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## Financialization in emerging Europe

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Hochschule für  
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# Financialization in Emerging Europe

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# **Financialization in Emerging Europe**

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## **Abstract**

This paper contributes to the financialization literature exploring the dynamics of financialization in eight emerging European economies (EEEs) compared to the Anglo-Saxon countries. Our analysis encompasses the decade before and the years following the financial crisis in 2008, including the latest developments in conjunction with the Covid-pandemic. Hungary, Bulgaria, Croatia, Turkey, and to a lesser extent, Czech Republic and Poland experienced strong financial inflows, and an accumulation of foreign liabilities. Foreign financial flows in Russia were not as significant for the process of financialization, but rather the state itself. In this paper we identify two types of financialization: ‘foreign-finance-led’ and ‘state-led’ financialization, where ‘foreign-finance-led’ financialization is characterized by increase in net capital inflows and subsequently, foreign indebtedness, whereas the government (the state) in the ‘state-led’ financialization has a predominant role in the financialization process. Most of the EEEs fit the ‘foreign-finance-led’ financialization, but with a tendency of a significant state involvement in the financial systems during the Covid-pandemic. Based on the analysis of financialization in EEEs, our findings show that EEEs had variegated financialization dynamics. Financialization in the EEEs was less pronounced compared to United States and United Kingdom. Despite this fact, the dynamics of financialization took a significant pace in the EEEs in the years following the financial crisis of 2008, with rising debt levels during the Covid-pandemic.

**Keywords:** financialization, financial crises, emerging countries, Central Eastern Europe

**JEL classifications:** E44, F34, F36, F65, G01, G20, P51, P52

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## 1. Introduction

There are variances in the interpretations of the concept ‘financialization’. Mader, Mertenés, and van der Zwan (2020) provide an excellent overview of the definitions of financialization existent in the literature. In this paper we will use the definition by Epstein who conceptualized financialization within the framework of

(...) the increasing role of financial motives, financial markets, financial actors, and financial institutions in the operations of the domestic and international economies. Epstein's (2005: 3)

Our focus in this paper is the literature on financialization in emerging countries. Authors like Bonizzi, Kaltenbrunner, and Powell (2020) used the term ‘subordinate’ financialization to emphasize the emerging countries’ subordinate position in the world production, trade, as well as international finance and capital movements.<sup>1</sup> In this paper we will continue this debate, showing that financialization in most of the countries in our sample has been predominantly driven by foreign capital flows. In Russia, however, foreign capital flows have had a less dominant role in the financialization process. Here, the government’s involvement in the banking system and the financial system overall cannot be overseen. One can speak of state-led financialization, which means a financial system that is:

(...) largely controlled by the state as most key financial firms, including banks, securities firms, insurance companies are state-owned. Pan, Zhang, and Wu (2021: 750)

In the state-led financialization the government plays a predominant important role in encouraging and promoting financialization using various tools. Pan, Zhang, and Wu (2021) explore the financialization dynamics in China and identify two characteristics of state-led financialization in China. On the one hand, the government promoted market-based reforms to open up financial markets, but on the other, supported by state-owned banks and state-owned financial institutions, the government set the main directions for the development of financialization in this country.<sup>2</sup> According to the authors, the combination of the government and state-owned companies on the one hand, and the market-orientation on the other hand, is the key to understanding state-led financialization in China.<sup>3</sup>

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<sup>1</sup> Cardoso and Faletto (1976) use the term ‘dependent development’ to explain a development dependent on foreign capital.

<sup>2</sup> The Chinese government is interested in promoting financialization, for instance, via encouraging an entry of state-owned enterprises in the stock exchange (Pan and Xia 2014).

<sup>3</sup> Pan, Zhang, and Wu (2021) argue that the forms and characteristics of state-led financialization can vary between countries.

We will analyze eight emerging countries in Europe: Poland, Czech Republic, Hungary, Bulgaria, Romania, Croatia, Russia, and Turkey. We will use the abbreviation EEEs (Emerging European economies) for this group of countries. Moreover, for comparison, we will include United States and United Kingdom that are considered to be two of the most financialized countries worldwide. Hopefully more data will become available for our future studies to include the countries in South-Eastern Europe or the CIS (Commonwealth of Independent States).

The period we will concentrate on is the decade before the financial crisis of 2008 and the years thereafter, including 2020, which was characterized by an exogenous shock – the spread of the Covid-pandemic. There are several elements or interpretations of financialization that we will address: external financial liabilities, financial liberalization, financial system depth, shift from bank-based towards market-based financial system, the debt of the households, non-financial corporations (NFCs), and the government, and their external debt position. These will be elaborated in more details in the next section.

The rest of the paper is organized as follows. The second section provides an overview of the existing literature of financialization in emerging countries. The third section gives some stylized facts about the capital account liberalization and the background in which financialization started to thrive in the EEEs. Afterwards we will analyze the development of financialization in the EEEs using eight indicators. In the section that follows we will look at the types of financialization identified in EEEs. The last section offers concluding remarks.

## **2. Literature on financialization in emerging countries**

Financialization has become a central point of research among scholars in economics, political economy, sociology, and other disciplines especially in humanities particularly since the outbreak of the financial crisis in 2008.<sup>4</sup>

This paper will necessarily focus on the financialization literature with respect to emerging countries, which does not do justice to the complexity of the research done on financialization at large. The interest on financialization in emerging countries gained momentum in the recent years. For instance, Bonizzi (2013) provided an extensive survey on the main theories used to explain financialization and the characteristics of financialization in emerging countries with particular focus on capital/financial account openness. Moreover, Karwowski and Stockhammer (2017) made a systematic overview of the financialization literature in emerging

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<sup>4</sup> For illustration, the number of journal articles that dealt with financialization increased four times between 2018 and 2010 (see Figure 1.1 in Mader, Mertens, and van der Zwan 2020:4).

countries investigating the development of financialization in 17 emerging countries from Asia, Latin America, Africa, and Europe. Our paper can be, to a certain extent, seen as a continuation of the work by Karwowski and Stockhammer (2017).

One nexus between financialization and emerging countries is the Washington Consensus debate on capital/financial account deregulation as one of the recommendations by the IMF and the World Bank (Rodrik 1998, Priewe and Herr 2005, Stiglitz and Ocampo 2008).

Analysis of financialization in the Minskian tradition of boom-bust cycles has been applied to developing/emerging countries by authors like Arestis and Glickman (2002), de Paula and Alves (2000), Kregel (1998) or Schroeder (2002). These authors argued that East-Asian countries went forth with capital account deregulation that spurred large amounts of capital flowing in these countries, increasing foreign indebtedness of the domestic private sector. Often these capital flows were directed towards the real-estate and the stock markets, which created asset-price bubbles that were doomed to burst as soon as economic growth slowed down and the exchange rate depreciated.

Frenkel and Rapetti (2009) addressed the financial crisis of 2008/2009 and its effects on the developing/emerging countries. They argued that the conditions that were conducive for the financial crisis were different in developing compared to developed/advanced world. In developing countries, the specific set of macroeconomic policy interventions, including capital market deregulation encouraged higher risk-taking of the private sector.

Several authors emphasized the international aspect of financialization and the dependency of emerging countries on foreign capital flows for development (Becker et al. 2010, Bortz and Kaltenbrunner 2018, Bonizzi and Kaltenbrunner and Powell 2020, Datz 2008, Kaltenbrunner and Paineira 2015, Paineira 2011, 2012, Tyson and McKinley 2014). This strand emphasizes the necessity of maintaining relatively high interest rates and overvalued exchange rates that itself constrains the governments and central banks in the conduct of macroeconomic policies. Bonizzi, Kaltenbrunner, and Powell (2020) argue that emerging countries have a subordinate position in the international aspect of financialization. They are subordinate in the global value chains, which means that they provide raw materials and low value-added intermediate products to the leading companies of the value-chain (Dühnhaupt and Herr 2020). Emerging countries are also dependent on foreign capital flows (denominated in a foreign currency) and have to offer relatively high interest rates because their currency is positioned at a low level in the currency hierarchy compared to advanced countries. According to these authors, financialization worsens the already subordinate position of emerging countries.

From the Regulation school perspective, Becker (2009, 2011) and Becker and Jäger (2010) analyzed the accumulation regimes in the Central Eastern European countries. They identified two accumulation regimes for these countries: ‘dependent industrialization’ and ‘dependent financialization’ regime. The former is characterized by strong growth of the manufactured sector and exports, while the ‘dependent financialization’ regime (Romania, Bulgaria, and the Baltic countries) is characterized by a surge in capital flows in the financial sector that contributed to their de-industrialization.

More often than not has financialization in emerging countries been applied to individual countries (see for example, Ashman, Mohamed, and Newman, 2013, for South Africa; Lapavitsas, 2009a, Gabor, 2012, for individual countries in Central Eastern Europe; Kalinowski and Cho, 2009, for South Korea; Rethel, 2010, for Malaysia, Hong Kong, and Indonesia).

One attempt to provide a more encompassing analysis of a group of emerging countries is provided by Akcay, Hein, and Jungman (2021). Using macroeconomic demand and growth regime analysis, they identify four regimes: debt-led private demand, export-led mercantilist, weakly-export-led, and domestic demand-led regimes, in which selected emerging countries are classified. China and Argentina are found to have export-led mercantilist regimes, Brazil, and Russia – weakly export-led regimes, India, Mexico, and Turkey - domestic demand-led regimes, and South Africa – debt-led private demand boom regime. Karwowski and Stockhammer (2017) provided a systematic comparison across seventeen emerging countries in Asia, Central Eastern Europe, and Latin America using specific indicators of financialization. The authors identified six interpretations in the literature explaining the financialization development in emerging countries. These are: financial deregulation, foreign financial flows, asset price volatility, the shift from bank-based to market-based finance, debt of businesses, and household debt.

### **3. Notes on the indicators**

In the current paper we will analyze the development of financialization in the emerging countries in Europe. Through a descriptive analysis of seven indicators, we want to find out the similarities/differences in financialization between the selected countries in Emerging Europe. The following aspects of financialization will be investigated: degree of financial liberalization, external financial liabilities, financial system depth, shift from ‘bank-based’ towards ‘market-based’ financial system, the household debt of the households, the NFCs, and the government, and their external debt position.

