MUNI ECON

Name: Amir Shikhaliyev

Causes of Household Indebtedness in Germany and Australia

1. Introduction

Throughout history, debt has been a pervasive aspect of human societies, shaping economies and influencing social structures. From ancient civilizations to modern nations, the concept of indebtedness has played a crucial role in economic systems and societal dynamics. According to David Graeber's book "Debt: The First 5,000 Years," debt has been a fundamental element in human interactions, serving as a means of exchange, a tool of power, and a source of social and economic relationships (Graeber, 2011). Indebtedness refers to the financial state wherein individuals or families owe money to lenders, typically due to mortgages, loans, credit card debt, or other financial obligations. This phenomenon is influenced by a complex interplay of socio-economic factors, including macroeconomic conditions. The global rise in household debt levels following the 2007 financial crisis has become a cause for concern worldwide. The objective of this research is to bridge these gaps by undertaking a comprehensive investigation into the social and economic factors influencing household indebtedness in Germany and Australia. By addressing this research gap, we hope to contribute to a deeper understanding of this critical issue and provide valuable insights for policymakers and individuals alike.

2. Literature review

Indebtedness was very sensitive issue which was triggered by many simple factors that was difficult to realize by policymakers. One of those factors was financial innovation which was mentioned by Dynan (2007), he highlights the role of financial innovation in expanding access to credit and facilitating the accumulation of debt, particularly in the mortgage market in US. Expanding access to credit made it easier for households to get mortgages. Furthermore, the Dynan (2007) explores the consequences of high levels of household debt, focusing on the impact on consumption, financial stability, and economic growth. Author discusses the potential risks associated with increased household indebtedness, such as vulnerability to economic shocks, reduced consumer spending, and the amplification of financial instability. The paper emphasizes the need for policymakers to address the challenges posed by rising household debt and suggests potential policy measures to promote responsible borrowing, improve financial literacy, and enhance consumer protection. It also calls for further research to deepen the understanding of the complex dynamics between household debt, economic behavior, and systemic risks. In summary, Dynan's paper provides a comprehensive analysis of the causes and consequences of the increase in U.S. household indebtedness. It highlights the importance of addressing this issue to safeguard financial stability and underscores the need for informed policy interventions and continued research in this area.

Following this, we can see positive effect of social policies in regard to indebtedness. Study by Bernheim et al. (2001) uses data from the U.S. Survey of Consumer Finances, the study finds a positive correlation between education and saving behavior. Individuals with higher levels of education tend to save more, accumulate greater wealth, and exhibit a higher likelihood of holding financial assets. The authors also explore potential mechanisms through which education influences saving behavior. They suggest that education enhances individuals' financial literacy, improves their ability to make informed financial decisions, and increases their awareness of long-term financial goals. Furthermore, the study examines the impact of educational policies and programs on savings behavior. It suggests that policies aimed at promoting access to education and improving the quality of education can indirectly contribute to higher levels of saving and financial well-being. Overall, the paper underscores the importance of education in fostering saving behavior and highlights the potential benefits of educational initiatives in promoting financial security and wealth accumulation among individuals and households.

These findings shed light on main determinants of indebtedness across the world. Among G20 nations Germany had a relatively low household debt-to-income ratio compared to some other large economies. In Germany, several studies have examined the levels and determinants of household debt. Lusardi et al. (2014) discuss the potential mechanisms through which financial literacy impacts economic outcomes, including improved understanding of financial products, increased confidence in financial decision-making, and enhanced ability to navigate complex financial markets. Furthermore, the paper emphasizes the societal benefits of financial literacy, such as reduced reliance on public assistance programs, increased financial stability, and improved overall economic well-being. Based on their analysis, the authors suggest that promoting financial literacy through education and targeted interventions can have substantial economic implications, leading to better financial outcomes for individuals, households, and the economy.

However, household debt was equivalent to around 1.86 times the annual disposable income in Australia according to Australis Bureau of Statistics (2020). It has also been the subject of extensive research by many scholars. Lars E.O. Svensson (2022) examines the impact of household debt on consumer spending during the financial crisis in Australia. The author challenges the conventional belief that high levels of household debt led to a significant decline in consumer spending during the crisis. Through a comprehensive analysis of household-level data, Svensson argues that the notion of a "debt overhang" effect, where high levels of debt constrain consumer spending, is not supported by the empirical evidence in the Australian context. Instead, he suggests that factors such as income shocks and changes in expectations had a more substantial influence on consumer spending behavior during the crisis. The paper emphasizes the need for a nuanced understanding of the relationship between household debt and consumer spending, cautioning against overgeneralizations and highlighting the importance of considering other contextual factors. The findings contribute to the ongoing debate on the role of household debt in shaping economic dynamics and challenge the commonly held belief regarding its impact on consumer spending during times of financial crises.

3. Conclusion

In conclusion, this comprehensive literature review has explored the multifaceted nature of household indebtedness and its wide-ranging implications for individuals, households, and economies. The reviewed studies have illuminated several key factors that influence household debt, including economic variables, demographic factors, financial market characteristics, and education. Furthermore, this review challenges conventional beliefs regarding the impact of household debt on consumer spending during financial crises. The findings suggest that factors such as income shocks and changes in expectations have a more substantial influence on consumer spending behavior than the level of household debt itself. These insights caution against overgeneralizations and emphasize the need for a nuanced understanding of the relationship between household debt and consumer spending dynamics during times of economic downturns. By addressing the research gaps identified in this review, future studies can contribute to a deeper understanding of this critical issue and inform evidence-based policy-making and interventions that promote financial stability and well-being for individuals, households, and economies as a whole.

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