International Journal of Economics, Commerce and Management
United Kingdom Vol. III, Issue 2, Feb 2015
http://ijecm.co.uk/ ISSN 2348 0386

CASUALTIES AND EFFECTS OF HOUSEHOLD DEBT IN ASEAN COUNTRIES

Maryam Dikko
Othman Yoep Abdullah Graduate School of Business, Universiti Utara, Malaysia
Maryam.dikko@gmail.com

Ahmad K. Madi
Othman Yoep Abdullah Graduate School of Business, Universiti Utara, Malaysia

Abstract

Rising household debt has become a disturbing phenomenon in a number of Asian countries. This paper presents literature on the different causes of the situation in selected ASEAN countries, which range from regulatory and institutional, socio-demographic, economic factors to financial literacy, and the possible macroeconomic and social effects of household debt. The paper concludes that one of the major causes is the departure from Islamic financial principles concerning attitude to and the management of debt. Therefore, solutions can be gleaned from looking towards Islamic ideals.

Key words: Household debt, ASEAN countries, debt management, Islamic financial principles, effects of debt, Islam and debt, causes of debt.

INTRODUCTION

Within the last two decades, there have been changes in the economic landscapes of quite a number of countries in Asia. Most of the countries have experienced economic boom and have moved from under developed or developing to major players in the world financial market. In recent times, as part of the changing landscape, particularly after the Asian financial crisis, there has been the move towards household financing. Banks and other financial institutions have leaned heavily towards the household sector as a means of diversifying fund raising strategies. Endut and Hua (2009) have determined that where lending to the housing sector was just one third of the exposure of banks before the crisis, it has now risen to more than half.

Over time, household indebtedness in Asia has reached a record high. Though it has been a part of most western countries for over three decades (Barba and Pivetti, 2009), this phenomenon is relatively new to Asian countries and has therefore not been fully studied. It has however been determined that Malaysia, Thailand, Korea and Singapore have the highest levels of household debt in Asia (Standard & Poor's, 2013).

This paper aims to present the views of scholars on the causes and effects of rising household debts in these and other ASEAN countries. It also looks at the causal factors from an Islamic point of view.

The paper is divided into four sections. The first section gives an overview of household debt and its importance to any economy, the second section looks at different factors responsible for rising household debt both in general terms and with particular reference to the ASEAN countries within our study. The third section considers the effects of the phenomenon while the last presents summaries, conclusions and recommendations.

DEFINITION OF HOUSEHOLD DEBT

Household debt is the amount of money that all adults in a household owe financial institutions and includes consumer debt and mortgage loans. It is an obligation or liability arising from borrowing money or taking goods or services "on credit", i.e. against an obligation to pay later. (Van der Walt & Prinsloo, 2002).The status of household debt plays a key role in the economic welfare of any country (Cecchetti, Mohanty & Zampoli, 2011). Acceptance of the relationship between rising household debt and economic downturn (Leigh et al, 2012) becomes fundamental to formulating key economic and financial policies. Barba and Pivetti (2009) noticed that the most prevalent form of debt is credit card debt with mortgages coming in a close second. In Malaysia however, the highest proportion of debt is used for housing followed by the purchase of transport vehicles. These are followed by debts for personal use while credit card debt comes last (Endut & Hua, 2009).

Household debt in itself may not be an issue unless over indebtedness is considered. The European Commission (2010) considers over indebtedness as the inability to meet recurrent expenses without the need to borrow more. D'alesso and Iezzi (2013) include, as determinants of over indebtedness, making high payments relative to income, being in arrears for more than two months, making heavy use of credit or a declaration, by the debtor, that debt repayments are a heavy burden. Endut and Hua (2009) on the other hand, use the debt to disposable income ratio to determine over indebtedness.

CAUSES OF HOUSEHOLD DEBT

This part is based on a conceptual framework of causes of over-indebtedness which include regulatory and institutional factors, socio-demographic factors, economic borrower characteristics, business and loan-related factors, sociological influences, and psychological/cognitive influences (Schicks, 2013). Each of these factors will be studied from the conventional perspective while placing them within Islamic parameters.

Regulatory and Institutional Factors

Financial deregulation decreased credit rationing and lowered interest rates (Persson, 2009; Debelle, 2004). Wan (2013) has established that there is a positive relationship between private consumption and low interest rates as it encourages borrowing. This is also supported by studies conducted by Lopes (2008) and Barnes & Young (2003). In Singapore (Wan, 2013), Malaysia (Endut & Hua, 2009), and Korea (Kang & Ma, 2009), the loose monetary policies ensure that households, do not in the short term, feel burdened by the repayment of debts. Advances in technology also make it easier to give credit by ensuring the establishment of an adequate system for keeping track of creditors and their credit.

From the Islamic point of view, the huge debt that currently burdens households can be attributed to loans that have charged interest (Khatija, Sapora, Zulkiple & Jusof, 2013). They have also not shared risk between the lenders and the borrowers and have, therefore, contravened the two most fundamental principles of Islamic finance. *"O believers! Do not live on usury that is compounded over and over again. Have fear of Allah so that ye may prosper" (3:130)*

Socio-Demographic Factors

A borrower's risk of personal over-indebtedness varies with his/her age. Younger age seems to imply higher risk of indebtedness (Bridges and Disney, 2004, Drentea and Lavrakas, 2000, Lea et al., 1993; Livingstone and Lunt, 1992; Vogelgesang (2003) . This factor has shown prominence within countries like Malaysia which have a high proportion of their population being within the younger age bracket.

Livingstone and Lunt (1992) find that in the UK, having more children reduces risk, assuming that children create discipline in their parents. Except for Tokunaga (1993), most studies find increased over-indebtedness among single adult households, particularly after a divorce (Bridges & Disney; 2004, Canner & Luckett, 1991; Del-Río & Young, 2005; Lea et al., 1993; Webley & Nyhus, 2001).

Several UK studies also determined higher debt risk for renters as opposed to home owners (Bridges & Disney, 2004; Disney et al., 2008; Lea et al., 1995). Concerning education, Bridges and Disney (2004), Canner and Luckett (1991) and Tokunaga (1993) discovered a higher risk of debt when a borrower's level of education is low. However, in Ghana, a higher level of education corresponds to more active use of financial products (Boakye & Amankwah, 2012).

Peer income is another factor that exerts considerable influence on debt. Kapteyn et al(2011) established that persons who believe that their income is below their social circle will tend to borrow more.A final socio demographic factor indicates, through extensive literature, the differences in the over-indebtedness risk of male and female borrowers. Jianakopolos & Bernasek, (1998) and Olsen & Cox (2001) establish that women behave differently in financial decisions and tend to be more risk averse.

Generally, society's attitude has deviated away from Islam's attitude towards debt (Zakaria et al., 2012). Going by Islamic financial principles, debt should be a last resort used only to finance basic necessities. The Prophet's Muhammad said, as narrated by Abu Dawud, "*Whoever asks people for money when he has what is sufficient for him is only asking for more of the embers of Hell*." They asked him, "*O Messenger of Allah SWT, what is sufficient so that he does not have to ask for more*?" He said: "*Having enough to eat lunch and dinner.*"

With a country like Malaysia, Islamic ideals are negated by the rising desire within Asians to stylize their lives to fit in with their western counterparts thusthe rise in household borrowing is the direct consequence of overconsumption, or the consumerism phenomenon (Mokhtar, 2013) and the use of debt for financing luxuries.

Economic Factors

A major cause of indebtedness is low income (Bridges and Disney, 2004; Disney et al; 2008; Lea et al., 1993; Lea et al., 1995 and Livingstone and Lunt, 1992). Income is, however, not significant in the US studies by Canner and Luckett (1991) and Tokunaga (1993).Moreover, the literature points to a negative association between wealth levels and debt, both in developed countries (Del-Río & Young, 2005; Disney et al., 2008) and in the microfinance context (Godquin, 2004; Sharma and Zeller, 1997).

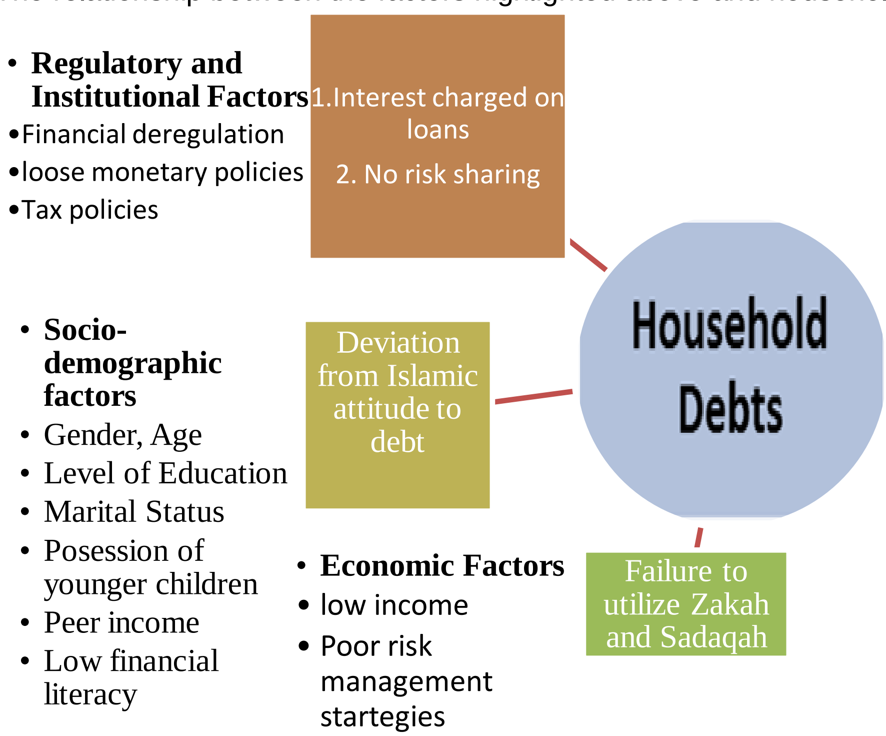
In the developing country context, there is extensive literature on shocks and the coping strategies or sacrifices they trigger. Dercon (2002) points out that poor households often lack risk management tools to meet adverse shocks: assets, informal insurance mechanisms, and public safety nets are in many cases not sufficient to buffer the risks poor people face. In effect, some households use assets (debts) to smooth consumption (Carter & Lybbert, 2012).

From the Islamic perspective, the main economic factor responsible for rising debt levels is non-adherence to Islamic economic principles of wealth sharing through the payment of zakat and voluntary contributions, or sadaqah and. The purpose of zakat is to promote equality by redistributing wealth from the rich to the poor as well as keeping wealth clear of greed selfishness. Also, if creditors fail to alleviate the burden of debt, then debtors are eligible for zakah. The Qur'an states "*The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, to free captives and the debtors in need, and for the cause of Allah and the needy travellers". (9:60)*

Financial Literacy

The literature indicates that a borrower's financial literacy may be related to over-indebtedness. A recent study from the UK relates a lack of financial literacy both to default on consumer loans and to self-reported excessive financial burdens of debt (Gathergood, 2012). Correspondingly, some researchers suggest financial literacy trainings as the best way to prevent debt problems among consumers (DeLaune et al., 2010 and Wolfe-Hayes, 2010). Other studies have shown that micro financed groups that received good loan literacy training and had good leadership had a higher repayment performance, confirming the positive effect of financial literacy (Paxton, Graham, & Cameron, 2000; DeLaune et al., 2010; Wolfe-Hayes, 2010). Fig. 1 provides a diagrammatical representation of issues identified in this study.

Figure1 The relationship between the factors highlighted above and household debt



THE EFFECTS OF HOUSEHOLD OVER- INDEBTEDNESS IN ASEAN COUNTRIES

Macroeconomic Effects

Though in Singapore (Wan, 2013) and Malaysia (Endut & Hua,2009), Thailand (Subhanij, 2009) household are in a strong financial position and have the ability to withstand adverse shocks of higher interest rates and other financial shocks, regardless of whether households have "over-borrowed", the increase in household debt has important macroeconomic implications. Persson (2009) believes that there is cause for concern since most debts are used for purchase of mortgages. This was reflected in Korea where a credit card crisis in 2003 caused by a lending boom had a painful effect on the economy (Kang & Ma, 2009). Also, recent international experience shows that excessive indebtedness and looser lending standards can also make households more vulnerable to adverse shocks and increase risks to the financial system (Crawford & Faruqui, 2012).Standard and Poor's (2013) also believe that the continuing rise in household debt could eventually weigh down Asia's banks. .

Personal Bankruptcy

Zhu (2011) argues that households consume above their means and jeopardize financial security. Jegarasasingam (2011) has already established that using the financial assets of households to calculate payment resilience may not give an accurate indication of the strength of the sector. Where households inevitably become unable to meet their obligations, they have to file for bankruptcy.

Personal bankruptcy has become a common occurrence in developed economies. This trend has now spread to Asia. In Singapore, bankruptcy orders have risen to about 14%, their highest level since 2009. Cheng et al (2014) discovered that between 2005 and 2012, there were 124, 708 cases of personal bankruptcy filings in Malaysia. This is corroborated by Noordin et al (2012) whose study shows that cases of bankruptcy are more predominant among those below the age of 30 (particularly executives) who have access to housing loans but is caused primarily by credit card debt.

CONCLUSION

The increase in household debts in ASEAN countries can be attributed to a wide variety of factors ranging from macroeconomic to low or no financial literacy. It can even be blamed, particularly for Malaysians, on the departure from Islamic norms and values as Islam has a deep aversion to debt. According to Islamic debt principles, debt should be a last resort used only to finance basic necessities. The current practice of obtaining everything via debt by the use of credit cards can thus be viewed as quite un-Islamic.

The acceptance of the seriousness of the situation of rising household debt in these ASEAN countries and the timely introduction of effective countermeasures is necessary to avoid the occurrence of personal finance failures and to protect the stability of the financial systems. Working knowledge of the causes of the phenomenon and possible side effects will provide guidelines that may be used effectively by policy makers. It is recommended that policy makers look to Islamic financial and economic guidelines for the solutions

REFERENCES

Atkinson, A., McKay, S., Kempson, E., & Collard, S. (2006). Levels of Financial Capability in the UK: Results of a Baseline Survey. Consumer ResearchNo. 47, London.

Barnes, S., and Young, G., (2003). The Rise in US Household Debt: Assessing its Causes and Sustainability. Bank of England Working Papers, No 206.

Boakye, C., & Amankwah, N. (2012). Determinants of The Demand For Financial Products in Ghana, Accra.

Bridges, S., Disney, R. (2004) Use of Credit and Arrears on Debt Among Low-Income Families in the United Kingdom, Fiscal Studies, 25 (1) (2004), pp. 1–25

Canner, G. B., &Luckett, C. A. (1991) Payment of Household Debts, Federal Reserve Bulletin, 77 (4) (1991), p. 218

Carter, M. R., Little, P. D., Mogues, T., &Negatu, W. (2007)Poverty Traps and Natural Disasters in Ethiopia and Honduras, World Development, *35* (5), pp. 835–856

Carter, M. R.&Lybbert, T. J. (2012) Consumption Versus Asset Smoothing: Testing the Implications of Poverty Trap Theory In Burkina Faso, Journal of Development Economics, 99 (2) (2012), pp. 255–264

Cheng, E. H., Wei, K. K., Rajagopalan, U. &Abdulhamid, B. (2014). Causality of Personal Bankruptcy in Malaysia,

Chucherd, T. (2006).The Effect of Household Debt on Consumption in Thailand".Bank of Thailand Discussion Paper DP/01/2006.

Chung, K. (2009). Household Debt, the Savings Rate and Monetary Policy: the Korean Experience. BIS Papers No 46, pp83-94.

Courchane, M., Gailey, A. & Zorn, P. (2008) Consumer Credit Literacy: What Price Perception?Financing Community Reinvestment and Development, 60 (1–2) (2008), pp. 1*25–138*

Crawford, A. and Faruqui, U. (2012).What Explains Trends in Household Debt in Canada? Bank of Canada Review, Winter2011–2012.

D'Alessio, G. and Iezzi, S. (2013). Household Over-Indebtedness: Definition and Measurement with Italian Data, Questioni di Economia e Finanza (Occasional Papers) 149, Bank of Italy, Economic Research and International Relations Area.

Debelle, G. (2004). Household Debt and the Macroeconomy", *BIS Quarterly Review,* Bank for International Settlements.