#### a) Degree of financial liberalization

Several authors have in different contexts emphasized the importance of these aspects of financialization for understanding its dynamics. Lapavitsas (2009b) and Correa, Vidal, and Marshall (2012) highlight the significance of financial deregulation for the rise in financialization. They see the origins of financialization in the emerging/developing countries in the 1970s when these countries embarked on a journey of labor market and financial account liberalization.

[F]inance has grown extraordinarily in terms of employment, profits, size of institutions and markets. There has been deregulation, technological and institutional change, innovation, and global expansion. Finance now penetrates every aspect of society in developed countries while its presence has grown strongly in the developing world. (Lapavitsas 2009b: 126).

Financial account deregulation especially in emerging countries has led to substantial increases in capital flows during the 1990s and even more strongly in the 2000s, leading to higher integration of these countries in the international financial structure (Aizenman, Jinjark, and Park 2013). Financial inflows, particularly when dominated by portfolio flows, tend to increase the fragility of the financial systems in emerging countries.<sup>5</sup> As an indicator for financial liberalization, we will use the Chinn-Ito index. The higher the Chinn-Ito index is, the higher the level of financial account liberalization.<sup>6</sup>

#### b) External financial liabilities

Financial flows have been a source of increasing foreign debt in the emerging countries. In the emerging countries in Central Eastern Europe, capital inflows by foreign banks contributed to the financialization dynamics of the former (Gabor 2012). These financial flows were often directed towards the real estate and the construction sectors, and away from productive investment in the manufacturing industry. The index we will use is stock of external liabilities

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<sup>5</sup> Under the assumption that it does not merely entail a change of ownership (like in privatizations, or mergers and acquisitions), but it also involves transfer of know-how and technology, foreign direct investment (FDI) can be favored as a desirable type of capital, as it can support import substitution and potentially also lead to higher exports Priewe/Herr (2005). According to the same authors, other types of capital flow can also be sustainable, if they do not contribute to currency mismatches. One such example is bank credit denominated in a foreign currency that is used for production and exports. Thailand is a positive case of a country that used its FDI inflows to finance investment and economic growth (Priewe and Herr 2005).

<sup>6</sup> We use the Chinn-Ito index as an indicator for country's financial account openness (see the database related to the paper Chinn/Ito, 2006). A country can obtain a score within the range of -1.9 and 2.4. The higher the index is, the more liberalized the financial system is and *vice versa*. Notes on the methodology of the calculation of the index can be found on the website: [http://web.pdx.edu/~ito/Chinn-Ito\\_website.htm](http://web.pdx.edu/~ito/Chinn-Ito_website.htm).



(as a share of GDP) from the Lane/Milesi-Ferretti (2018) database. The higher this indicator, the larger the foreign indebtedness is. In that case, financialization is strongly driven by foreign financial flows.

c) Financial system depth

Financial system deregulation in advanced countries has led to an emergence and growth of non-bank financial institutions, such as pension- and mutual-funds or insurance companies (Toporowski 2000). The assets of insurance companies, financial corporate investors, and pension funds have increased by around four times between the 1980s and 2000s in the UK and the US. We will use the ‘financial development index’ by the IMF as an indicator for the depth of the financial system (IMF 2015). This index shows three dimensions of development of financial institutions and financial markets: depth, access, and efficiency. The higher the value, the more developed the financial system is.<sup>7</sup>

d) Shift from ‘bank-based’ to ‘market-based’ financial system

The shift from a bank-based to a market-based financial system has been identified in the literature as another important indicator for financialization. The study of Karwowski and Stockhammer (2017) reviewed the increasing importance of capital markets (relative to bank credit) as a source of funding for firms as one driving force behind financialization. Whereas in the bank-based systems, bank credit is the most dominant source of finance for firms, in the market-based systems capital markets are the key source of funding for firms (Gerschenkron 1962). Beginning in the late 1970s when the process of financial market liberalization in the advanced countries started to unravel, stock markets gained significance (Aglietta and Breton 2001). Lapavitsas (2009a) argued that in relation with the Washington Consensus ‘recommendations’ for capital market deregulation by the World Bank and the International Monetary Fund (IMF), a shift from a bank-based to a market-based financial systems occurred in the emerging countries. The stock market value traded relative to bank credit (both as a share of GDP) will be used as an indicator for the shift towards ‘market-based’ finance. The higher the indicator, the bigger the tendency towards ‘market-based’ finance.

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<sup>7</sup> One can look separately at the development of the three dimensions (depth, access, and efficiency) for each country for both financial markets and financial institutions. However, this kind of analysis goes beyond the scope of our paper. For more information, visit the IMF website: <https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B>

e) Debt of households, the government, and the corporate sector

Accumulation of debt among households and NFCs has been largely associated with financialization in the emerging countries in Central Eastern Europe (Gabor 2012). The entry of foreign banks in these countries has created ample opportunities for favorable credit for households that unlike firms, do not typically use credit for increasing their cash flow (Karwowski and Stockhammer 2017). NFCs, especially in advanced countries, have been put under pressure to make short-term investments in order to stay internationally competitive. Hence, there is a tendency of NFCs becoming quite active in the financial markets. Authors have pointed towards a shift of firms from stakeholder to shareholder corporate structure (see Lazonick and O'Sullivan, 2000 for the US). Household debt and NFCS debt (both as a share of GDP) will be used as indicators for the exposure of households and NFCs to financial markets and their debt burden.

The government is an important actor in the process of financialization as well. Karwowski (2019) identified four ways in which the state/government is involved: through adoption of financial logic, supporting financial innovation practices, encouraging financial accumulation, and through financialization of the 'lives' of its population. The author explores the changing role of the government in these financialization venues by focusing on monetary policy (central banks' pursuit of financial market deregulation and promotion of market-based liquidity management of the financial institutions) and fiscal policy (through creating secondary markets for public debt and through transformation of public services, like pensions and social provision). In order to have a more complete analysis of the government's involvement in the financialization dynamics we need to also look at the structure of public revenues and expenditures. But, due to the limits of this paper, we will focus primarily on the government debt.

f) External debt position of the households, the government, and the corporate sector

It is, however, even more important to look at the composition of debt of the economic sectors. Capital account liberalization has made the financial markets of EEEs more vulnerable and exposed to capital fluctuations in and out of the countries. Accompanied by exchange rate fluctuations, capital account deregulation has impaired the domestic economic actors in servicing their external debt.<sup>8</sup> Driven by the relatively low borrowing costs of credit

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<sup>8</sup> We apply here the definition of the World Bank with regards to external debt: "Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of interest and/or principal by the debtor at some point(s) in the future and that are owed to

denominated in euros, dollars, or Swiss franc, firms in EEEs preferred external finance to credit denominated in a domestic currency. If the domestic currency has lost one or more of its money functions, dollarization and currency mismatch can occur. To address the external debt position of the economic actors, we will look at the external debt of the private sector (including the external debt of the households, financial and non-financial companies, and banks), and the external public debt (composed of the external debt of the government, and the central bank).<sup>9</sup>

#### **4. The drivers of financialization in emerging Europe**

The restructuring of the EEEs after the collapse of the Soviet Union in the early 1990s was accompanied by substantial losses in output and employment. But, by the mid-1990s most of the countries, with the exception of Bulgaria, Romania, and Russia, managed to recover. In the late 1990s Russia was hit by a financial crisis, which also had an impact, although to various degree, on the rest of the EEEs. From the early-2000s until the outbreak of the financial crisis of 2008, the countries enjoyed an almost uninterrupted economic growth supported by large capital inflows.

Towards the late 1990s the EEEs started the process of capital account liberalization, as a result of which these countries became an attractive destination for capital inflows. Another important factor that played a role in attracting a sizeable amount of capital was the entry of Poland, Hungary, Czech Republic, Bulgaria, Romania, and Croatia, and the announced candidacy of Turkey in the European Union (Becker et al. 2015: 87). The EU accession was particularly important for the capital inflows being directed in the banking sector of these emerging countries.

Against the background of highly liberalized capital markets, banks in EEEs could receive credit from the Western European banks at relatively low money-market interest rates. The short-term interest rates in the Euro area and Switzerland were lower than the interest rates in the EEEs. After a period of relatively high nominal interest rates to fight the inflationary development in the late-1990s, nominal interest rates started declining at the beginning of the 2000s. Nonetheless, the latter had to be kept at a relatively high level to compensate for the lower currency premium in the EEEs relative to the Euro area. Table 1 shows the development of the interest rates on average in the period before and after the Great Recession. EEEs (with the exception of Czech Republic) had higher nominal short-term interest rates than the Euro

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nonresidents by residents of an economy.” See the website of the World Bank for more information: <https://datahelpdesk.worldbank.org/knowledgebase/articles/474124-what-is-external-debt>

<sup>9</sup> Owing to data unavailability for the external debt of the individual economic sectors for the EEEs, we focus on the two composite indicators: external private debt and external public debt.

area countries in the early-2000s. Interest rates in the EEEs as well as in the Euro area declined in the aftermath of the financial crisis in 2008. However, short-term interest rates in the EEEs remained higher than in the Euro area. The biggest interest rate differential relative to the market interest rates in the Euro area can be spotted in Turkey, Romania, and Poland.

