

Fig. 5 (net lending = - borrowing + lending) confirms the situation implying that in Germany there is a tendency for households to try to free themselves from debt. It is evident that the creation of savings in Germany is greatly influenced by the level of disposable pension. On the other hand, in the other economies we are concerned with, households are willing to get far deeper into lending. Households’ susceptibility towards getting into debt may lead to an adverse situation from the point of view of savings and future consumption.

![Graph](image2.png)

Fig. 5. Net lending households Mrd ECU/EUR.
Source: Ameco, European Commission [1]

The ratio domestic credit to private sector again implies that the level of debt is falling in Germany. Development in Germany is diametrically opposite to that in the other economies in question. Although Germany shows the highest value of loans provided to the private sector in proportion to GDP, the other countries are forever catching up and their proportion shows uninterrupted growth.

![Graph](image3.png)

Fig. 6. Domestic credit to private sector (% of GDP).
Source: The World Bank [33]

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<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
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<tbody>
<tr>
<td>Czech Republic</td>
<td>4.6</td>
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<tr>
<td>Poland</td>
<td>5.3</td>
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<tr>
<td>Slovakia</td>
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<td>Hungary</td>
<td>4.7</td>
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<td>Slovenia</td>
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<td>Estonia</td>
<td>6.5</td>
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<tr>
<td>Germany</td>
<td>7.9</td>
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</tbody>
</table>

Table. 1. Corruption perception index 2010.
Source: Transparency International [31]
From the point of view of corruption, according to Transparency International the Czech Republic is classed as a country with a very unfavourable rating [29]. It is far behind the Scandinavian countries, but also behind the countries we have included in our research [6]. The situation in the Czech Republic has remained stable yet unfavourable for a number of years now [9]. In this respect the Czech Republic is one of the worst of all the EU member countries. This institutional environment, together with a lack of consumer awareness concerning finance opens up the way for non-banking institutions. All in all this leads to an increasing risk of overindebtedness and rising numbers of cases of household insolvency [8].

Conclusion
The causes and consequences of rapid household indebtedness are difficult to foresee nowadays. It is difficult to assess the indebtedness of transitive economies purely on the basis of traditional theoretical approaches and a formal comparison of the level of household debt with that in developed EU countries. We are still unable to provide a satisfactory explanation for many phenomena and trends. We assume that the data from the analysis needs to be appraised together with the quality of the institutional make-up of the loans market and with regard to the predominant standards of behaviour on the part of debtors and creditors.

From the analysis it is clear that there is a narrowing gap between Germany and transformational economies in the volume of household loans proportionate to their disposable pension and the total of private sector loans to GDP. In contrast, the different tendencies between Germany and the countries we are concerned with can be seen in the rise in household savings in favour of Germany.

If the above indicators are correlated, we can expect similar risks in relation to rising household debt as those that have been seen in developed countries. Households may become unable to pay off their loans particularly when interest rates rise, which makes households overindebted and sees their disposable pensions fall. From the point of view of their inability to pay off their loans, households are also at risk from potential job losses. The high level of debt may also have adverse consequences in that a considerable part of disposable income goes on paying the costs associated with a loan. Consumption will therefore be reduced by these costs. It is essential to maintain the growth rate of GDP together with a suitable type of economic growth. Somewhat ineffective in this respect is the type of economic growth where an increase in GDP is accompanied by rising unemployment.

Assessments of household debt in transitive economies carried out in the context of consumer habits, the given institutional structure of the loans market and the level of the population’s financial literacy all show that the dynamics of indebtedness in transitive economies are a risk. Their household loans markets are vulnerable and susceptible to sudden deviations from the trend. We also verified this characteristic of household debt in comparison with the household loans market trends in Germany.

In the Czech Republic there is still no analytical apparatus able to provide us with a structured characterisation of the general and specific conditions of indebtedness affecting Czech firms and households, conditioned by the present-day changes in the global economy together with the specific characteristics of the development of transformational economies. There has not yet been enough research focusing on this area. The absence of research is particularly clear as regards analysis of the ability of Czech households, or households in countries with transformational economies, to resolve their debts due to the speed at which they accumulate and also due to the new conditions resulting from the global crisis.

References:


