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The Impact of Household Debt on Korea's Economy and Society

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Abstract

The topic of household debt has not only economic implications for consumers and the country as a whole, but it is also a significant factor affecting the social stability of its citizens. This problem also parallels the recent financial crises in the U.S., the aftermath of which still plagues its economy. Against this backdrop, this paper aims to review and investigate the trends and determinants of the rising household debt and declining savings in Korea so policies can be implemented to deter and effectively counter the problems that low savings and countervailing high debt will pose on the Korean economy. This study will add to the existing literature by providing new evidence of its implications toward the household debt problem in Korea. I argue that globalization, government policies and generous credit resulting from the low interest policy contributed to the increase in debt in Korea. The tight restrictions on commercial banks' lending practices will put the borrowers at a much worse position, exacerbating the low saving and high debt problem. Despite the volume and the seriousness of the household debt in Korea, the efforts to reduce it have not been satisfactory. To address the rising household debt problem, it is recommended that an active intervention should be implemented toward job creation, employment security and closer monitoring of the lending practice. It is also recommended to offer more information about the loans for indebted low-income class and to simplify the procedures to apply for those loans.

Key words: *Korea's household debt, Savings, Debt relief, National Happiness fund*

1. Introduction

The first years of 2000 marked the outbreak of the household debt in Korea as the most significant potential risk factor that can threaten the stability of the financial system, especially when it is linked to the economic slowdown and ongoing real estate slump after the global financial crisis.[1]

On April 22, 2013, Bank of Korea (BOK) Governor Kim Choong-soo remarked that "The nation's household debt reached a limit" in his report to the Korean National Assembly. He was also recently quoted as saying, "The household debt has been rising faster than income and the nature of household debt has also deteriorated. Efforts should be exerted not only to reduce the volume of debt but also to improve the vulnerable structure of household debt."[2] His remarks along with statistical evidence reported in the next paragraph signify the seriousness of household debt in Korea. Against this backdrop, this paper reviews the trends of household debt in Korea and investigates the background of its rise in recent years along with a discussion on the current policy measures taken by the Korean government to address the rising household debt.

As of 2012 4th quarter, the household credit[3] in Korea reached 963.8 trillion *won* (USD 853.7 billion at the exchange rate of USD1=1129 *won* on June 12, 2013) that includes household loans of 905.9 trillion *won,* a 5.2 percent year-on-year increase and a purchase on credit of 57.9 trillion *won*, a 3.1 percent year-on-year increase.[4] Since the household disposable income rose 4.1 percent, the ratio of household debt to disposable income reached 136 percent, the highest level since 2003 when the related data began to be collected. Accordingly, the household

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debt per capita reached the highest level at 19.3 million *won*, almost 74 percent of GDP per capita, as the average household debt also increased to 53 million *won*.[5] The banking sector mortgage loan balance also rose to 316.9 trillion *won* at the end of 2012 from 264.2 trillion *won* at the end of 2009, an increase of 19.9 percent.

Korea's household debt also poses potential threats to the nation's economy when the debt is viewed from the international perspective. According to OECD statistics, which also include the financial debt of non-profit organizations, the ratio of Korea's household debt to disposable income rose to 150.8 percent in 2010 from 116 percent in 2004 and 139 percent in 2007. An increase of 11.8 percent from 2007 to 2010 after the global financial crisis is higher than that of other OECD countries. In 2010, the average debt-disposable income ratio of 25 OECD countries for which data was available was 128.8 percent; in comparison, the average debt-disposable income ratio in the U.S. was 122.5 percent in 2010, the lowest since 2003 and a 13.9 percentage point decline from its peak (136.4) in 2007.[6] The ratio of household debt to GDP reached 81 percent in 2010, higher than the OECD countries' average of 73 percent.[7]

A major consequence of Korea's rising household debt is the decline in household savings. Korea's household savings rate declined significantly after the financial crisis from over 20 percent in the mid-1990s to a mere 2.7 percent in 2011. This is only half of the average household savings rate of 5.3 percent among the 23 OECD countries where data was available. For the U.S., in comparison, the average household savings rate was 4.2 percent in 2011.[8] The sudden decline of Korea's household savings rate, which registers as one of the lowest along with New Zealand (2.3 percent) and Japan (2.9 percent), is unprecedented in terms of the time period of the overall drop in savings among the OECD countries.[9] The average household savings rate in Korea from 2000 to 2010 was 4.7 percent, which is less than one-fourth of the average savings rate (19.8 percent) from 1990 to 1999. The savings rate in Korea especially plummeted after two periods of economic distress: from 1998 to 2002 after the Asian financial crisis when the savings rate dropped from 21.6 percent to 0.4 percent; from 2004 to 2008 after the credit card crisis, the savings rate declined from 8.4 percent to 5.8 percent.[10]