*Table 1: Nominal and real short-term interest rates in EEEs and the Euro area, average values 2000-2020*

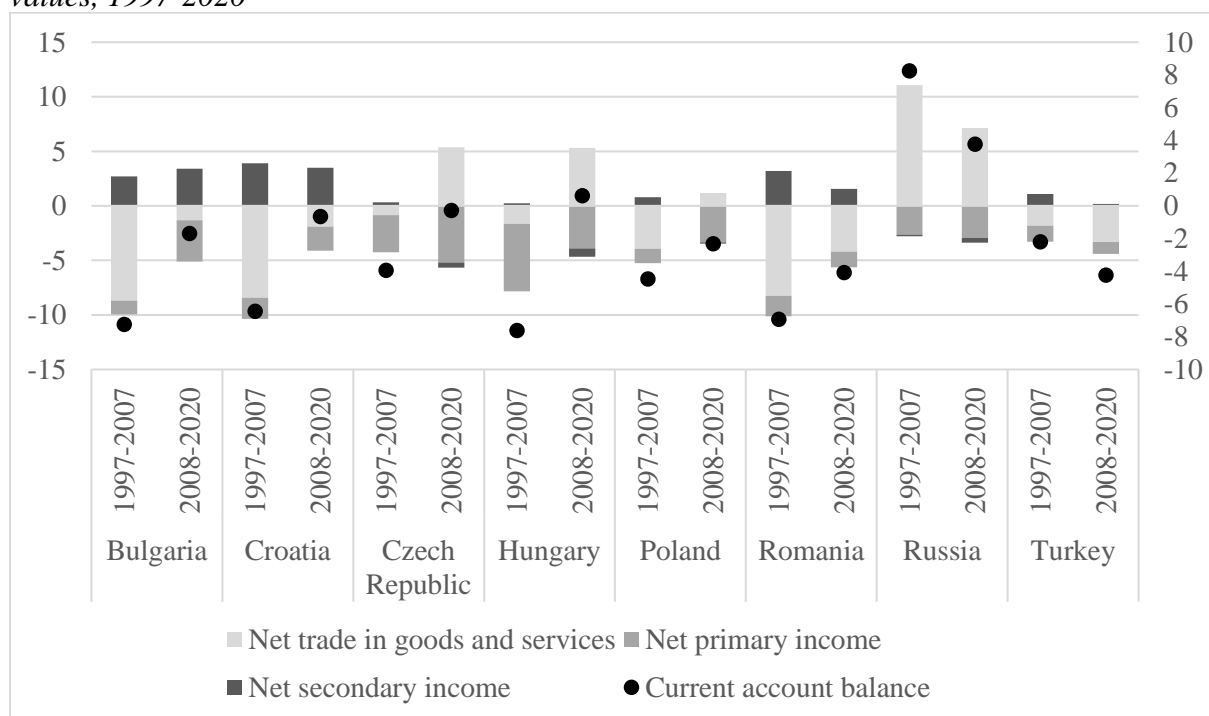
	<i>nominal short-term interest rate</i>		<i>real short-term interest rate</i>	
	2000-2007	2008-2020	2000-2007	2008-2020
Euro area	3.3	0.6	1.1	-0.5
Bulgaria	4.3	2.0	-0.1	0.2
Czech Rep.	3.3	1.2	1.0	-0.5
Croatia	n.a	1.2	n.a	0.3
Hungary	9.2	3.8	2.7	0.6
Poland	8.8	3.0	5.1	1.0
Romania	22.5	4.5	4.1	0.7
Turkey	36.8	11.6	9.4	3.8

Note: <sup>1</sup>3-month money market interest rates. <sup>2</sup> Deflator private consumption is used for the calculation of real short-term interest rates. <sup>3</sup> N.a. stands for 'not-available'.

Source: Eurostat 2021, author's calculations.

The process of capital market liberalization made more funds available for the domestic economic actors in these countries, but it also made their financial systems more vulnerable to capital movements and led to an accumulation of current account deficits. The current account deficits soared in the early 2000s reaching 26 per cent of GDP and 14 per cent of GDP in Bulgaria and Romania in 2007 (World Bank 2021). Not only did the trade balance deteriorate owing to the high growth in imports over exports, but so did the (primary) income balance of the current account. As recipients of large amounts of FDI and portfolio flows, the EEEs saw their primary income deficits rise (Figure 1). Interest payments, dividends, and profit repatriations of international financial and non-financial companies contributed to an increase of the primary income deficits (Kazandziska 2019).

Figure 1: Composition of the current account in EEEs (share of GDP, per cent), average values, 1997-2020



Source: World Bank, 2021.

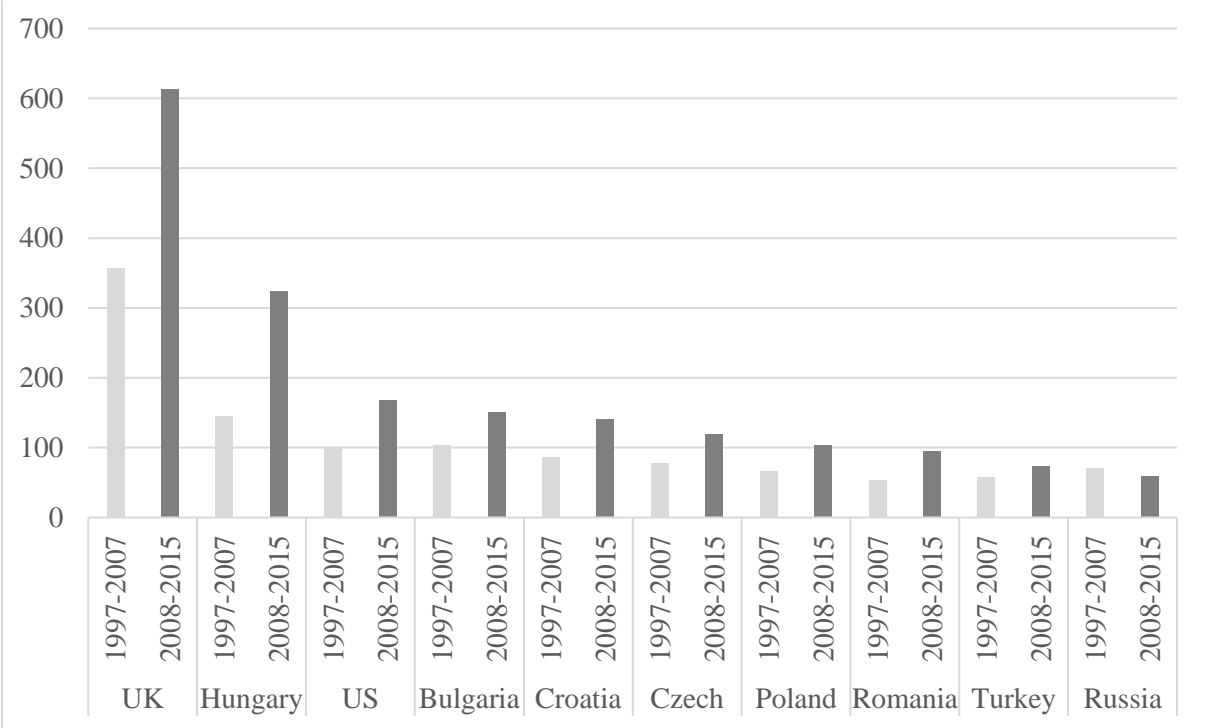
Only after the outbreak of the financial crisis in 2008, did these countries see an improvement of their current account balances. Against the backdrop of high trade openness of the EEEs, exports of these countries slowed down, which meant less funds to finance imports and to service their external debt. At the same time, imports lagged behind exports, which reduced the countries' trade imbalances. In the Polish case, the relatively quick recovery of the German economy, which was the largest importer of Polish products, had a positive impact on the reduction of the trade deficit in Poland. Similar to China and other Asian net-exporters, Russia experienced a fall in its exports owing to a fall in world demand. This decreased its current account surpluses. Turkey is the only country in our sample that saw its current account position deteriorate in the wake of the financial crisis of 2008/09 primarily due to its increase in the trade deficit. The dependency on imported goods for production and the overvaluation of the Turkish lira against the inflation targeting monetary policy strategy seemed to have played a very significant role in the persistence of current account deficits (Yurdakul and Cevher 2015: 93). Moreover, in Hungary, Romania, and Turkey primary income deficits declined in EEEs as net capital inflows slowed down. As a result of the strong decline in the growth of imports and the improvement in the primary income balance, Hungary managed to achieve current account surpluses in the aftermath of the Great Recession. However, this can be interpreted as a 'cyclical surplus' that tends to disappear once the economy starts to recover (Prieue and Herr 2005).

**5. Financialization indicators**

In this section we will delve into these aspects of financialization: external financial liabilities, degree of financial liberalization, financial system depth, the shift from a ‘bank-based’ towards a ‘market-based’ financial system, the debt of the household, the NFCs, and the government, and their external debt position.

One of the most important drivers of financialization particularly in emerging countries as elaborated earlier is the growth of capital inflows. The stock of total external liabilities as a share of GDP will be used as an indicator for the development of financial inflows. This indicator is provided for the EEEs in Figure 2. The development of this indicator will be compared to the UK and US, as some of the most financialized countries in the world.

*Figure 2: Stock of total external liabilities in the EEEs, US and UK (share of GDP, per cent), average values, 1997-2020<sup>1</sup>*



*Note:*<sup>1</sup> Data are available until 2015.

*Source:* Lane/Milesi-Ferretti 2018.

Figure 2 shows that Hungary in particular, experienced strong increase of capital inflows compared to the rest of the EEEs in our sample. The stock of foreign liabilities reached a level of 146 per cent relative to GDP in the decade before the financial crisis of 2008. In the aftermath of the financial crisis, its foreign liabilities increased at a much stronger pace than before, exceeding the 300-per-cent level and thus, getting closer to the UK that had the highest values of this indicator. Although Bulgaria, Croatia, and Czech Republic had a much smaller stock of

foreign liabilities than Hungary (or UK) before the outbreak of the financial crisis, they marked a significant rise of their foreign liabilities of about 50 percentage points in the wake of the Great Recession. Russia seems to be the least dependent country on foreign financial flows, reducing its stock of external liabilities to below 60 per cent of GDP in the years succeeding the financial crisis. Turkey experienced strong volatility of capital movements. It is a country where one can clearly spot an example of boom-bust cycles. In the late 1990s, Turkey went through an episode of strong capital inflows (supported by high interest rate policy), which ended in a financial crisis in 2001. Between 2005 and 2007, Turkey attracted large amounts of capital. The government encouraged the development of the bond market and the rise of the stock market trading. After the crisis of 2008, the government supported further the process of securitization and external credit for the NFCs, that could not list at the stock exchange (Akçay and Güngen 2019). In 2008 and 2009, Turkey had to go through massive capital outflows. This tendency of capital flow fluctuation continued in the decade following the financial crisis of 2008.

