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RESEARCH ARTICLE

The Rise of Household Debt in Global Economy and Türkiye

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ABSTRACT

This paper investigates the rise of household debt and its impact on class relations and the sustainability of capitalism. The analysis begins with a historical perspective on the factors contributing to household debt growth, such as declining wages, increasing pressure on organized labor, and the need to maintain consumer demand in the face of declining profit margins. The paper then compares the dynamics of household debt across countries and examines Türkiye's case in a global context. The findings suggest that unsustainable household debt levels, declining wages, and rising inequality; raise doubts about the long-term sustainability of capitalism as we know it. The paper advocates for rethinking economic policies and practices, prioritizing the well-being and prosperity of the majority.

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JEL Classification: G51, E31, F34

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1. Introduction

The oil shock of 1973 took a heavy toll on the global economy and brought about a sharp rise in production costs. At a time when profit rates in Western economies exhibited a continuous decline from their peak levels in 1950s, this supply shock meant a further squeeze on profit margins. Against this trend, capitalist states pushed back by increasing political pressure on organized labor. In the face of high inflation, real wages were significantly reduced in the face of high inflation. However, a consequent decline in the wage share of national income posed another threat for market capitalism, this time on the demand side. Consequently, the neoliberal transformation was accompanied by unprecedented increases in household debt, which became the driving force behind consumer demand. The rise of household indebtedness not only reshaped class relations but also profoundly affected daily life's social and economic aspects. Moreover, it fueled doubts about the sustainability of capitalism as we know it.

In Türkiye on the other hand, low level of household debt is often interpreted as an assurance for its sustainability. However, the trajectory of the household debt-to-income ratio and the composition of household debt merit a closer examination of the underlying dynamics.

This paper examines the rise of household indebtedness from a historical perspective, identifies its dynamics through cross-country comparisons, and discusses its implications for the future of global capitalism. The second part analyzes the Turkish case in a global context.

2. End of American Dream and Household Indebtedness

The post-World War II period was an era of rapid economic growth and rising prosperity in the Western world. In the United States, blue-collar workers enjoyed an unprecedented increase in income, and job security. Consequently, the living standards of Americans improved drastically. By the end of the 1950s, around 87% of all households owned at least one television, 75% owned a car, and 60% owned a home (Morgan, 2019).

After the war, more than 20 million people were released from the armed forces and related employment. The end of the war; economy could create a giant wave of unemployment unless the civilian economy absorbed these masses. In just two years, the US reallocated 16 million people, a third of the labor force, to non-military sectors. President Truman described this mobilization as the "swiftest and most gigantic change-over that any nation has made from war to peace" (Bohanon, 2012, p. 3). The emergence of mass consumption culture was critical in this process. Public figures ranging from government officials to columnists, business executives to labor union leaders, emphasized the importance of mass consumption in creating well-paying jobs. Consumption was no longer a matter of personal indulgence, but a civic responsibility. Growing consumer demand would promote economic growth, increase employment and wages, and lead the pathway to the realization of an affluent society. Thus, a "consumer's republic" was born (Cohen, 2004).

During this period, American working class also recorded significant gains in working conditions. Average work hours in the civilian economy were reduced from 47 to 40 hours between 1944 and 1953. Paid vacations and holidays, uncommon until the 1940s, were extended to two-thirds of all nonfarm workers by 1968 (Moore and Hedges, 1971). In particular, union factory jobs, especially those that provided better working conditions came to be accepted as a "critical steppingstone to the middle class" (Biondi, 2006, p. 26). Union membership also exhibited a steady rise and the unionization rate; as a percentage of wage and salary employment; peaked in 1954 at 34.8% (Mayer, 2004, p. 11).

Between 1948 and 1973, the US economy grew dramatically, expanding at an annual rate of 3.95% (Fernald, 2016, p. 8). Conversely, inflation had become an issue of the past, fluctuating in the range of 1%–2%. During this period, productivity growth reached 97% and became the main driver of economic expansion (Mishel, Gould, and Bivens, 2015). For nearly three decades, real wage growth kept pace with productivity growth, even exceeding it from 1953 to 1963. At its peak in 1970, wage share of GDP was 51.6% (FRED, 2022 February 23). However, postwar prosperity did not last long for blue-collar America. The pursuit of the American dream was thwarted by economic and political events that resulted in a profound economic transformation and tilted the balance of power against workers.

In the 1970s, Americans faced an economic slowdown and a dramatic inflation surge. The Vietnam War was an important factor, and it proved to be a costly mistake for the US government. In the face of recurring budget deficits and a growing current account deficit, the Nixon administration decided to end the dollar's peg to gold in 1971. This decision sent the dollar down against other major currencies and set the stage for an unprecedented period of inflation. Then came the 1973 oil shock. With rising production costs, inflation became out of control. Following the second oil shock in 1979, inflation accelerated to 13.5%. In response to inflation, the Fed raised the fed funds rate from 11% in 1979 to 20% in 1980 (FRED, 2022 February 22). This new monetary policy, the Volcker shock, not only managed to bring down inflation; but also caused the appreciation of the dollar against other currencies and widened the US's current account deficit. As a result, the unemployment rate increased dramatically from 6% to 10.8% between 1979 and 1982 (FRED, 2022 February 22.). The growing labor reserve army and high inflation laid the groundwork for a new era of real wages sharply declining. This new era also marked the rise of neoliberalism as a hegemonic ideology.

Profit rate analysis could provide more information about the class dynamics behind this transformation. The profit rates in the postwar US economy remained generally above 20% until 1966. Moreover, the profit rates began to fall in the second half of the 1960s, and the company suffered approximately a 50% loss over the period 1965-1974 (Moseley, 1997, p. 25). Increasing the bargaining power of labor unions surely played a pivotal role in this process. However, the 1973 and 1979 oil shocks caused a spike in raw material prices and dealt a fatal blow to the already struggling profit rates. American capitalists sought to recoup their profits by driving down real wages, launching a concerted attack on organized labor.

Economists often assume that wages are determined in the marketplace, and workers are paid the marginal product of their labor. However, the reality is much more complicated and involves political dynamics. Hibbs (1977) demonstrated the importance of labor unions and militancy of workers for the determination of wages. Similarly, Ashenfelter, Johnson, and Pencaval (1972) concluded that union strikes increase wage growth independent of supply and demand conditions. Meanwhile, Freeman and Medoff (1984) argued that unions appear to be beneficial to both non-union and union members. All these works, along with many others (Flanagan, 1976; Parsley, 1980), emphasized that wages are determined by "a tug of war between employers and workers" (Applebaum, 2019).

From the 1970s on, without a doubt, employers were gaining ground in the tug of war. Union membership has steadily declined, peaking at 22% in 1980 and falling to 15% in the early 1990s (Mayer, 2004, p. 22). During this time, wage growth lagged far behind productivity growth. From 1973 to 2013, productivity growth averaged around 74%, whereas real wage growth remained at 9% (Mishel et al., 2015). Similarly, the wage share of GDP fell from 51.6% in 1970 to 45% in 1996 and reached 42% in 2013 (FRED, 2023 February 23).. Wage inequality has also increased at an unprecedented rate. Over the period, the top 1% of wage earners saw their annual pay increase by 138%, whereas the bottom 90% saw a mere 15% increase (Mishel et al., 2015). As a result, the postwar period's burgeoning middle class shrank substantially.

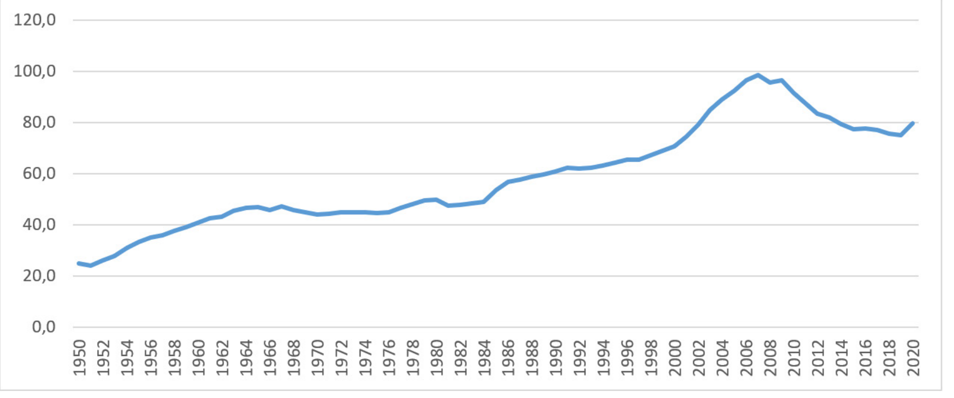
The deterioration of income equality would have adverse effects on consumer demand. However, it was just the opposite. At a time when the US middle class contracted, consumer demand continued to expand. Moreover, between 1981 and 2009, consumption growth outpaced GDP growth as the share of personal consumption expenditures in GDP increased from 60% to 69% (FRED, 2022 February 23). One major dynamic responsible for this otherwise inexplicable phenomenon was the rise in household debt, which more than compensated for the loss of pace in real wage growth and fueled consumer demand.

3. Financialization and Household Indebtedness in the Capitalist World Economy

An important feature of the transformation of the US economy in the 1980s was financialization. In response to the drop-in profit rates, US firms shifted their investments from production to finance. Ample liquidity, low interest rates, and deregulations further supported the burgeoning financial sector. Financialization not only meant rising dominance of the financial sector, but also increasing reliance of nonfinancial firms on financial services and their increasing participation in financial markets. In the 1970s, the share of financial income in nonfinancial firms' realized profits was approximately 15%, but by the 2000s, this ratio had risen to 40% (Lin and Tomaskovic-Devey, 2013, p.1287). Household financialization is a related development that is characterized by the emergence of households as investors, increasing levels of household debt, and the development of a financial system that integrates individual households into global financial markets (De Vita and Luo, 2020).

Household debt consists mainly of mortgage loans, motor vehicle loans, student loans, credit cards, and other consumer loans. In the US, mortgage loans are by far the largest component, making up around 70% of total household debt (Catanzaro, 2020, p. 21). Over the years, household debt grew rapidly, especially after the 1980s. The household-debt-to-GDP ratio was around 25% in the early 1950s, but it rose to 50% in 1980 and 98% in 2007. Following the 2008 mortgage crisis, it declined significantly due to expansionary policies, stricter regulations, lower interest rates, and considerably lower debt service costs. In 2020, it was approximately 80% (Fig. 1).

Figure 1. The US Household Debt, Loans, and Debt Securities (percent of GDP), 1950–2020.



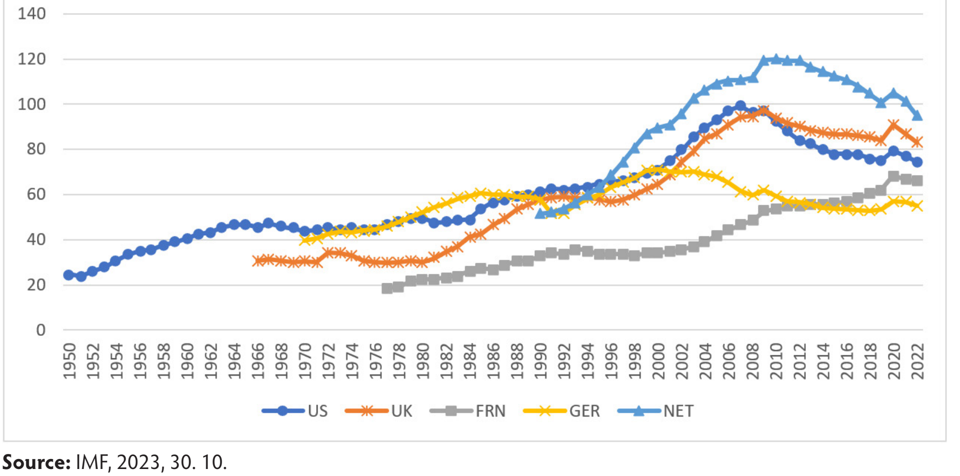
Source: IMF, 2023, 30. 10.

Securitization was a major contributor to the dramatic increase in household debt. In the 1970s, government-backed agencies pioneered the securitization of mortgage loans. The securitization market expanded dramatically in the 1980s, and other income-generating assets began to be securitized. Many banks are securitizing their loans and transferring credit risk to third-party investors. Initially, this process was widely considered the "greatest financial innovation of the twentieth century," and its side effects were believed to be benign (Wong, 2009). Millions of Americans could access financial markets and borrow at considerably lower rates. However, because the loan originator did not bear the credit risk, it led to lax screening procedures and created a moral hazard problem (Keys, Mukherjee, Seru, and Vig, 2008). Following the 2008 financial crisis, the risks associated with securitization became more apparent.

Market interest rates also play a crucial role in the trajectory of the household debt. After the burst of Nasdaq bubble in 2000, Fed pursued an expansionary monetary policy and significantly lowered the interest rates. In this period, household debt grew much higher than GDP, and household debt ratio increased from 70% to 98% in only 6 years. However, the upward pressures on the interest rates increases the cost of servicing debt and the likelihood of defaults. Fed monetary tightening after mid-2004 became the main catalyst in the mortgage crisis and exposed the fragility of the entire system.

The rise in household debt was not peculiar to the United States. After the 1980s, the widespread adoption of neoliberal policies and the emergence of the consumer culture as a global phenomenon brought a worldwide rise in private household liabilities. In the US and Western Europe, household debt rose, particularly in the early 1990s and 2000s (Fig. 2). In many developed countries, consumer spending took a heavy hit after the crises of 2008. The sudden surge in the household debt ratio in this period was largely due to the contraction of the GDP. Among these countries, the Netherlands deserves special attention because it is ranked first. The Dutch are known to be the most indebted households in Europe due to tax breaks for leverage and high housing prices. Furthermore, unlike in the US and the UK, Dutch households have very limited options for debt restructuring due to the legal framework. Negative equity affects one-third of Dutch homeowners. However, due to the Draconian nature of the regime, many people choose not to use the consumer insolvency procedure, which is unlikely to result in debt discharge (Klein, 2016).

Figure 2. Household Debt, Loans, and Debt Securities (percent of GDP) in Selected European Countries and the US, 1950–2022.



Source: IMF, 2023, 30. 10.

4. Social Consequences of Over-Indebtedness

In recent decades, the capitalist world economy has witnessed an unprecedented surge in household debt. This development not only increased the fragility of the economic system, but also had profound effects on social life and well-being of the individuals.

Financial distress is a major contributor to psychological and physical health issues. Individuals who are struggling to meet their debt payments suffer severe stress, work longer hours, and cut back on health care and medicine. According to empirical research, people who have unpaid loans are more likely to have suicidal thoughts and suffer from depression (Turunen and Hiilamo, 2014, p. 7). Mental stress often leads to physical ailments. A significant portion of individuals with debt suffer from tension, headache, upset stomach, and loss of appetite (Hiilamo, 2018, p. 115). Another study reported that over-indebted individuals experience physical pain more frequently than the general population, although they are less likely to use pain medication (Warth et al., 2019). Furthermore, even when controlled for other socio-economic factors and pre-existing health problems, people with financial debt are two and a half times more likely to commit suicide (Rojas, 2022, p. 1448).

According to studies, increasing debt causes people to cut back on social activities and focus on the necessities of daily life. Many people describe their lives as a struggle to make ends meet and describe themselves as "existing" rather than "living" (CPEC, 2013, p. 176). Over-indebtedness results not only in social exclusion but also exclusion from many essential household services such as internet or phone subscription. It is also more difficult for them to find a new job (CPEC, 2013, p. 189; Ford, 2018, p. 137).

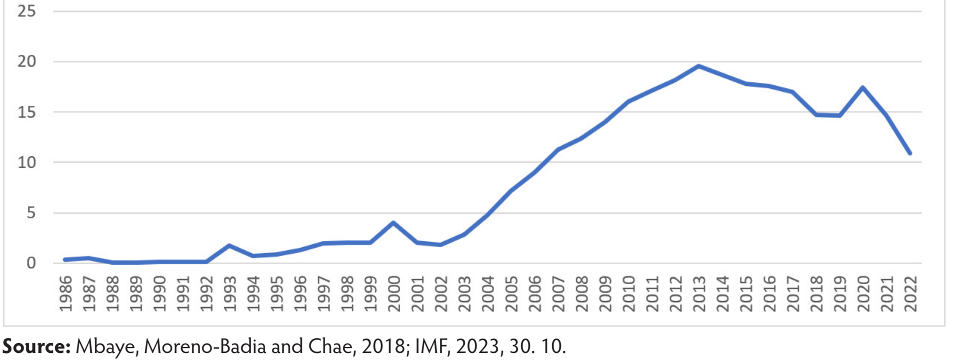
Marx famously said, "the proletarians have nothing to lose but their chains" (Engels and Marx, 2004 [1848], p. 103). Today, the lower and middle classes live in houses paid by the banks, driving cars paid by the banks, and even wearing clothes paid by the banks. Not only do they not own them, but a significant portion of households also have a deficit net worth. However, this does not mean they have nothing to lose. They can lose the home they live, the car they drive if they somehow lose their income stream. Household indebtedness serves as the shackles of the modern-day working class. Afraid of losing their means of livelihood, billions of people cling to their jobs and avoid any frictions in the workplace, regardless of how dissatisfied they feel with their work, pay, or their working conditions.

Today, household indebtedness is an essential component of modern capitalism. It enables a greater surplus value extraction by restricting the bargaining power of the working class, who accept longer working hours and lower subsistence levels. Over-indebted workers can no longer risk losing their jobs and are less likely to organize unions or defend their rights through strikes (Lattanzi-Silveus, 2019).

5. The Rise of Household Debt in Türkiye

In Türkiye, the household-debt-to-GDP ratio remained considerably low until the early 2000s and increased from 0.4% to 4% in the 1986–2000 period. Following the 2001 crisis, which shook the economy to its core, the country implemented a comprehensive banking reform. A more robust banking system combined with a favorable global liquidity environment fostered credit expansion, and by 2020, the household debt ratio reached 17.4% (Fig. 3).

Figure 3. Household Debt, Loans, and Debt Securities (as % of GDP) in Türkiye, 1986–2022.

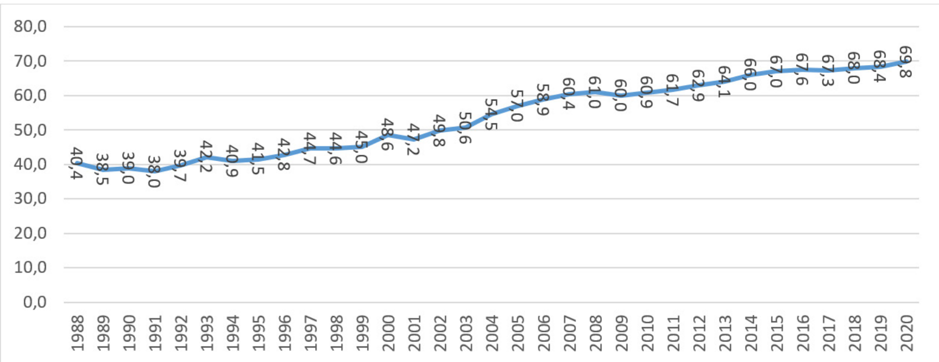


Source: Mbaye, Moreno-Badia and Chae, 2018; IMF, 2023, 30. 10.

In the pre-2001 period, total assets of the banking system were composed mainly of government debt. The financing of public debt through central bank was a major problem behind the surging inflation of the 1990s. The reforms implemented after the crisis aimed to tame the inflation through fiscal discipline and monetary tightening. The government was no longer allowed to borrow funds from the central bank. These reforms, along with the easing liquidity conditions in the global markets, brought down the inflation and lowered interest rates on government bonds. Changing economic environment also led the banks to shift their focus away from government debt instruments to private lending activities (Türel, 2011).

During this time, wage increases were primarily tied to the central bank's announcement of inflation target. However, realized inflation rates frequently remained above the inflation target, eroding wage earners' purchasing power. This caused households to rely heavily on bank loans to maintain their standard of living (BSB, 2015). On the other hand, firms sought foreign currency loans with considerably lower interest rates due to favorable conditions in foreign exchange markets. Therefore, banks turned to consumer lending and developed aggressive marketing strategies for consumer credit markets (Akçay, 2017).