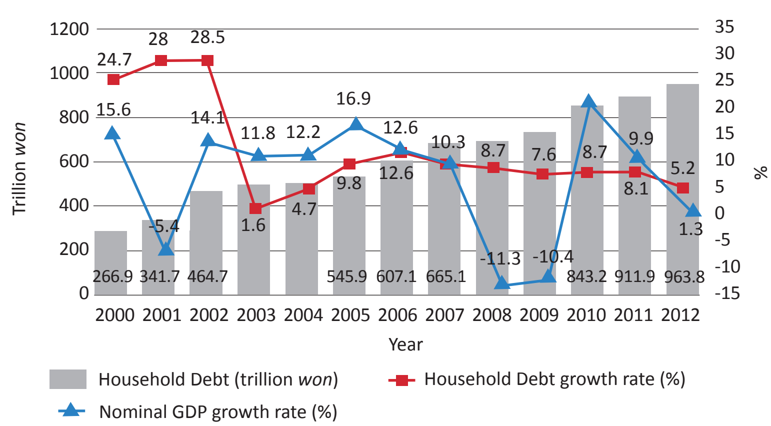
From the macroeconomic view, the decline in savings rate caused from the rise in household debt turns a virtuous cycle into a vicious cycle among savings, investments and economic growth. Therefore, the lack of sufficient savings in an economy will retard economic growth in the future.[11] At the household level, the decline in savings will exacerbate the household debt problem and can create more credit defaulters and bankruptcies. The limited existing evidence which foreshadows only the tip of the magnitude of the problem also underscores the claim that the rising household debt, despite the government policies to rein in the problem, remains one of the predominant risk factors that could threaten the stability of the Korean economy.[12]

2. Trends of Korea's Household Debt

There are two ways to define household debt in Korea. First, if the household is the focus of analysis (as it is with this paper), the term for "household debt" is synonymous with "household credit" (가계신용), which is defined as the sum of household loans and purchases on credit. Second, however, for cross national comparison, the term for household debt is "individual financial debt (개인금융부채)," which also includes debt incurred by the self-employed and non-profit organizations in addition to households, better represents the household debt since such statistics are prepared according to an accepted global method (System of National Account).[13] This paper uses the first definition of household debt ("household credit (가계신용)") to be consistent with other related studies.[14]

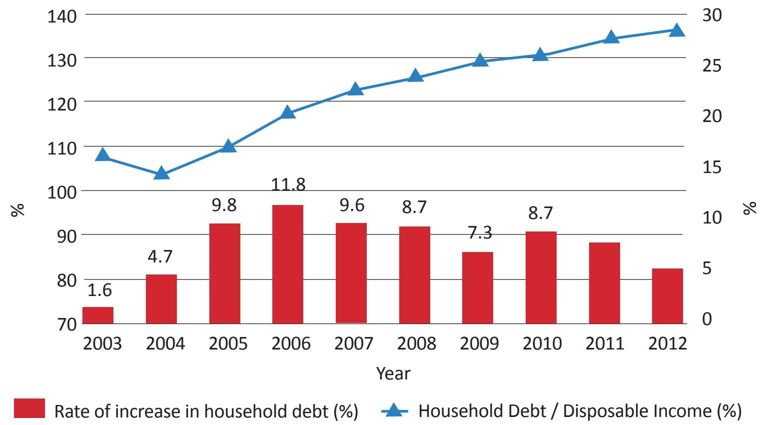
Figure 1 shows that Korea's household debt has risen continuously since 2000, although the rate of increase varies from time to time, and has declined since 2010. The household

Figure 1: Trends of household debt in Korea



Source: Author's creation with data from the Bank of Korea, Household Credit Trends debt problem in Korea has arisen as the result of the interplay among many factors such as accommodative monetary policy, lending practices of financial sectors, booming real estate market, and untimely policy responses of the regulating authorities. Other contributing factors are decline of household savings due to the changes in demographic structure and the expansion of real estate ownership of baby boomers.[15] After the Asian financial crisis in the late 1990s, financial institutions shifted their business focus from lending to companies to private and household lending. Korea's household debt since then has grown over 10 percent a year on average, much faster than the nation's GDP growth rate.[16]

Figure 2: The share of household debt to disposable income

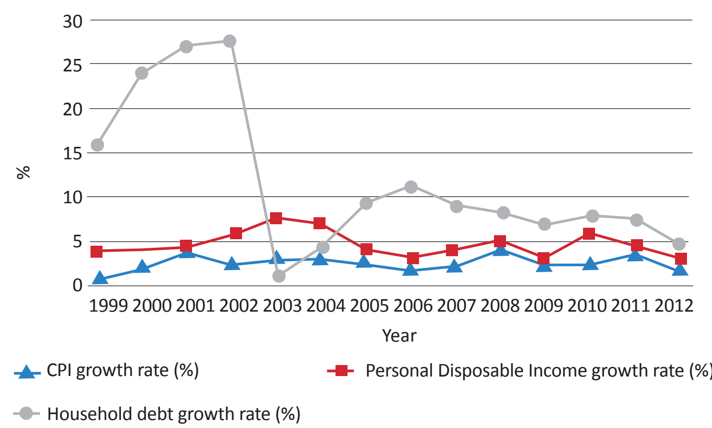


Source: Statistics Korea

Figure 1 shows that the average growth rate of household debt from 2000 to 2012 is 12.1 percent, much higher than that of the nominal GDP at 7.6 percent during the same period. The growth rates of the household debt were much higher from 2000 to 2002 exceeding 25 percent. Excluding these years, the average growth rate of household debt (7.6 percent) becomes much similar to the average growth rate of the nominal GDP (7.5 percent). The annual growth rates of household debt from 1997 to 1999 are 20.9 percent, -13 percent and 16.5 percent. Including these years, the average growth rate of household debt from 1997 (when the Asian financial crisis hit) to 2012 is 11.3 percent.

Although the growth rate of the household debt has declined from 11.8 percent in 2006 to 5.2 percent in 2012 except in 2010, the amount of household debt has increased 58.7 percent during the same period and reached a level that was described by the current BOK Governor as a limit.

Figure 3: Growth rates of CPI, personal disposable income and household debt



Source: Statistics Korea, and Economic Statistics System of BOK

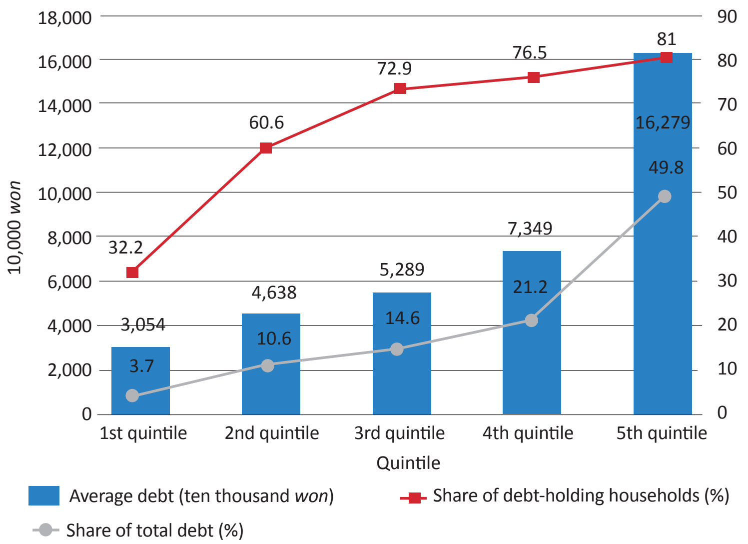
Figure 2 shows the trends in the share of household debt to disposable income. The share has risen continuously from 2004 and reached the record high level of 136 percent in 2012. As shown in Figure 3, while the growth rate of personal disposal income has been greater than that of CPI since 2000, the growth rate of household debt has exceeded that of personal disposable income since 2005, presenting evidence of households' economic hardship.

Despite the widespread concern over Korea's household debt, it is also argued that major credit default is not on the horizon since the debt is more concentrated in the high-income households as shown in Figure 4, which depicts the shares of households with debt, the volume of household debt, and the share of total debt by income quintiles in 2012.

In Figure 4, the household debt was concentrated in the 5th quintile (top 20 percent) that has ability to service the debt. Eighty-one percent of the households in the 5th quintile have an average debt of 162.7 million *won*. On the other hand, 32.2 percent of the households in the 1st quintile have an average debt of 30.5 million *won*. The 5th quintile's share of total debt stands at 44.5 percent whereas that of the 1st quintile was much lower at 3.7 percent. Based on this, some would argue that the household debt problem in Korea still is not at a serious level.[17]

Nevertheless, the rise of household debt also affects overall demand and consumption. There are three ways through which household debt leads to changes in private consumption.[19] First, consumption may rise as the households have more

Figure 4: Share of debt-holding households, average debt and share of total debt by income quintiles in 2012



Source: Press release material for 2013 report on the survey of household finance and living conditions, Figure 1, Statistics Korea.[18]

purchasing power from incurring debt. Second, the wealth effect from the rising value of assets acquired with the debt may also raise consumption. However, the interest payment burden from the debt would lower the disposable income, leading to a decline in consumption. The third channel is less direct, involving expectations of the household-debtors. To the extent that people expect that the economy keeps on stagnating, they preemptively respond by lowering consumption. It is also important to note that when the bubble bursts in an overheated asset market, the ensuing rapid decline in asset value will result in a precipitous decrease in consumption. While household debt may raise consumption in the short run, its impact on investment is estimated to be negative, which along with low savings will dampen the long-run growth potential of an economy.

In summary, despite arguments that it is not a problem, the household debt in Korea will affect the Korean economy in the following ways. First, the rising household debt will reduce savings and investment which can slow down economic growth and potential economic growth rate. Also the lower savings rates can make the Korean economy more dependent on foreign capital and susceptible to the fluctuations in the global financial markets. Second, as the household debt rises, private consumption and demand in the housing market will decline. This will also retard economic growth. Third, the mounting household debt may lead to insolvency when debtors are unable to repay their loans on time, creating instability in the financial system. Fourth, if the number of households struggling under heavy debt burden rises, the government may need to step in and increase its subsidies (or transfer payments), which will correspondingly raise the government debt.[20] Fifth, when the household debt is rising or has reached a critical point, the government will not be able to freely use interest rate policy to stabilize the economy to control inflation by increasing interest rates as such a move will put households into a more difficult financial position because they will be burdened with higher interest payments. Sixth, the rising household and government debt can make the Korean economy more vulnerable to exogenous shocks. To the extent that the existing size of household and government debt is viewed as a structural weakness, an event such as a global financial crisis will lead to insufficient foreign currency reserve due to capital flight, and fluctuations in exchange rates. This may negatively affect Korea's international credit rating. Lastly, the rise of household debt can also exacerbate the income inequality, creating uncertainty and instability in Korean society.[21]

3. Reasons for the Rise in Korea's Household Debt[22]

The household debt in Korea has expanded through four channels. First, the policy change at the end of the 1990s created the liquidity effect, marked by an excess liquidity in 2003. After the Asian financial crisis in 1997, the target price level for price stabilization was set too high and this led to a supply of excess liquidity. The accommodative monetary policy helped to maintain the interest rates at a low level after the financial crisis.

Second, after the Asian financial crisis, the Korean government at the end of 1997 "adopted the policy to encourage the use of credit cards to boost the economy through raising consumption"[23] and increasing the transparency of financial transactions, which would in turn provide an information source to allocate tax schemes that were fairer. This benign intent, however, led to a

> "...the rising household and government debt can make the Korean economy more vulnerable to exogenous shocks."

rise in credit card use and raised the competition among credit card companies that over-issued credit cards to non-qualified applicants. Eventually, this led to the credit card crisis at the end of 2003 when the delinquency rate of credit cards rose as the result of declining household income and repayment ability, worsened by the delayed recovery in the Korean economy.[24]

Third, the artificially created low interest rates induced large credit creation. The boom in the housing market linked with low interest rates also helped the household debt to expand.[25] The rising value of real estate, especially in residential housing, induced people to borrow heavily to purchase more real estate in expectation of profits. For example, the expansion of real estate ownership by Korean baby boomers, who were born between 1955 and 1963 and comprise one-fifth of the population, is cited as a reason for the rise of household debt in the 2000s.

Fourth, after the 1997 Asian financial crisis, Korean financial institutions lacking appropriate risk management systems, such as credit appraisal, shifted their focus from lending credit lines to firms to household loans, as firms became more risk averse. This was facilitated with the continuation of low interest rates from the accommodative monetary policy. What also fueled the expansion of household debt were loose regulations and the lack of systemic accountability, which contributed to the inability of Korean financial regulators to adequately supervise the banking sectors and also paved the way for other unregulated non-banking sectors that can freely lend for-profit loans. Such unrestrained household loans from non-banking financial institutions could create real estate bubbles.[26]

The notion of the so-called "realty invincibility" can also partially explain the rise in household debt in Korea. This is due to the Korean banks' lending practices through which the debtors can acquire additional loans as their portfolio increases. This is accomplished through additional acquisition of assets (collateral) with an increased valuation (appraisal), which would have accumulated on the original collateral due to the constant and intense real estate market speculation.

As a result, the banking sector mortgage loan balance rose significantly. Mortgages and home equity loan programs in Korea typically have a few years of an interest only repayment period built in at the beginning, during which debtors pay only the interests on the loan until the end of the designated term at which time the payment of the principal must be paid in full. This type of loan is equivalent to a balloon payment in the U.S.[27] However, in a highly speculative and burgeoning real estate market, the housing prices will inevitably rise during the repayment period. This will create an incentive for the borrower to take additional risks by purchasing more real estate with the increase in the asset valuation gained during the repayment period. The original asset then would be sold with a significant profit to pay off the original loan. The rising value of real estate also contributed to the expansion of real estate related project financing (PF) loans. It was reported that as of March 2009, the volume of PF by financial institutions as a whole stood at 81.7 trillion *won*. Financial institutions concentrated on the home equity loans, for which the risk management is easier since the loan only occurs with secure collateral. Since the housing price depends on the structural changes in the housing market, the lending practice concentrating on home equity loans creates structural vulnerability.[28]

If the returns from the booming housing market exceed the amount of loans and associated financial costs, the rising household debt (and declining savings) incurred in expectation of the future profits from the booming housing market would not pose a problem, since the gained equity will be sufficient to pay off the debt. But the recent housing market stagnation created some pessimism giving less credence to the past trend of a robust housing market. Despite the government policy to boost the housing market, which will be discussed more in detail later, the stagnating housing market does not show sufficient signs of upturn.

According to a recently released BOK report, 34.7 percent of the sample households replied that the price of real estate they owned declined (8.2 percent for significant decline), whereas the percentage of households that replied that the value of real estate they owned rose was 24.4 percent (5.1 percent for significant rise). Not surprisingly, the household debt problem is expected to exacerbate as 58.9 percent of the households replied that they are having a difficulty in their daily lives due to the repayment of principal.[29]

Especially vulnerable groups are the low-income class with bad credit, debtors with multiple loans, and small-scale self-employed merchants whose debt structure is worsening. As the result of stricter regulations on loan appraisal, those with relatively lower credit ratings are forced to take out loans from the non-banking financial institutions[30] that would charge higher interest rates.[31] According to a report from Korea's Financial Supervisory Service (FSS) released in 2012, as the banks shifted their lending practices to those with collaterals categorized as lower risk assets, the share of loans extended to borrowers with low credit ratings, i.e., those whose credit ratings are below category 7, declined from

14.5 percent in 2008 to 11.4 percent in 2012. The report also showed that the share of low-income class in taking loans from the non-banking sector rose from 43.2 percent at the end of 2008 to 47.3 percent in June 2012.[32] The delinquency rate for the New Hope Dream Loan Program, designed to cater to individuals with poor credit ratings, also rose from 1.7 percent in 2011-end to 2.6 percent in September 2012.[33]

While some supervision of the financial sectors was actively implemented from the Early Warning System (EWS), especially centered on the home-equity loan, the strength of the supervision was not sufficient to rein in the expansion of household debt as it only focused on the Loan to Value (LTV)-oriented regulation and the different regulation systems for different financial sectors. Accordingly, in the early stage of increase in housing prices, the regulation centered on the LTV failed to effectively rein in the expansion of household debt. The failure of sequentially implementing the Debt to Income (DTI) regulation after the LTV regulation, due to the resistance from the financial sector and arguments against the use of DTI as it is an excessive policy intervention, is also regarded as a reason that the exploding rise of household debt was not preemptively suppressed.[34]

The LTV ratio is the most effective policy tool that the financial regulation authority can use to manage risks associated with the fluctuation in the value of real estate. The LTV ratio in Korea, except the savings banks and financial companies specializing in loan business, is still lower than that of other countries. However, the LTV ratio can be underestimated if it does not properly account for the Jeon Se deposit, a unique system in Korea where substantial deposit is required to lease a property. Currently, in the Seoul Metropolitan Area (수도권) that includes the city of Incheon and Gyeonggi Province, the LTV ratio is 50 percent on houses of price lower than 600 million *won* and 60 percent on others. Also DTI ratio is 50 percent in Seoul, and 60 percent in the Seoul Metropolitan Area.[35] Even the DTI-oriented regulation, which was fully implemented by the end of 2006, had little desired effect, as the regulations had to be adapted to accommodate the global financial crisis at that time.

Another concern is the pattern of debt transfer from household to government (i.e., welfare). If the rising household debt puts some households in an economically dire situation, the government may need to intervene and increase assistance and welfare payments such as college tuition breaks and other forms of subsidies. The rise of government welfare payment will also enlarge the government debt. In 2012, the government debt stood at approximately 774 trillion *won* or 35 percent of the GDP when only the government debt is considered. If the debt of government-owned (or subsidized) companies is also considered, the amount becomes approximately 1,255 trillion *won* or 65 percent of the GDP, approaching a dangerous level.[36]

4. Remedies Attempted by the Korean Government

To alleviate the rising concerns regarding the household debt in Korea, many policies were implemented with a varying degree of success. Two such measures are "Comprehensive measures to induce a soft landing for household debts" in June 2011 and "Supplementary rules for non-banking household loan activities" in February 2012. Despite the government policies to rein in the household debt problem with which the growth rate of household debt has slowed, the household debt problem still remains one of the most significant risk factors threatening the stability of the Korean economy.