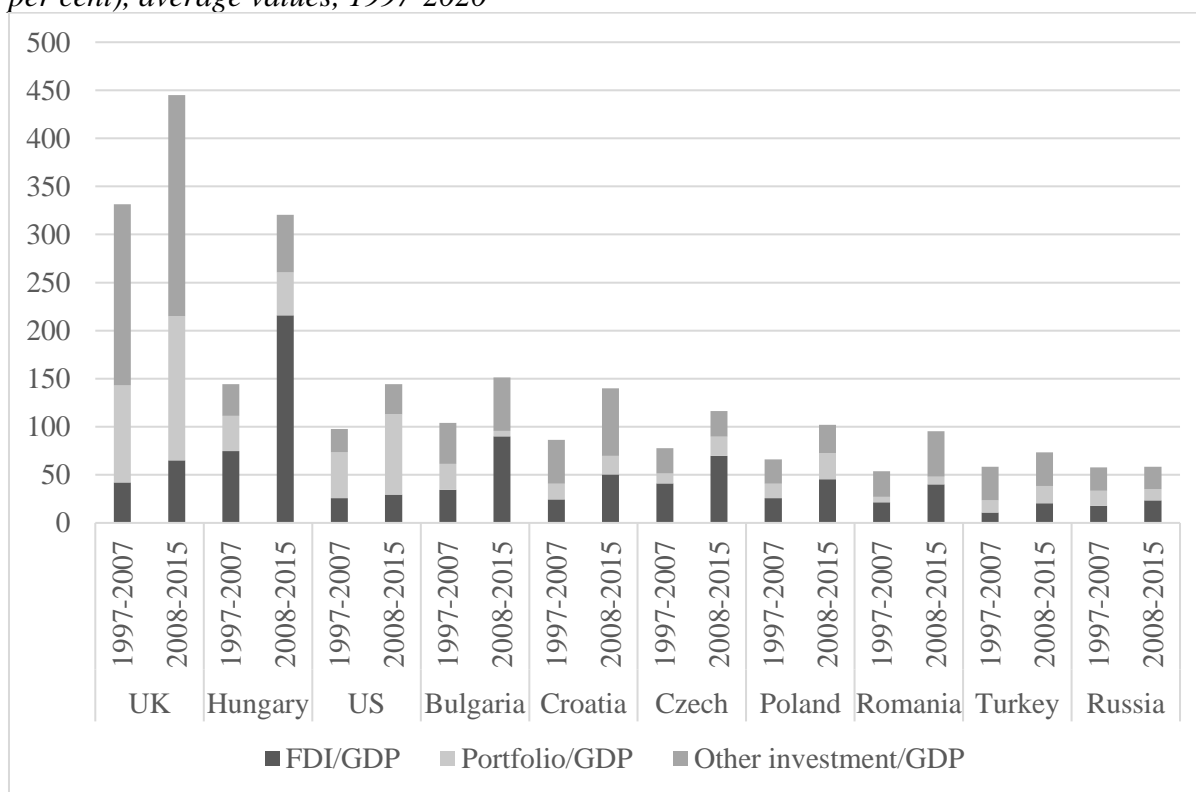
One can look at the composition of the financial liabilities to understand the source of financial inflows and the accumulation of liabilities in the EEEs. Figure 3 shows that a few emerging European countries from our sample (Hungary, Czech Republic, and Poland) received capital flows primarily in the form of FDI. The latter was an important driver for economic growth in these countries. In the run up to the financial crisis of 2008, the stock of foreign liabilities in Croatia, Romania, Turkey, Russia, and Bulgaria increased predominantly due to other investment inflows (Figure 3).<sup>10</sup> These countries received a significant part of their capital inflows in the form of interbank loans and trade credit (Bogumil 2014: 2).

Russia is the only net creditor country in our sample. It invests heavily in foreign assets, primarily in foreign exchange reserves. In the late 1990s, amidst the financial crisis, the central bank of Russia introduced a managed floating exchange rate regime. Throughout the early 2000s the central bank intervened strongly in the foreign exchange market to prevent an appreciation of the ruble. At the onset of the financial crisis in 2008, the central bank reduced its purchases of foreign exchange reserves to reduce the depreciation pressure on its currency (BIS 2013: 295).

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<sup>10</sup> US and UK saw their foreign liabilities increase owing to portfolio investment and other investment inflows.

Figure 3: Composition of the stock of FDI and foreign liabilities in EEEs (share of GDP, per cent), average values, 1997-2020<sup>1</sup>



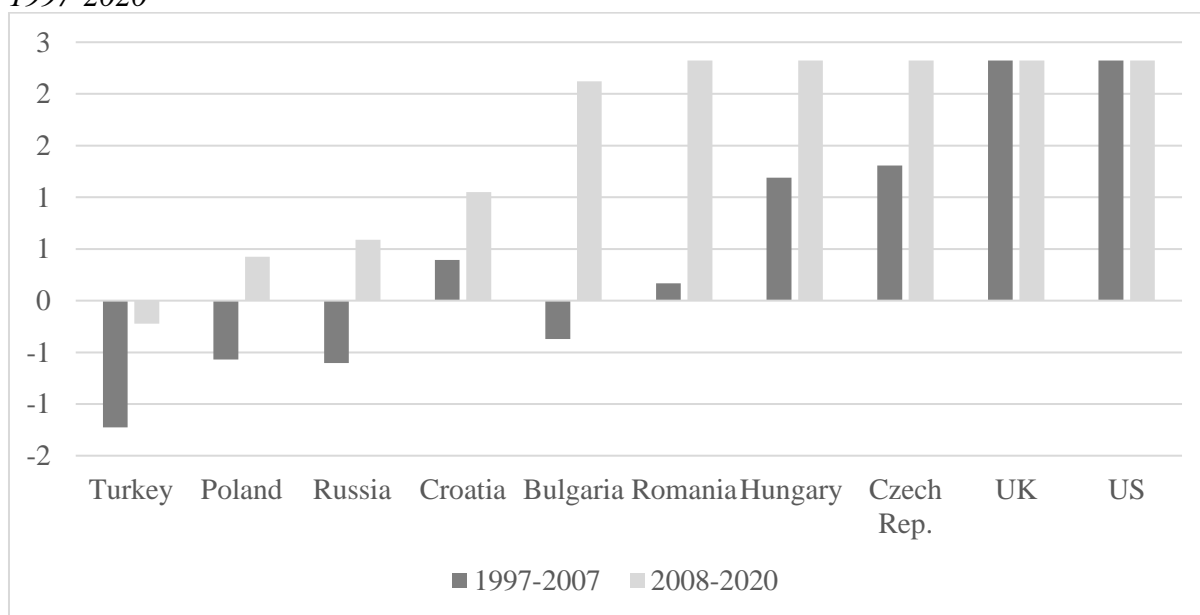
Note: <sup>1</sup> Data are available until 2015.

Source: Lane/Milesi-Ferretti 2018.

The next indicator we will look at is the Chinn-Ito index as a proxy for the level of capital account liberalization. Figure 4 shows the capital account openness among the EEEs. Vis-à-vis the Anglo-Saxon countries that already liberalized their capital account to the fullest extent in the 1990s, the EEEs in our sample maintained some capital controls as a remnant of the transition period. The EEEs can be classified in two groups depending on the level of capital account openness. On the one hand, there is a group of EEEs that did not fully deregulate their capital account. Turkey, Poland, and Russia are the least financially liberalized countries in our sample. According to the Chinn-Ito database, Poland has the lowest level of capital account liberalization within the EU. On the other side, Romania, Czech Republic, and Hungary went for (at least ‘de-jure’) full capital account liberalization in the decade after the financial crisis.



Figure 4: Capital account liberalization in the EEEs, (average values of the Chinn-Ito index) 1997-2020<sup>1</sup>



Note: <sup>1</sup> Data are only available until 2019.

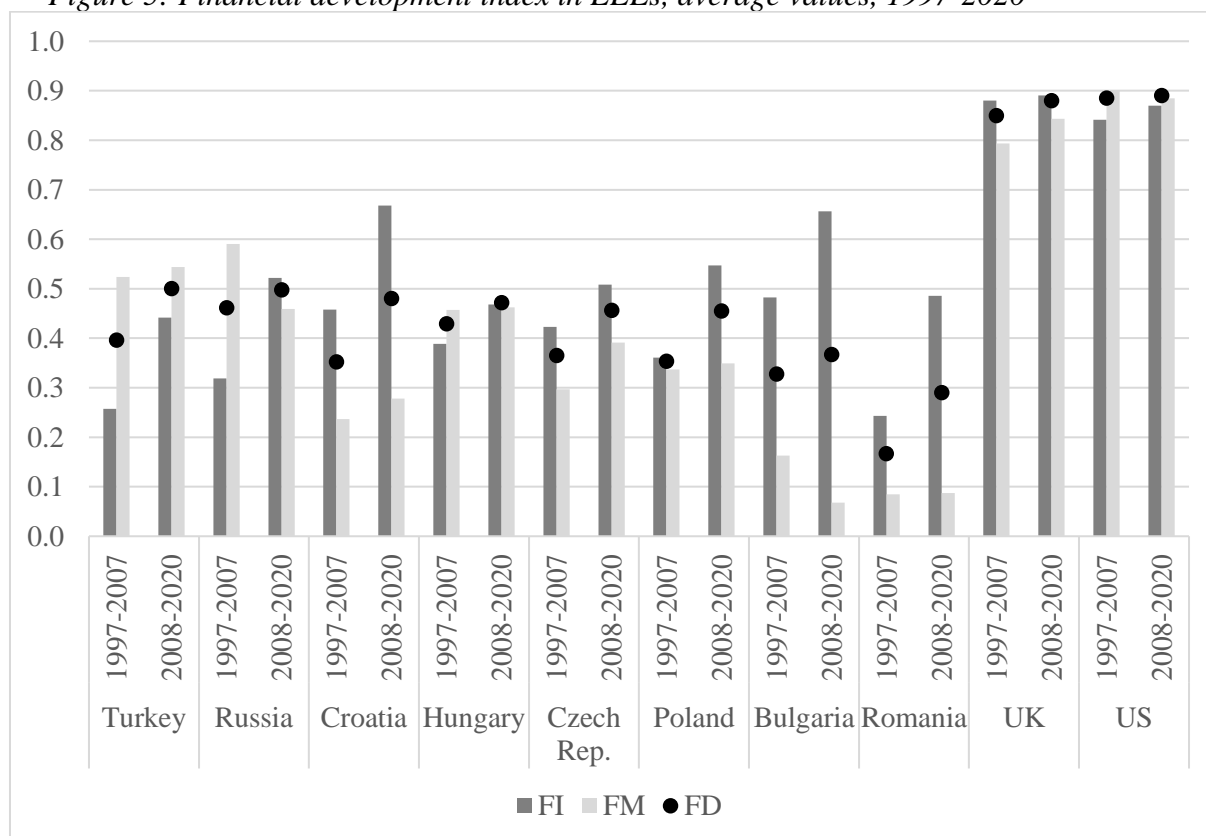
Source: Chinn/Ito 2021.