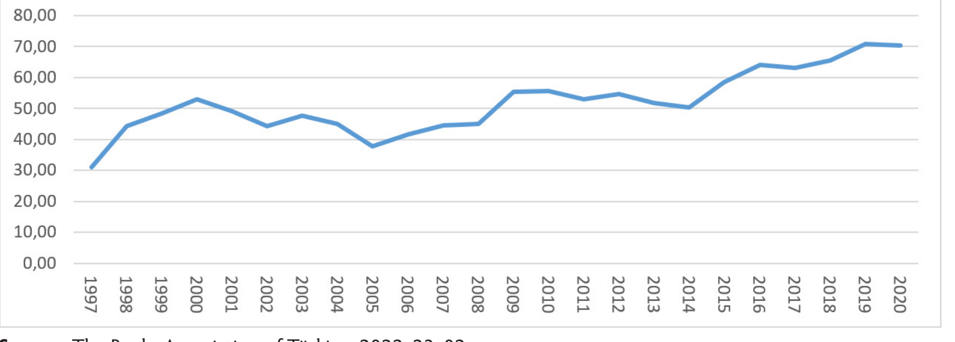
Figure 4. Wage Worker (% of Total Employment)



Source: TURKSTAT, 2022.

Between 1988 and 2020, the share of wage earners in total employment rose from 40% to almost 70% in Türkiye (Fig 4). The dramatic change in the employment structure also played a pivotal role in reshaping the banks' loan portfolios, which placed a growing emphasis on wage earners. This period was also marked by market reforms to deepen the country's integration into global markets by increasing international competitiveness through a more flexible labor market and lower labor costs. Wage earners increased their use of bank loans to compensate for real wage losses in a more flexible labor market with high unemployment and widespread concerns about job security (Karaçimen, 2014). Particularly during economic downturns that brought mass layoffs and delayed wage payments, Turkish households resorted to consumer loans, and many found themselves gradually drawn into a spiraling debt trap (Karaçimen, 2015).

Figure 5. Ratio of Loans Used by Wage Employees to Total Consumer and Housing Loans



Source: The Banks Association of Türkiye, 2022: 23. 02.

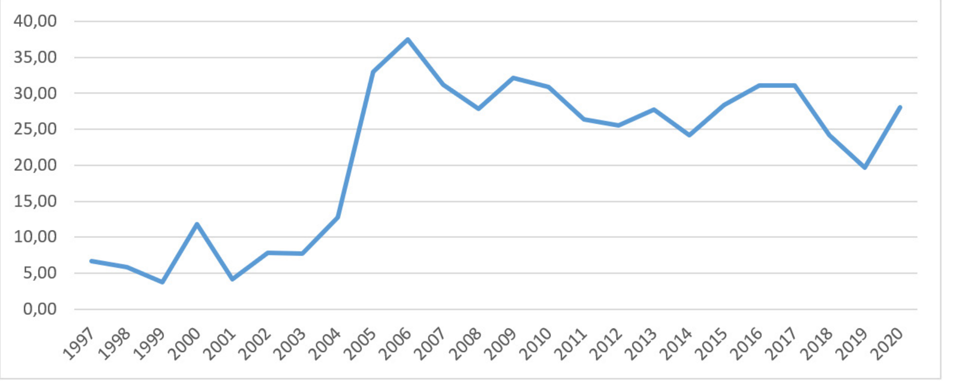
As shown in Figure 5, the proportion of consumer and housing loans made to waged employees increased from 30% in 1997 to 70% in 2020. This dramatic increase was partly caused by an increasing share of wage employment in total employment. However, another major reason was the employees' real wage losses.

Changes in consumption patterns were another major factor driving the rise in household debt. Several factors, including globalization, technological advancements, and rapid urbanization, radically altered Turkish household consumption patterns beginning in the 1980s. Initially, electrical products such as televisions, washing machines, and refrigerators were used, and then electronic products such as computers and smartphones became household staples in Turkish homes. This period also marked the emergence of consumer society in Türkiye, which brought greater reliance on bank loans (Öztay, 2021).