The rising household debt in Korea emerged as one of the major issues in the 2012 presidential election. During the campaign, candidate, now President, Park Geun-hye, made a pledge to launch a National Happiness Fund (NHF)—a form of debt relief fund—of 18 trillion *won* (approximately USD 17 billion) to ease the debt burden of the low-income class, in particular the 3.22 million people who are unable to service their debts. This election pledge was fulfilled and the NHF was launched on March 29, 2013. The Fund "aims to help credit recovery of delinquent borrowers and heavily-indebted low-income earners with programs including restructuring debt, easing debt servicing burden on student loans, and converting high-interest loans to lower-interest ones."[37]

The NHF gives debtors more time to repay their loans and reduce their interest rates for a limited time. In particular, loans with interests in excess of 20 percent were targeted to reduce their rates to 10 percent range for loans taken out from financial institutions that charge high interests, sometimes over 20 percent. Those who had been diligently paying off debts for the six months leading to the end of February 2013 may be entitled to this debt relief program with maximum loan amount of 40 million *won*.[38]

Obviously, this plan can create a moral hazard as the government will help the borrowers repay their debts. One expert added that "The NHF plan is quite unrealistic, because the government will have to issue bonds that are ten times greater than their original value."[39] They are also skeptical of the efficacy of the NHF as the funding sources for the plan are too small and it is applicable to only a minority of people who took out institutional loans.[40]

The biggest criticism against the NHF policy is that the debt relief is a form of political populism that threatens the market order and creates conflicts among debtors who have sincerely tried to pay their debts. Some experts even say that the use of bankruptcy court or rehabilitation procedure is more advantageous than the use of NHF. In addition, individuals who are classified as the basic livelihood security recipients rarely have the ability to repay. One economist opined that although the NHF writes off a portion of the debt, 70 percent at the maximum, it would be more advantageous for some debtors to declare bankruptcy since the redemption by installment for the balance, 30 percent of the debt at the least, would not be easy for the basic livelihood security recipients who eke out a bare existence from day to day.[41] Although it is not easy to distinguish those who would be better served by declaring bankruptcy, it is reasonable to expect that a basic livelihood security recipient who is dependent on a minimum daily wage for sustenance would have a very hard time repaying the debt even after 70 percent of the debt is written off.

The long redemption period of ten years was also pointed out as an obstacle to the success of NHF. If a NHF beneficiary fails to meet the terms stipulated by the NHF for only a year after successful compliance for nine years, the efforts would turn out to be in vain. However, the Financial Services Commission (FSC) responded that the longer redemption period lowers the amount of each payment installment. The FSC's support for the NHF is premised on the argument that the use of bankruptcy procedure will leave a record that may prevent the bankrupt from engaging in economic activities (and limit their financial transactions). The FSC further claimed that the same negative consequence is not true for those who utilize the NHF. While the NHF is not the fundamental solution to the household debt problem, the fund expects to ease some of the acute debt burden of the least privileged. For this reason, the NHF should be understood in light of social security and rehabilitation rather than credit amnesty.

The NHF and other related policies mainly focus on the rehabilitation of vulnerable social groups and credit recovery. However, not enough policy attention is paid to lower the total volume of the household debt. The competing effects of policies are also responsible for difficulties in implementing the right policies that address household debt by boosting economic conditions. For example, the recently announced "4.1 Real Estate Measures," for which a series of major bills related to real estate were already passed in the National Assembly, is viewed as a policy to stabilize and boost real estate transaction which will in turn stimulate the economy. This measure along with the lower interest rates announced by the BOK already began to boost the housing market.[42] As of May 20, 2013, the market price of high-rise residences apartments has been increasing in the last eight consecutive weeks in the Seoul Metropolitan Area and eleven consecutive weeks in the non-Seoul Metropolitan Areas, and reached a level higher than that of end-2012 by 0.18 percent.[43]

The "4.1 Real Estate Measure" is expected to raise home equity loans and household debt. The recently passed April 30, 2013 amendment to the Tax Reduction and Exemption Control Act exempts the transfer income tax for a newly-built housing unit for a household under the value of 600 million *won* or 85 square meters, acquired from April 1 to December 31, 2013, if the unit is to be transferred within five years of acquisition.

Proponents argue that this amendment is a desperate measure to normalize real estate transactions, adding that this limited-time measure aims to facilitate the disposal of housing for the poor and the middle/low-income class. Opponents of the amendment argue that the bill is inconsistent; they favor smaller housing units that meet space requirements in affluent areas over the bigger units that are slightly over the price restrictions in non-Seoul Metropolitan Areas that more urgently need assistance for this type of bill. Another line of criticism leveled against the bill is based on the short-term nature of the supposed remedy. One National Assembly member argues that the short-term benefit will be overshadowed by the long-run harmful effect, as the profit-seekers entering the housing market can destabilize the housing market.

Although condition in the housing market is one of many factors affecting the household debt, the controversies revolving around the "4.1 Real Estate Measure" depict the difficulties in addressing policy objectives including household debt. Also, due to the rise of household debt, the Korean government is not able to boost domestic demand by stimulating personal consumption.