We will use the indicator ‘financial development index’ from the IMF (2021) as a proxy for the level of financial development of a country. This indicator consists of two elements: financial institutions and financial markets, and captures the depth, efficiency, and access of these two elements.<sup>11</sup> The highest value of the financial development index (as well as its two components – financial institutions and markets), is one, and the lowest is zero. Figure 5 shows that in the aftermath of the financial crisis of 2008 the overall financial development in the EEEs increased compared to the period before. Yet, relative to the UK and the US, the EEEs reached a much lower level of financial development. It is also noteworthy to mention that using this indicator, Russia and Turkey are some of the countries that had a relatively high level of financial development. They had strong development of their financial markets in the late 1990s/early 2000s, but the level of financial market development in Russia dropped at the onset of the Great Recession. Turkey’s financial markets continued to grow when the government actively supported the process of securitization and the deepening of the bond markets in 2009. Before the financial crisis of 2008, Turkey’s financial institutions were relatively poorly developed, but they caught up in the aftermath of the financial crisis. Croatia and Bulgaria also reached a relatively high level of development of their financial institutions. However, these

<sup>11</sup> Visit the website of the Financial Development Index Database of the IMF (2021) for more information on the construction of the index and its components (Financial Development - Story - IMF Data). Financial markets compose predominantly of stock and bond markets, while financial institutions include banks, mutual funds, pension funds, insurance companies, and other non-bank financial institutions.

two countries did not necessarily have the same success in terms of developing their financial markets. Romania shows the lowest degree of financial development throughout the whole period of observation.

Figure 5: Financial development index in EEEs, average values, 1997-2020<sup>12</sup>



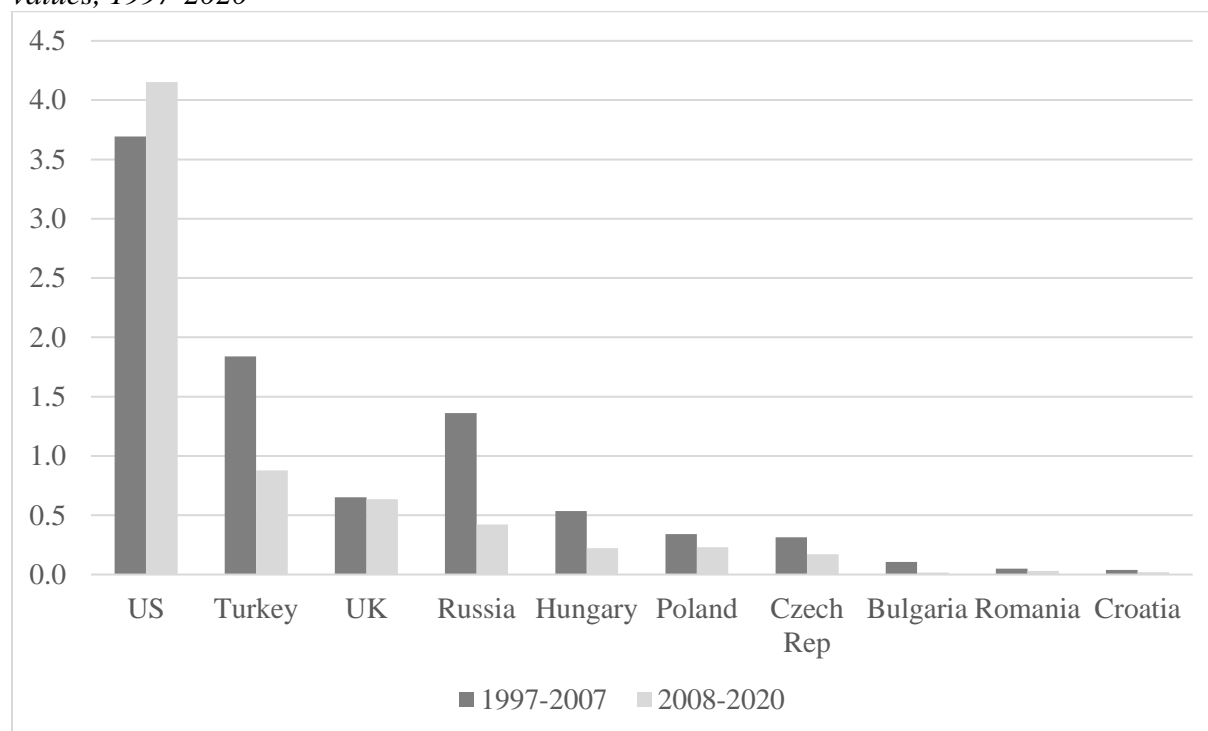
Note: <sup>1</sup> FD stands for financial development index, FM – financial markets, and FI – financial institutions. <sup>2</sup> Data are only available until 2019.

Source: IMF Financial Development Index Database 2021, author's calculations.

Figure 6 shows the development of market-based in relation to bank-based financial systems. Following Karwowski and Stockhammer (2017), we use the ratio of stock market value traded divided by bank credit (both as a share of GDP) to show the increased role of the capital-markets vs. bank-dominated financial systems. Turkey and Russia show the most prominent shift from the bank-based towards the market-based financial system in the decade prior to the financial crisis in 2008. Using this indicator, these two countries had a stronger shift towards market-based finance than the UK. The stock market value in Turkey increased almost twice as much as bank credit. In the other EEEs the ratio of stock market value traded relative to bank credit was lower than 1, which means that bank credit remained the most important source of external funds for firms. The stock market in relation to bank credit was the lowest in Croatia and

Romania. It is noteworthy to mention that in all the EEEs, bank credit regained its importance in the years following the Great Recession.

Figure 6: 'Market-based vs. bank-based' indicator (share of GDP, per cent), average values, 1997-2020



Source: World Bank 2021, authors calculations.

The fall in nominal and real interest rates in the early-2000s encouraged borrowing of the private sector in the emerging countries of our sample. Figure 7 shows the level of debt of non-financial corporations. Non-financial corporations (NFCs) debt-to-GDP ratio will be used as a proxy of financial distress of firms. The data for this indicator are retrieved from the Bank for International Settlements (BIS). This database unfortunately does not contain data on NFC debt for Croatia, Bulgaria, and Romania; therefore, Figure 7 does not include these countries.<sup>12</sup>

Before the Great Recession, Czech Republic had the highest level of NFCs debt with an average value of slightly less than 60 per cent, followed by Hungary with an average value of 55 per cent. During the same period, the NFCs in Russia were the least indebted according to this indicator. After the outbreak of the financial crisis in 2008, the NFCs in EEEs increased their debt relative to GDP. In Czech Republic, however, they switched towards deleveraging.

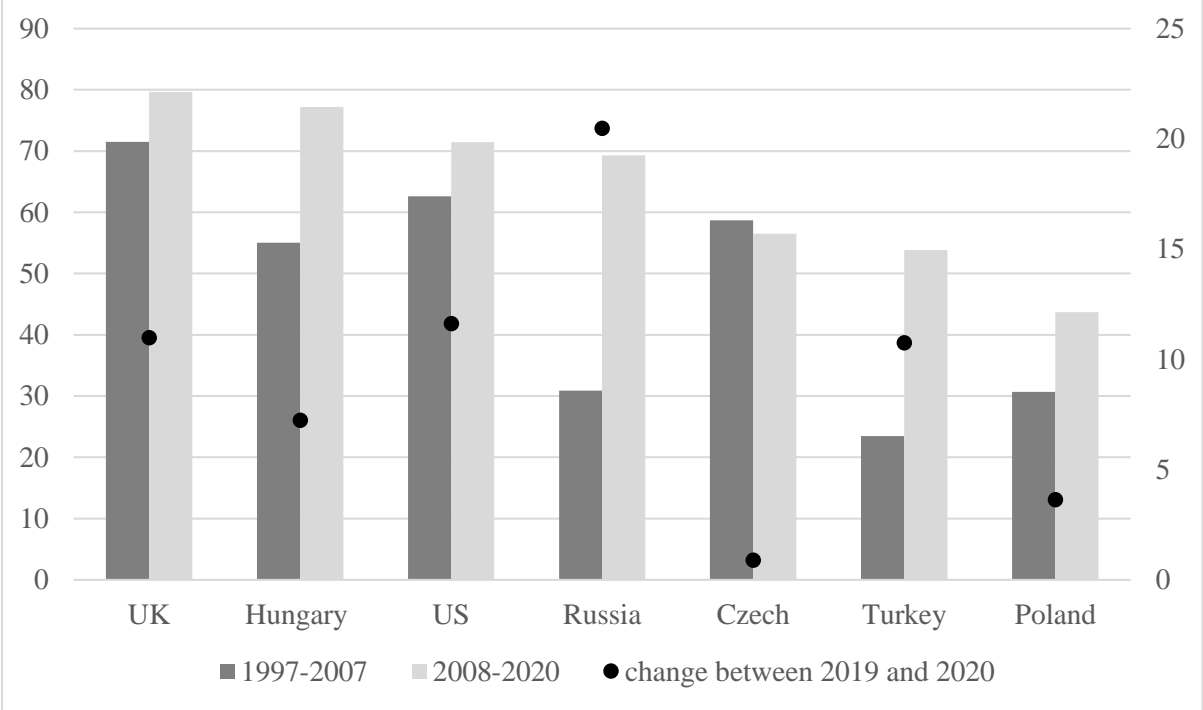
<sup>12</sup> The Eurostat database could be also used to obtain data for NFCs debt. However, this database lacks data on the UK and the US. Furthermore, data on NFCs' debt diverge (for some countries of our sample) significantly from the BIS database, which is more commonly used in the financialization literature. Therefore, we decided to use the BIS database instead, for the debt of NFCs, governments, and households.