In consumer societies, positional concern is another key determinant of household consumption. Studies show that households with relatively lower incomes tend to spend a higher portion of their income on consumption and are more likely to increase their consumption through debt to "keep up with the Joneses" (Albayrak, 2020).

The increase in housing loans is another important factor driving household debt. As shown in Figure 6, the share of housing loans in total consumer and housing loans increased from 6.6% in 1997 to 37% in 2006 and is observed to reach 28% in 2020. Behind this surge is a bold growth strategy highly dependent on the construction sector. During its tenure, the AKP (Justice and Development Party) government prioritized the construction sector as the backbone of Turkish industry and channeled funds to it to stimulate economic growth. These efforts also occurred during rapid urbanization, which increased housing demand in metropolitan areas. Because of the availability of relatively low-cost mortgage loans, the urban middle classes were able to finance their housing demand through the banking system. Therefore, along with the transformation of the banking system, demographic factors also played a significant role in the increase in household debt in the country (Aslan and Dinçer, 2018). To mitigate the negative effects of the global crisis, the Turkish government pursued a loose monetary policy and increased credit supply, particularly after 2009, encouraged by global liquidity conditions. However, due to increasing unemployment and substantial real wage losses, households facing severe financial difficulties frequently turned to consumer loans to maintain their standard of living. Therefore, the share of mortgage debt in total household debt decreased.

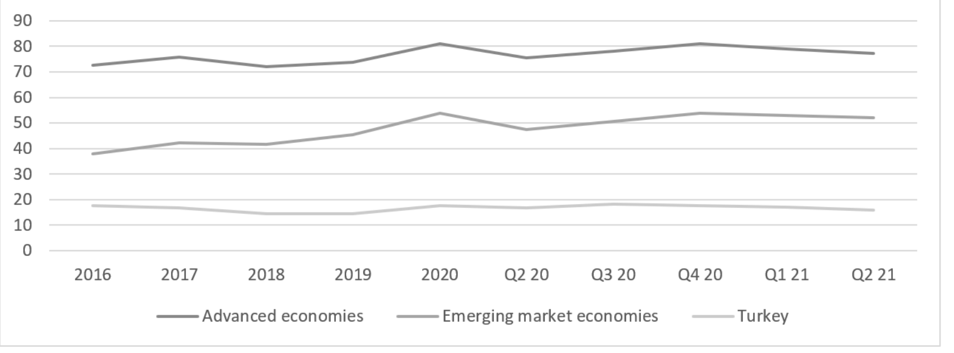
Figure 6. Ratio of Housing Loans in Total Consumer and Housing Loans in Türkiye



Source: The Banks Association of Türkiye, 2022: 23. 02.

Figure 7 enables us to assess Türkiye's current state of household Türkiye debt globally. The household debt-to-GDP ratio is significantly higher in developed economies -around 80% on average - due to several factors such as deeper financial markets, lower financing costs, greater financial inclusion, and greater financial literacy. On the other hand, Türkiye has a household debt-to-GDP ratio of 17%, which is even considerably lower than the average in developing countries. This huge gap might be attributed in part to religious values. In Türkiye, a significant portion of the population abstains from interest-based financial dealings due to their religious beliefs (Davutyan and Öztürkal, 2016). In times of financial need or distress, these people frequently seek loans from family and friends and prefer to borrow foreign currency or gold. As a result, official household debt figures remain significantly lower than they should be. Furthermore, according to some studies, Türkiye has the lowest financial literacy score among developing countries (Karakurum-Özdemir, Kokkizil, and Uysal, 2019). The lack of familiarity with financial instruments and concepts is another factor that leads to low financial inclusion.

Figure 7. Total credit to households (core debt) as a percentage of GDP.