DeLaune, L. D., Rakow, J. S., Rakow, K. C. (2010) Teaching Financial Literacy in a Co-Curricular Service-Learning Model, Journal of Accounting Education, 28 (2) (2010), pp. 103–113

Del-Río, A., & Young, G. (2005). The Impact of Unsecured Debt on Financial Distress AmongBritish Households. Working Paper No. 262, Bank of England, London.

Dercon, C. (2002) Income Risk, Coping Strategies, and Safety Nets, World Bank Research Observer, 17 (2) (2002), p. 26

Disney, R., Bridges, S., Gathergood, J (2008) Drivers of Over-indebtedness: Report to the Department for Business, Enterprise and Regulatory Reform

Drentea, P., &Lavrakas, P. J.(2000). Over the limit: The Association among Health, Race, and Debt.Social Science & Medicine*,* 50 (4) (2000), pp. 517–529

Endut, N. &Hua, T. (2009). Household Debt in Malaysia, BIS Papers *No 46*, pp 107-116.

Godquin, M. (2004). Microfinance Repayment Performance in Bangladesh: How to Improve the Allocation of Loans by Mfis, World Development, 32 (11) (2004), pp. 1909–1926

Jegarasasasingam, A. (2011). Malaysian household debt: Lingering concerns trigger tighter regulations, MARC Analytical Insights, Malaysia Rating Corporation Berhad.pp. 1-8.

Jianakopolos, N. A. &Bernasek, A. (1998) Are Women More Risk Averse? Economic Inquiry, 36 (4) (1998), Pp. 620–630

Kang, T. & Ma, G. (2009).Credit Card Lending Distress in Korea in 2003".BIS Papers N*o 46*, pp95-106.

Kapteyn, A., Kuhn, P., Koorman, P. &Soetevent, A (2011). The Effects of Lottery Prizes on Winners and their Neighbors: Evidence from the Dutch Postcode Lottery, American EconomicReview, 101, 2226-2247.

Lea, E.G., Webley, P., &Levine, R. M. (1993).The Economic Psychology of Consumer Debt.Journal of Economic Psychology, 14(1): 85-119.

Lea, S.E.G., Webley, P. & Walker, C. M. (1995). Psychological Factors in Consumer Debt: Money Management, Economic Socialization, and Credit Use Journal of Economic Psychology, 16 (4) (1995), pp. 681–701

Livingstone, S.M. & Lunt, P. K (1992). Predicting Personal Debt and Debt Repayment: Psychological, Social and Economic Determinants. Journal of Economic Psychology, 13(1): 111-134.

Lopes, P. (2008). Credit Card Debt and Default over the Life Cycle. Journal of Money, Credit and Banking, Vol. 40, No 4, pp 769-790.

Mokhtar, M. (2013).Shariah Issues in Managing Household Debt.Journal Pengurusan, Vol. 37, pp 63-76.

Noordin, N., Zakaria, Z., Sawal, M., Ngah, K., &Hussin, Z. (2012).Bankruptcy Among Young Executives in Malaysia. A Paper presented at International Conference on Economics and Management, Singapore.

Prinsloo, J W (2002).Household Debt, Wealth and Saving, South Africa Reserve Bank Quarterly Bulletin, pp 63-78.

Stephen G., Cecchetti, M., Mohanty, S., and Fabrizio, Z. (2011).The Real Effects of Debt.BIS Working Papers No 352. pp 1-34.

Subhanij, T. (2009).Household Sector and Monetary Policy Implications. Thailand's Recent Experience. BIS Working Papers No *46*, pp 136-161.

Yusuf Ali Translation.The Holy Qur'an.

Weller, C.E., (2007). Need or Want: What Explains the Run-up in Consumer Debt? Journal of Economic Issues*,* 41(21): 583-593.

Zakaria, R. H., AbdulKader R., Jaafar, N &Marican, S. (2012). Burgeoning Household Debt: An Islamic Economic Perspective, Middle East Journal of Scientific Research, Vol. 12, pp 1182-1189.

Zhu, N. (2011). Household Consumption and Personal Bankruptcy. The Journal of Legal Studies, Vol. 40 No 1, pp 1-37.