Compared to the two Anglo-Saxon countries, we can argue that the NFCs in EEEs had lower debt as a share of GDP.

However, looking more closely one can observe that EEEs marked a strong increase of their NFCs debt-to-GDP ratios relative to the Anglo-Saxon countries. For example, the NFCs in Russia had initially a low level of debt of about 30 per cent on average between 1997 and 2007. However, the NFCs debt rose by more than 120 per cent to a level of 69 per cent in the second period of analysis (2008-2020). Similar dynamics of growth could be identified for Turkey.

The NFCs became strongly affected by the Covid-pandemic, particularly in the tourism, travel, accommodation, and retail sectors. The debt of the NFCs in 2020 rose to the largest extent in Russia and to the smallest extent in the Czech Republic (Figure 7).

Figure 7: Level of debt of non-financial corporations (NFCs) (as a share of GDP, in per cent), and the growth of the NFCs debt in the pandemic



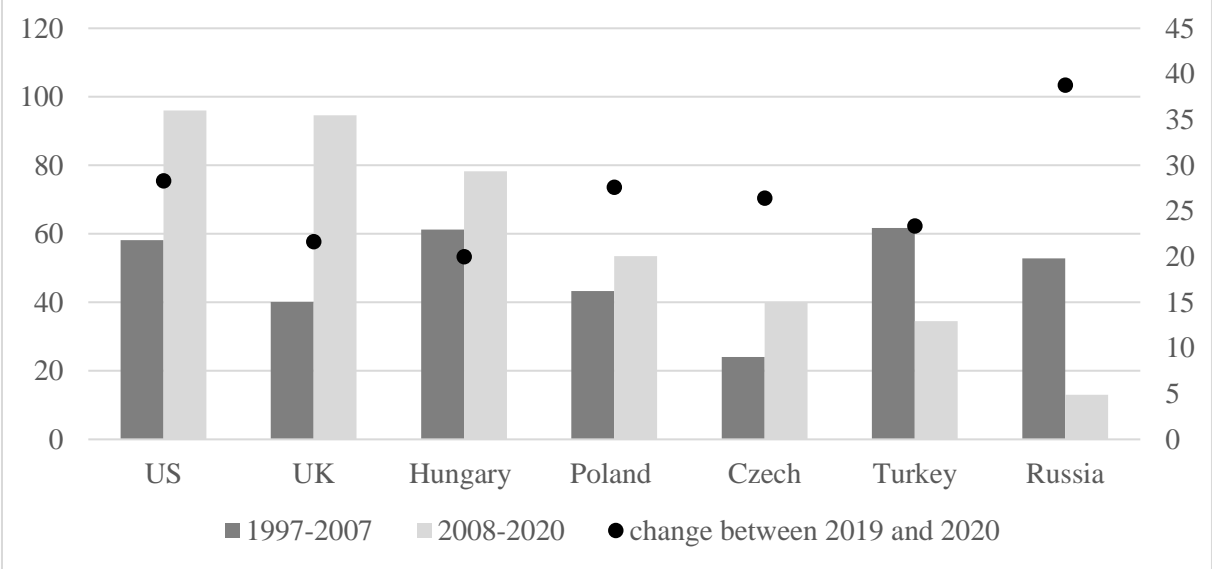
Note: The averages (1997-2007 and 2008-2020) for the NFCs debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

Source: BIS 2021, author’s calculations.

Public debt-to-GDP is the next indicator we will analyze. In the decade succeeding the financial crisis in 2008 the governments in Turkey and Russia managed to reduce their public debts relative to GDP, whereas public debt continued to rise in Poland, Czech Republic, and Hungary (Figure 8). The Covid-pandemic led to serious collapses of the economies in emerging countries also in Europe. The governments in EEEs increased their borrowing with public debt-

to-GDP ratios increasing manyfold. For instance, in Russia the public debt to GDP ratio rose by almost 40 per cent between 2019 and 2020. The rest of the EEEs (led by Poland and Czech Republic) also saw their public debt-to-GDP ratios increase substantially. Relative to UK, government debt-to-GDP in EEEs increased at a larger pace during the Covid-pandemic.

Figure 8: Level of public debt (as a share of GDP, in per cent), and the growth of public debt in the pandemic



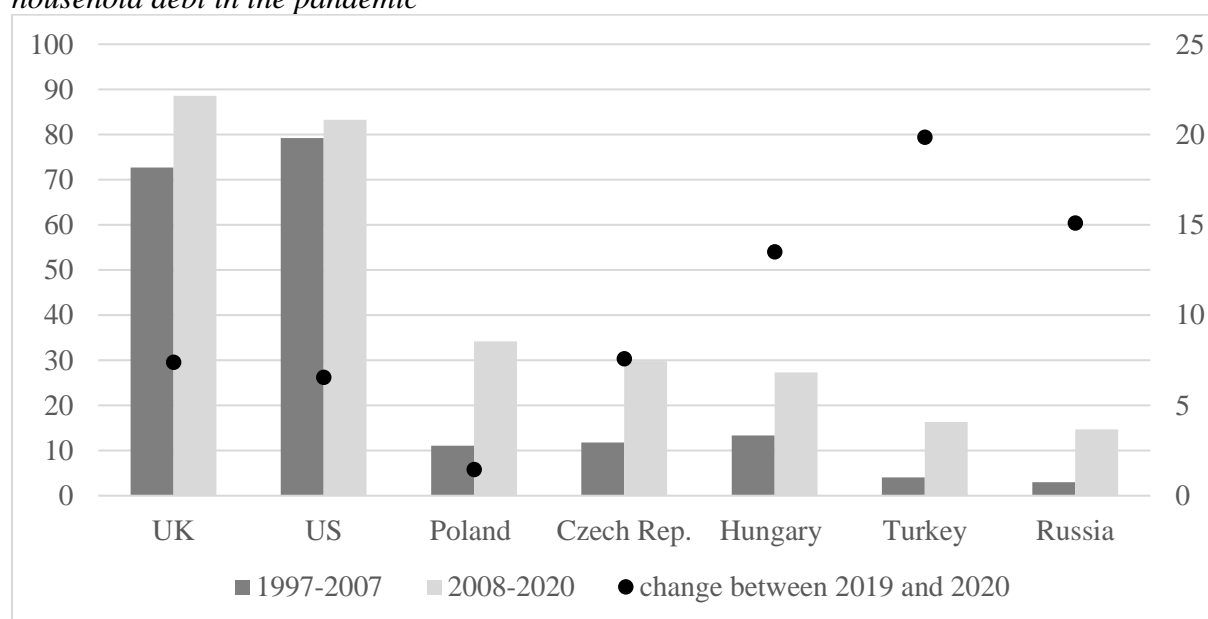
Note: The averages (1997-2007 and 2008-2020) for the public debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

Source: BIS 2021, author’s calculations.

Households increased their appetite for borrowing as well. Households have become involved in the financialization process of EEEs through the privatization of the health-insurance system, as well as the (at least partial) privatization of the pension system, and increasingly through real-estate and stock purchases (Lapavitsas 2009b).

Figure 9 shows the level of households’ debt measured as a ratio of household debt-to-GDP. Relative to the households in the Anglo-Saxon countries, their counterparts in the EEEs were less indebted. Russia, followed by Turkey, had the lowest household debt-to-GDP ratio. Using this indicator, we can argue that the households in EEEs were less exposed to financialization than the Anglo-Saxon countries, whose household debt-to-GDP ratio ranged between 70 and 80 per cent on average before the financial crisis. However, we can also spot a tendency of a rise of households’ indebtedness in the years following the Great Recession. The household-to-GDP ratio in Poland reached the highest level of around 34 per cent.

Figure 9: Level of household debt (as a share of GDP, in per cent) and the growth of the household debt in the pandemic



Note: The averages (1997-2007 and 2008-2020) for the household debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

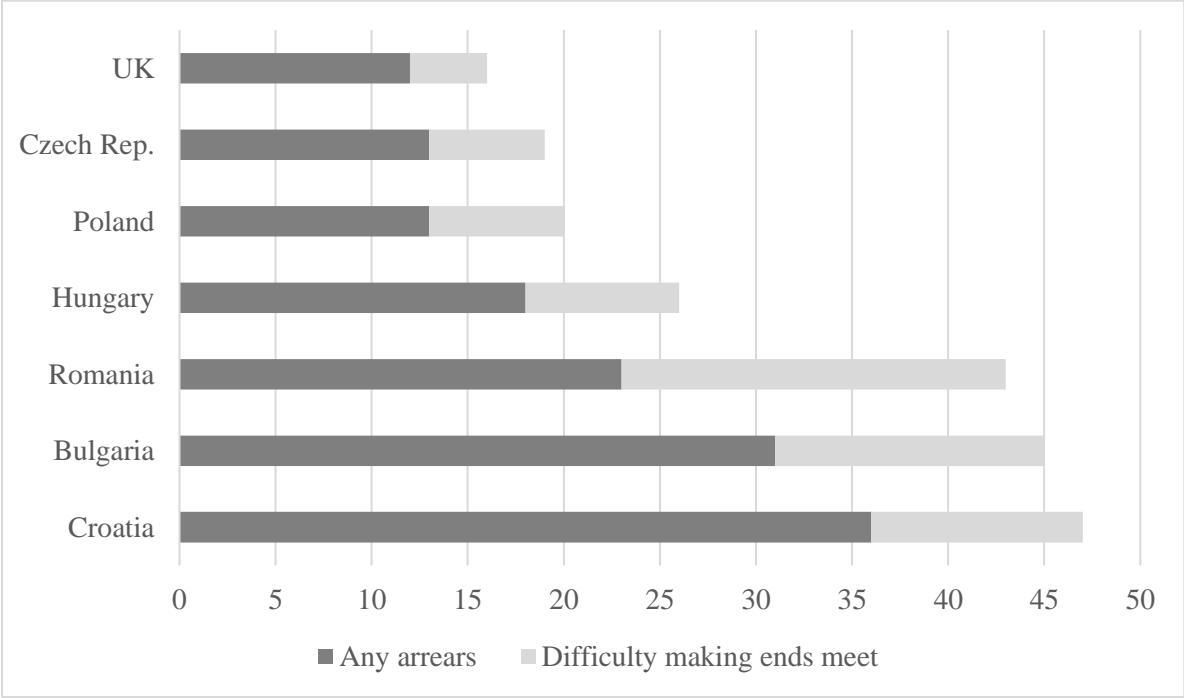
Source: BIS 2021, author's calculations.