5. Recommendations

Although major sources of the household debt problem in Korea are factors related to financial and banking sectors, the remedies to alleviate the problem should be found in more fundamental areas in Korean economy and society. First, in order to address the household debt problem, job creation should be considered especially for the least privileged. Since secure employment is one of the most important bases for living and related economic activities including the payment of debt, more endeavors are called for to create decent jobs, better employment security, and employment training programs. Despite the low unemployment rate of 3.0 percent in 2012, "the quality of new jobs being created is declining" and many of them are concentrated in the service sector and are on short-term contract basis.[44]

To the extent that the NHF recipients have a hard time finding regular employment, the workers in the non-regular sectors (비정규직) need special assistance in finding employment, such as job fairs targeting low-income areas. Providing employment opportunities (through job creation) to the recipients of debt reduction (or debt relief) is also necessary to sustain the momentum of easing household debt. Unless the structural weakness of the household debt for the low-income class and other vulnerable individuals is addressed, the current stagnating economy[45] along with the slump in the real estate market will further exacerbate their ability to generate income and service debts.

Second, in order to control the size and composition of the household debt, policy attention should be paid to both debtors and lenders. For debtors, more financially supported policies such as microfinance and petty loans for the low-income class are needed within the range that does not create or minimizes moral hazard. To relieve the indebted individuals with low income from the acute financial burden at least temporarily, policy efforts are necessary to adjust the loan structures by flexibly transferring high-interest debt into lower-interest debt as well as to extend the repayment period.

Although there are policies such as Smile Loan and Sunshine Loan already in place to alleviate the financial difficulties, problems occur since barriers to those policies are still high due to the lack of information and complex procedures for application for such loans. Opening more branches dealing with these loans, offering extended business hours, and disseminating loan application information more effectively (such as setting up a call center for credit management counseling) are recommended. Policies, such as the LTV and DTI regulations, should also be implemented in a timely manner to guide all forms of lenders to be careful not to overextend loans. Due to the lag between the implementation of policies and actual impact, preemptive measures are urgently called for, such as the adjustment of LTV and DTI ratios.

Finally, all the implemented policies must be monitored and data should be collected to see if these policies are actually working.

6. Conclusions

The household debt in Korea has become one of the most significant potential risk factors that can threaten the stability of the financial system, especially when it is linked to the economic slowdown and ongoing real estate slump after the global financial crisis. This paper has reviewed and investigated the trends and determinants of the rising household debt and declining savings in Korea so that policies can be implemented to deter and effectively counter the problems that low savings and countervailing high debt pose on the Korean economy.

Korea needs to address the rising household debt problem in a more proactive manner by adopting the recommendations grounded in the more fundamental areas in Korea's economy and society. By doing so, Korea can alleviate this serious problem to its economy and society and provide greater strength and flexibility for the domestic and international markets.

Endnotes

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3 Household credit is defined as the sum of households' borrowing from financial institutions and their purchases on credit.

4 Bank of Korea. *Trends of Household Credit*, 2012. http://www.index.go.kr/egams/stts/jsp/potal/stts/PO_STTS_IdxMain.jsp?idx_cd=1076.

5 At the end of 2012, the number of households in Korea was estimated to be 17.95 million, and the population was 50.004 million. In household debt, the share of financial debt is 68%, a decrease of 1.1% from the previous year, and that of security deposit is 32%, an increase of 1.1% from the previous year.

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7 "Household debt ratio much higher than OECD average: report," *The Korea Times*, June 14, 2012, http://www.koreatimes.co.kr/www/news/biz/2012/06/123_113021.html.

8 The momentum of the declining savings rate was temporarily lost after the 2003 credit card crisis occurred and the savings rate rose to 8.4% in 2004. For more details see *The effect of decline in savings rates* (2013), http://hri.co.kr/upload/publication/20133775814[1].pdf.

[9] The trend of declining saving rates and policy task (2012), Korea Institute of Finance. This report offers seven reasons for the decline in Korea's savings rate. They are 1) the declining growth rate of disposable income, 2) weak employment prospects, 3) low fertility and the rise of aging population, 4) expansion of social security system, 5) the rise in consumption, 6) the decrease of borrowing cost due to lower interest rates and 7) the rising housing price.

[10] Eun-mi Lee, "Reasons for the decline in the household savings rate in Korea and policy recommendations," *Samsung Economic Research Institute* (2011). http://m.seri.org/fpdf/DB/rpt/20111204.pdf.

[11] The 1% decline in household savings rate is estimated to lower the investment by 0.25% and the rate of economic growth by 0.1%. For more details see Cheon-gu Kim, "The effect of decline in savings rates," *Hyundai Economic Institute* (2013). http://hri.co.kr/upload/publication/20133775814[1].pdf.

[12] Other factors threatening the stability of the Korean economy include decline in workforce because of demographics, weak service economy, overdependence on international trade, high income inequality, and overconcentration of manufacturing and *chaebols* that inhibits the development of other firms.

[13] Bank of Korea, 2012 Money Flow Tables (Tentative Report released in March 18, 2013) at http://www.equity.co.kr/upfile/issue/2013/03/18/1363580815325.pdf.