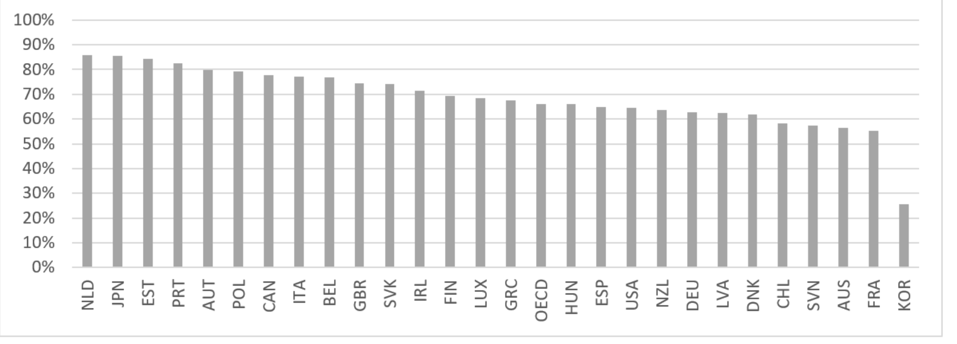


Source: Bank of International Settlements, 2022: 23. 02.

Another important aspect of household debt in Türkiye is the composition of debt. In OECD countries, mortgage debt holds a 66% share in total household debt (Fig. 8). Despite its recent growth, the share of mortgage debt is still considerably lower, around 28% in Türkiye. One major reason for this disparity is the relatively underdeveloped nature of financial markets, specifically the country's secondary mortgage market (Karaçimen and Çelik, 2017).

In Türkiye, a low household debt-to-GDP ratio is frequently interpreted as guaranteeing household debt sustainability. This argument may be deceptive for several reasons. First, economic growth in developing countries is highly volatile. The Turkish economy is an excellent example, with periods of rapid growth followed by severe recessions. A sudden and severe economic contraction would also result in a significant increase in household debt ratio. Second, the significant share of consumer loans in total household debt indicates that a sizable portion of the population borrows to make ends meet or to pay off an existing loan with a new loan. Because consumer loans have little or no collateral, their growing share of total credit increases to the banking system's vulnerability.

Figure 8. Share of total mortgage debt in total household debt



Source: OECD (2021).

6. Conclusion

Growing household debt is a necessary component of the modern capitalist world economy. On the one hand, it maintains capitalism's inherent inequalities. Despite suppressing real wages, it boosts consumer demand and stimulates economic growth. On the other hand, it also reproduces capitalist class relations, enabling a greater surplus value extraction by restricting the working class's bargaining power.

It is only in times of economic contraction that over-indebtedness is identified as a major problem. As companies go bankrupt and unemployment soars, markets witness a credit crunch. Households that can no longer float their debts face debt service difficulties. The household debt ratio rises in tandem with the GDP decline, the ratio of nonperforming loans to total loans rise drastically. Suddenly all key indicators go south.

For the last two decades, at this financial crisis stage, central banks have stepped in with an unprecedented amount of cash injections and lent at historically low interest rates. Through these interventions, they managed to elevate the asset prices and restored the credit flow. However, in the long run, they only created more debt to finance the old debt, increasing the fragility of the financial system and raising questions about its sustainability.

Developing countries, due to the presence of relatively immature financial markets and limited financial inclusion, have considerably lower household debt ratios. Yet, in recent years they went a long way towards catching up with developed countries in recent years. Their main issue is that their lack of domestic savings and high reliance on foreign capital flows make them more vulnerable to global market fluctuations. Concerns about exchange rates and inflation severely limit central bank policies. Hence even lower household debt levels can cause great economic and social instability.

The Turkish economy is a typical example. In the last 20 years, Türkiye has witnessed a drastic increase in household debt. One major reason was the transformation of the banking sector after the 2001 crisis and banks' increasing reliance on consumer loans as a source of growth. During the same period, wage earners' share in total employment increased rapidly. Yet, real wage growth remained fairly limited and the average wage converged to the minimum wage. Hence, wage earners resorted to bank loans to make ends meet. Finally, another important factor was the growth of the Turkish economy, led by construction. The growing housing supply and the availability of low-rate mortgage loans boosted the demand for housing and contributed to the household debt burden.

The implementation of social welfare programs targeting low-income and disadvantaged groups is a crucial policy that governments should prioritize due to rising indebtedness and increasing income inequality. Additionally, economic support packages such as rental, food, and educational assistance should be addressed in order to compensate for some of the losses experienced due to increasing indebtedness, and declining wages in the face of soaring inflation, as has been the case in our country in recent years.

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