EEEs started off from rather low levels of household debt. The household debt-to-GDP ratio in Russia was less than 1 per cent in 1998 and increased to 10 per cent in 2007 (BIS 2021). But the growth dynamics of household indebtedness were spectacular. Among the EEEs of our sample, Russia and Turkey marked the strongest increase of household debt relative to GDP (the household debt-to-GDP ratio rose by more than 300 per cent in these two countries in the aftermath of the financial crisis). Hence, even though the level of household debt relative to GDP in the EEEs was lower than in the UK and the US, the increase of household debt as a share of GDP in EEEs was much stronger than in the Anglo-Saxon countries.

During the Covid-pandemic, all the EEEs experienced rise of the household debt-GDP ratio. In the first half of 2020 households were hesitant to consume as many countries were in a lockdown; hence, the household debt-to-GDP increased only slightly in the first quarter of 2020 (BIS 2021). However, in the second half of 2020, household debt started picking up. Low-income households were severely affected by the Covid-pandemic because they saw their incomes being reduced. They had to accept reduction of their working hours, were put on furlough, or lost their jobs (especially those working in the accommodation, tourism, gastronomy, or the retail sector). The borrowing of the low-income households picked up in the Covid-pandemic to cover the costs of food or rent because these households did not have

sufficient savings to weather even temporary losses of their income (Francis-Devine 2021: 13).<sup>13</sup> The households in Turkey and Russia experienced rise in their debt-to-income levels of 20 per cent and 15 per cent respectively (Figure 9).

Figure 10: Over-indebtedness of households in the EEEs in 2016<sup>1</sup>



Note: <sup>1</sup>Proportion of people aged 18+ at risk of over-indebtedness. ‘Any arrears’ means payment delay because of incapability of payment on time (for instance, delay in payment of rent or mortgage, utility or telephone bills, rent, etc., but also repayment of any household credit, including credit card overdrafts) (Eurofound 2020: 10). ‘Difficulty making ends meet’ shows the share of people, who reported to have difficulty making ends meet with their current income. Data for Russia and Turkey are not available

Source: Eurofound 2020: 10.

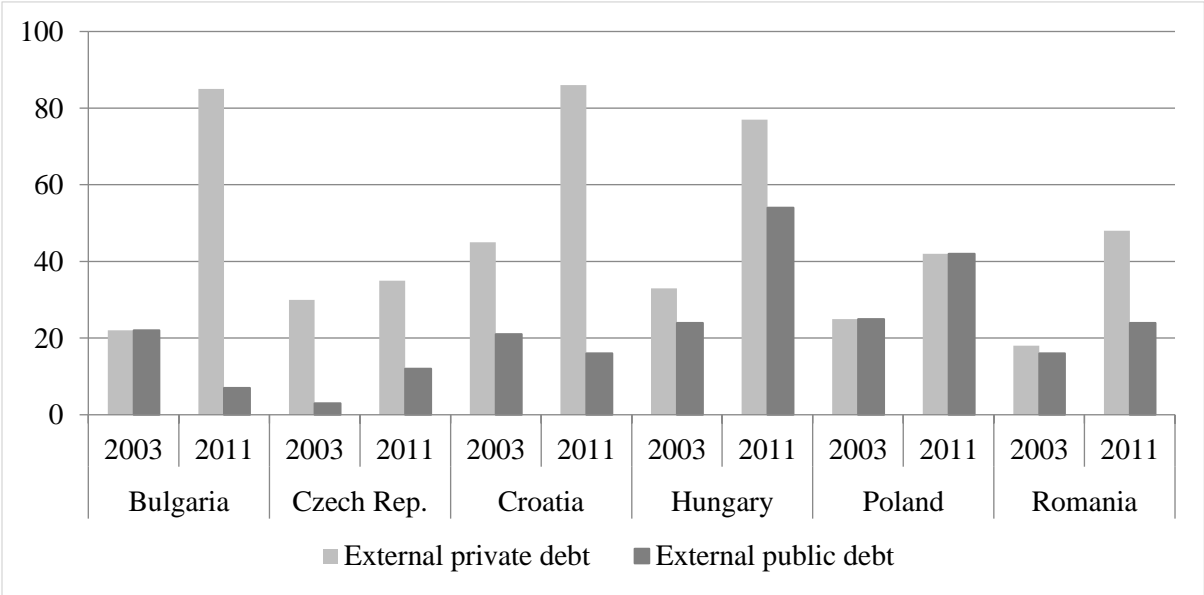
Albeit the level of indebtedness of households in EEEs is relatively low (compared to the UK and the US), the risk of over-indebtedness is quite substantial (Figure 10). For illustration, 36 per cent of the households in Croatia in 2016 were at risk of over-indebtedness, followed by Bulgaria (31 per cent) (Figure 10). According to Eurofound (2020), households are considered at risk of over-indebtedness, if in the past 12 months they were not able to make scheduled payments for rent, mortgage payments, payments for consumer loans, informal loans (taken from friends), utility or telephone/internet bills. Between 14 and 20 per cent of the households

<sup>13</sup> Poland did not see its household debt-to-GDP ratio rise. This is due to the fact that Poles are rather conservative towards consumption even during economic boom; hence, they largely resorted to depleting their savings in 2020 and 2021 (Szustak, Gradon, and Szewczyk 2021: 12). Between December 2019 and December 2020, the household debt-to-GDP ratio in Poland increased only by 1.5 per cent.

in Romania and Bulgaria made ‘ends meet’ with difficulty. Hence, even though financialization in EEEs is at a lower level compared to the UK, the risk of over-indebtedness in the former is significantly higher compared to the latter.

It is noteworthy to also take a closer look at the composition of debt of the economic sectors. Against the background of relatively weak or unstable domestic financial systems, firms in EEEs relied on external funds to finance investment and production. In the cases where the external finance predominantly finances the export sector, the danger of a currency mismatch could be minimized. However, if the domestic financial system does not properly function, and the domestic currency cannot fulfil all the functions of money, then the problem of a currency mismatch elevates. When capital inflows are suddenly reversed, the whole financial system can collapse. To address these concerns, we will explore the external private, and the external public debt. External debt of the private sector rose in all EEEs in the decade after the Great Recession (Figure 11). Overall, Croatia and Bulgaria, followed by Hungary had the highest external private debt as a share of GDP. In the years following the financial crisis of 2008, external debt of the public sector rose in the majority of the countries, and it declined in Bulgaria and Croatia (Figure 11).

Figure 11: External debt in the EEEs in 2003 and 2011 (as a share of GDP, in per cent) <sup>1</sup>



Note: External private debt includes debt of the households, financial and non-financial companies, banks, as well as inter-company loans. External public debt includes the debt of the government, and the central bank. Data for Russia, Turkey, UK, and US are not available.

Source: Giday 2013, Tables 7, 10.



In the context of external debt, we should mention that emerging countries face the problem of the ‘original sin’, *i.e.*, the restricted ability to borrow abroad in a domestic currency. Eichengreen and Hausmann (2005: 3) explained that

(...) the composition of external debt – and specifically the extent to which that debt is denominated in foreign currency – is a key determinant of the stability of output, the volatility of capital flows, the management of exchange rates, and the level of country credit ratings.

Thus, in addition to external debt ratios, it is of key importance to analyze the currency denomination of external debt to capture more closely the potential risk of dollarization and currency mismatch. In the EEEs foreign-currency-denominated debt constitutes the bulk of the gross external debt. In 2021 between 60 and 96 percent of the total gross external debt was denominated in a foreign currency in these countries (Table 2). The only exception is Czech Republic, where 52 percent of the external debt had domestic currency denomination. This implies that

*Table 2: Composition of external debt: foreign vs. domestic currency denominated debt in 2021*

	Foreign currency debt (share of external debt, %)	Domestic currency debt (share of external debt, %)
Bulgaria	96	4
Croatia	93	7
Czech Republic	48	52
Hungary	84	16
Poland	66	34
Romania	86	14
Russia	72	28
Turkey	95	5
United States	8	92

*Source: World Bank, 2022.*

We have created Table 3 as a summary of the results of the financialization analysis in the EEEs. The ranking in this table ranges between ‘high’, ‘medium high’, ‘medium low’ and ‘low’ to express the level of financialization dynamics using the selected indicators. The data used for the indicators have been sorted in quartiles for the country averages in the periods 1997-2007, and 2008-2020. Thus, the numbers in the table show the ranking of a country relative to the countries selected in this paper. We should also be aware of the fact that the results presented in Table 3 are static and do not capture the dynamics of capital flow movement (like in the case of Turkey) or the dynamics of growing debt levels that were very pronounced in the EEEs.