[14] Since the household credit includes households' non-profit loans but excludes the debts held by self-employed which may also be a part of households' financial burden, the use of household credit may underestimate the size of household debt. On the other hand, the Money Flow Table on which the individual financial debt is calculated includes not only households and small-scale individual business but also the non-profit organization. Therefore, the use of individual financial debt may overestimate the household debt. As of 2012, the household credit was 963.8 trillion won and the individual financial debt was 1158.8 trillion *won*.

[15] Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*.

[16] Lucy Williamson, "S Korea's surging household debt threatens its economy," *BBC Business News*, July 13, 2011, http://www.bbc.co.uk/news/business-14133337.

[17] Press release material for 2013 report on the survey of household finance and living conditions.

[18] The survey was conducted in April 1–18, 2013 and the full 2013 report on the survey of household finances and living conditions is scheduled to be released in November 2013.

[19] Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*.

[20] The ratio of government debt to GDP continuously rose, without missing a year, from 18.4% in 2000 to 34% in 2012. The government debt was 111.2 trillion won in 2000 and 445.2 trillion won in 2012. (KOSIS, Statistics Korea).

[21] Although the size and the extent of burden of the household debt may negatively affect the international credit standing of an economy if the debt causes financial institutions to fail, this is not the instance in Korea for its international credit standing at present is at its highest level since the Asian financial crisis. Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*.

[22] This section relies heavily on the 2012 KIF report Lee, Meyong-hwal, Gu, Bon-seong, and Gyu-bok Lee,"The analysis of the rise in household debt in Korea," *Financial VIP Series* (2011). http://www.kif.re.kr/KMFileDir/129683015415186250_FVIP2011-23.pdf.

[23] Ibid.

[24] Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*.

[25] Lee, Meyong-hwal, Gu, Bon-seong, and Gyu-bok Lee, 2012 KIF report "The analysis of the rise in household debt in Korea," *Financial VIP Series* (2011). http://www.kif.re.kr/KMFileDir/129683015415186250_FVIP2011-23.pdf.

[26] Lee Seong-tae, Governor of the BOK in 2009.

[27] According to a KIF report, the application of the risk weighting ratio of the home equity loan used in advanced countries also contributed to the banking sector's expanding home equity loan, which also raised the volume of household debt.

[28] Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*.

[29] Bank of Korea Report on the survey of household finances and living conditions (2012).

[30] All financial institutions except the BOK and deposit-receiving banks.

[31] Hana Institute of Finance, "자금: 비은행권의 가계대출 확대에 주목할 필요," *Weekly Hana Financial Focus*, 1, no. 32 (2011): 16-17, http://www.hanaif.re.kr/kor/pdf/focus111112/6.pdf.

[32] Ho Shin, "7등급 이하 대출 은행 3%p↓·비은행 4%p↑," YTN *24 Hour News Channel*, November 2, 2012. http://ytn.co.kr/_ln/0102_201211021326356909.

[33] The FSS opined that the delinquency rate of the New Hope Dream Loan Program is not that high in comparison with those of savings banks (a type of secondary financial institution) at 11.3% and credit card companies at 2.77%.

[34] Korea Institute of Finance (2013), *White Paper on Household Debt in Korea*. Also, Lee, Meyong-hwal, Gu, Bon-seong, and Gyu-bok Lee, 2012 KIF report "The analysis of the rise in household debt in Korea," *Financial VIP Series* (2011). http://www.kif.re.kr/KMFileDir/129683015415186250_FVIP2011-23.pdf.

[35] Financial Services Commission in Korea.

[36] Jung Sik Kim, (Professor of International Money and Finance, Yonsei University), interview by Gab Soo Kim, A New Morning, A Fresh Start on YTN FM 94.5 in Seoul, South Korea"국가부채 774조원. 외국자본유출 우려 ," YTN, June 01, 2013, http://www.ytn.co.kr/_ln/0102_201206011305244522.

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[42] In May 9, the BOK Monetary Policy Committee lowered the benchmark rate by 25 basis points to 2.5%.

[43] Park Sang-yong, "'4.1 부동산 대책' 약발 떨어졌나?...아파트 가격 상승폭 둔화," *Daum Real Estate*, May 23, 2013. http://realestate.daum.net/news/detail/hotissue_1092894/MD20130523110915945.daum?page=3.

[44] United Nations Economic and Social Commission for Asia and the Pacific, "Republic of Korea," *Economic and Social Survey of Asia and the Pacific 2013: Forward-looking Macroeconomic Policies for Inclusive and Sustainable Development.* (Bangkok: United Nations, 2013), 79. http://www.unescap.org/pdd/publications/survey2013/notes/rok.asp.

[45] Recently, the Korea Development Institute (KDI) cut Korea's 2013 growth from 3.0% to 2.6%.

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