From Table 3 it can be argued that the level of foreign indebtedness created through capital inflows was the most pronounced in Hungary, the UK, and the US, followed by Bulgaria and Croatia. Romania and Russia are the least dependent countries on foreign finance within our sample. Czech Republic, Hungary, UK, US, (and since the last decade also Romania) have characteristics of high capital account liberalization, whereas Russia, Turkey, and Poland have maintained their capital controls.

The depth of the financial system reached a high level in Russia, Turkey, and Hungary. In these countries one can also spot a shift from a bank-based to a market-based finance. Bulgaria and Romania seem to have the weakest financial system institutions and markets within our sample.

Rising NFCs' debt levels in the period following the Great Recession can be spotted in Hungary and Russia. In Poland, households had to struggle with increasing debt levels. The debt-to GDP ratio in the UK and the US has been remarkable in all three economic sectors. The economic sectors in Russia and Turkey seem to be the least indebted, but we should keep in mind that the analysis of the paper showed that these two countries exercised the strongest growth dynamics of household and NFCs debt. The external debt was high in Bulgaria, Croatia, and Hungary, and relatively low in Czech Republic.

Table 3: Summary of the financialization indicators, average values, 1997-2020<sup>1</sup>

	External financial debt	Financial liber.	Financial system depth	MB financial system <sup>3</sup>	Household debt	NFCs debt	Gov. debt	Ext.debt priv.(public) <sup>4</sup>
Bulgaria	high med. high	med. low med. low	low low	low low	2			low (med. high) high (low)
Croatia	med. high med. high	med. high med. low	med. low med. high	low low				high (med. low) high (med. low)
Czech Rep.	med. low med. low	high high	med. low med. low	med. low med. low	med. low med. low	med. high med. low	low med. low	med. high (low) low (low)
Hungary	high high	med. high high	med. high med. high	med. high med. low	med. high med. low	med. high high	high med. high	high (high) med. high (high)
Poland	low med. low	med. low low	med. low med. low	med. low med. high	med. low med. high	low low	med. low med. low	med. low (high) low (high)
Romania	low low	low high	low low	low low				low (low) med. low (med. high)
Russia	med. low low	low low	high med. high	high med. high	low low	low med. high	med. low low	
Turkey	low low	low low	med. high high	high high	low low	low low	high low	
UK	high high	high high	high high	med. high high	high high	high high		
US	med. high high	high high	high high	high high	high high	high med. high		

*Note:*<sup>1</sup> The left triangles in the cells represent the quartiles in the period 1997-2007, while the right triangles – the period 2008-2020.<sup>2</sup> The empty cells mean that no data was available for the given countries.<sup>3</sup> MB stands for market-based financial system. This indicator represents the shift from bank-based towards market-based financial systems.<sup>4</sup> Data on external public debt is presented in brackets.

## **6. Types of financialization in the EEEs**

Financialization in the emerging European countries (Hungary, Croatia, Bulgaria, and to a lesser extent, in Poland, and Czech Republic) has been determined by foreign capital inflows (Figure 2). The foreign ownership among banks in the EEEs increased substantially between the late 1990s and 2000s. Through the process of privatization, foreign banks (mainly Western European) increased their presence in Central Eastern Europe both through their subsidiaries and by cross-border loans (Bubbico et al. 2017). We can observe an increased share of foreign banks in the banking sector of these countries. The share of foreign-owned banks in the total number of banks ranged from only 9 per cent in Russia, and 49 per cent in Turkey to over 60 per cent in Hungary, Bulgaria, Poland, and Romania in 2008 (EBRD 2009). In the EEEs, except Russia and Turkey, the foreign banks have also owned the majority of assets in the banking sector (over 70 per cent in 2008).<sup>14</sup> As Berglöf and Bolton (2001) argue, by the end-1990s the financial systems were characterized by primarily foreign-owned commercial banks, which gave credit predominantly to the government. Companies at the time, received the bulk of the finance from their retained earnings.

From 2000s on there has been strong credit creation towards the private sector, whereby the borrowing dynamics of households in the EEEs seem to have been particularly pronounced. Foreign banks in Poland, as well as the other EEEs of our sample (excluding Russia) were the main providers of credit to the private sector. We can call this type of financialization ‘foreign-finance-led’. To a large extent denominated in a foreign currency (the Euro or the Swiss franc), the increase in debt led to financial distress of the households that had to take over the exchange rate risk of the foreign-currency debt (Bohle 2014). Mortgages denominated in a foreign currency were particularly attractive because they offered lower interest rates, less stringent assessment criteria, and had longer duration than mortgages in a domestic currency (Büdenbender and Lagna 2019).

Financialization in Russia, however, was not primarily driven by foreign capital inflows. Big role in the process of financialization has been played by the government. We can call this type

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<sup>14</sup> In Hungary, Bulgaria, Czech Republic, Croatia and Romania, foreign-bank assets made more than 80 per cent of total bank assets (EBRD 2009).

of financialization ‘state-led’ financialization. Let us elaborate on the Russian state-led financialization in more details.

Already in the mid-1990s there were recommendations by the IMF and the World Bank within the Washington Consensus policy package for Russia to follow the path of deregulation (Gilman 2010: 262–3). In 1997 and 1998 the capital account Russia started liberalizing the capital account, but only partially and primarily in the sphere of short-term government bonds, which was transitory because of the financial crisis that hit Russia in 1998. In the 2000s and especially between 2006 and 2008 Russia experienced strong increase in securitization. Nevertheless, as the global financial crisis of 2008/09 started spreading over the Russian territory, the government turned towards a policy of re-nationalization of banks, which could be interpreted as a:

(...) shift away from strengthening market institutions towards heavier government intervention. Aven (2015: 37)

The process of re-nationalization of banks was accelerated in 2014 as a result of the conflict that arose between Russia and Ukraine, when the former annexed Crimea.

The financial sector in Russia is highly dominated by the government and the Central Bank of Russian Federation (CBR). Hence, CBR has a dual role of a regulator and a partial owner of shares in the banking system in Russia (BER 2021). Commercial banks play an important role of accumulators of foreign currency through export revenues of their corporate clients, which the central bank needs for its foreign exchange reserves. Through commercial banks, the central bank and the government are involved in the allocation of credit, which can be politically motivated (Büdenbender and Lagna 2019).

Between the central bank and commercial banks there is one more important pillar in the banking system, which are the state-owned banks. Similar to China, state-owned banks make the bulk of the Russian banking system (Sutela 2012: 168–77). Over 55 per cent of the assets in the banking sector in 2019 belonged to the four largest state-owned banks (Sberbank, Gazprombank, VTB, and Rosselkhozbank). Assets of the state-owned banks in total made up over 65 per cent of the total banking sector assets (Bofit 2019). The largest state-owned banks are also the first ones that receive financial assistance from the government in times of crisis.

They act as agents of the monetary authorities in supplying credit, channeling liquidity into the system, bailing out weaker institutions, setting a politically desirable price level for loans and deposits, and supporting the money exchange and even the stock market. (Vernikov 2012: 257).

Overall, in the years of economic expansion, which are strongly correlated to oil price increases and rise in export surpluses, the government accumulates substantial foreign exchange reserves that are then used to bail out large private companies via state-owned banks (Viktorov and Abramov 2015).

Another important mechanism through which the government is involved in the process of financialization is through the state-owned Agency for Housing Mortgage Lending (AHML). In times of crisis AHML bought mortgage-backed securities and covered banks from commercial banks to 'free up their accounts' (Büdenbender and Lagna 2019: 112). Moreover, AHML has served as a vehicle for social policy for the government through which it gave preferential housing loans to socially vulnerable groups.

Other agents through which the government is involved in the process of financialization in Russia are Vneshekonombank (the state development bank), ASV (the deposit insurance agency) and various state-owned companies that were in charge of rescuing failed private banks after 2008 and 2014, using government funds (Vernikov 2012).

## **7. Conclusions**

In this paper we analyzed the dynamics of financialization in selected countries in emerging Europe and compared them with the developments in the Anglo-Saxon countries as some of the most financialized countries worldwide. The focus of this paper was on the decade before and the years after the financial crisis of 2008, including the latest course of events caused by the Corona-pandemic.

After providing an overview of the financialization literature related to emerging countries, the paper looked into some of the most important factors that contributed to the spread of financialization in the EEEs. During the transition period, these countries adopted trade liberalization, and financial account liberalization policies, as a result of which foreign financial flows rose and so did the entrance of foreign banks in these countries. It was found that EEEs particularly Hungary, Bulgaria, Croatia, and to a lower extent, Czech Republic and Poland experienced strong financial inflows and an accumulation of foreign liabilities. In the late 1990s Turkey was given as an example of boom-bust cycles and high volatility of capital flows, with episodes of high capital inflows that increased the vulnerability of its financial system, caused an appreciation of the currency, and resulted in financial crises. Russia was relatively less exposed to foreign finance. In Russia the government is an important factor for the development of financialization either in a direct (as a majority shareholder) or in an indirect way (banks controlled by state-owned companies and banks).

One can say that financialization in EEEs developed in a heterogenous way. There is a difference between countries in terms of the intensity of financialization dynamics portrayed through the financialization indicators. As a whole, the financialization in the EEEs was less intensive than in the Anglo-Saxon countries. However, the debt dynamics of the EEEs were more pronounced than in the latter, which raise concern about the fragility of their financial systems, particularly amidst the Covid-pandemic, when the households, the NFCs, and the governments saw their debt-to-GDP ratios rise. Government debt in particular increased strongly in 2020 and 2021 as a result of the rising expenditures and reduced public revenues. Hence, even though the level of debt relative to GDP has been low compared with the UK or the US, the debt dynamics over time need to be carefully approached and monitored. The level of external debt of the EEEs is important to be considered as well. Their external debt is increasing and is primarily denominated in a foreign currency, which increases the danger of currency mismatch and financial crises.

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## **Appendix**

### List of abbreviations

Emerging European economies	EEEs
European Bank for Reconstruction and Development	EBRD
Foreign direct investment	FDI
International Monetary Fund	IMF
Non-financial corporations	NFCs
United Kingdom	UK
United States	US

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