REVIEWS

A NOTEWORTHY BOOK ON THE FINANCIAL CRISIS AND PERSONAL FINANCE

DOI: 10.18267/j.pep.524

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Luboš Smrčka. The Great Global Crisis and Family Finance

Cambridge: Melrose Books, 2013. ISBN 978-1-907732-74-4.

Luboš Smrčka's book, *The Great Global Crisis and Family Finance* (Cambridge, Melrose Books, 2013), should be read by all who are not indifferent to the money they earn or manage. Luboš Smrčka, an associate professor at the University of Economics, demonstrates unusual erudition and contributes numerous valuable insights to the area of family finance. The economic public should devote special attention to the book.

The book consists of nine chapters. The first part analyses the origin of wealth. The second part draws attention to the limits of human behaviour. The third part discusses the indebting of families. The fourth part analyses lending and the position of the creditor. The fifth part discusses the phenomenon of our time – risk. The sixth part depicts family finance as an economic and moral problem. The eighth part analyses asset markets. The ninth part concerns investing.

The book is exceptionally topical especially today, when we are recovering from the economic crisis. The true meaning of Smrčka's book is a change in the mentality of people in developed countries. This change entails a shift from consumption (continuous use) to accumulation and creation of personal wealth. This moral appeal – relatively unusual among economists – makes Smrčka's book a true delight to read.

According to Smrčka, the main issue is not how to invest, but how to create the greatest possible resources for investment. Whether we deposit money into a bank, into shares, mutual funds or real estate is of secondary importance in these times. It is far more important to adjust one's thinking and understanding so that the primary task is to bridle one's passion for spending and acquiring goods which are of little or no use.

According to Smrčka, work is always the mother and father of wealth. It is noteworthy that, among the truly wealthy people of this planet, we find almost no scientists, no economic theorists that would become wealthy thanks to the use of their model knowledge in practice. There are certainly none in the top ten, certainly not in the top one hundred, and who knows whether at least one would be found in the top one thousand of the wealthiest mortals.

Smrčka's book is a valuable contribution to the analysis of the financial crisis. The total reduction of wealth among the most successful of people during the financial crisis is estimated at 20–30%. The drop of wealth in Asia was markedly different to that of the

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United States or Russia, for instance. During the crisis, the wealthiest people lost their property in the same way as did the representatives of the middle classes. Cynically put, the smallest loss was incurred by those who had nothing.

Czech investors fared relatively well in the crisis in comparison to West Europeans. Their distrust towards bonds and shares spared them from greater losses. The emphasis on bank deposits and pension insurance may incur certain losses at this time, but in comparison with the wild fall of markets and funds, these were relatively quiet and stable investments. According to Smrčka, the average Czech family therefore did not lose more than 5% of financial assets through the influence of the crisis.

Smrčka recommends diversification of investments both from the perspective of fields and regions, from the perspective of the actual type of investment and, finally, from the perspective of liquidity. All suicides connected with the financial crisis were the result of previous errors in investments. In the same way as the Christian should abide by the Ten Commandments, the investor – whether a professional or an amateur – should abide by several elementary rules of caution and financial safety.

Although financial education does not ensure wealth in any way, it can help to prevent problems, excessively high risk, hazards or a fall into the abyss. Caution and healthy scepticism to one's own possibilities and abilities, a conservative point of view on matters – none of these can earn anyone so much as a crown. According to the author, however, these abilities can save the entire family fortune.

According to Smrčka, roughly 30% of families regularly have at their disposal surpluses that can be systematically managed in a meaningful way. The remainder is satisfied to arrive at a situation which we term *a balanced budget.* Of those who purposefully manage finances and generate investable surpluses, many families focus on short-term goals, such as saving for a new motor vehicle.

The division of individual societies into those groups that are able to save and those who are, by contrast, unable to put aside practically anything or nothing at all is very similar in the majority of countries. Household debt is growing in developed countries. The burdening of families with debt service in old EU countries is substantially greater than in the new ones, both nominally and in proportion to the whole, despite the fact that family incomes in the West are far higher.

According to Smrčka, it is not incomes, but expenditures that make up the decisive component of the family budget. The road to greater family wealth and a secured future has to be embarked upon by initially subjecting expenditures to a hard and uncompromising analysis, after which we ascertain the amount of reserves we are in fact able to create. Smrčka recommends setting expenditures in such a way that they do not exceed 75% of regular (average) income.

The main problem of world economy prior to the commencement of the crisis, according to Smrčka, was the massive extent of state intervention into various areas – especially in the area of mortgages. This led to a gradual deepening of imbalances. In view of the fact that the whole mortgage system in developed countries was, in principle, covered by government guarantees, the willingness to perform operations that would be unthinkable and inconceivable in other areas grew.

Government protection of the whole system thus created an imbalance in the real standard of living for many families which could afford housing "on debt" of a much higher standard than what corresponded to their real economic standing. At the same time, it enabled a masking of risks that were connected with trading in derivatives derived from the above-mentioned mortgages and, ultimately, from other loans and financial obligations.

Smrčka analyses the investment triangle: risk, liquidity and profit. Personal finance, invested family wealth has to be diversified, both from the perspective of risk and from the perspective of investment liquidity so as to correctly combine riskier methods that have high yields with absolutely safe procedures that have low yields, as well as immediately accessible investments with investments that are necessarily long term (and therefore of low liquidity).

It is the wish of every investor and household to be victorious over inflation. Inflation is subtle and creeps, constantly corroding investments thereby. As long as the state and political decisions do not enter the picture, it is relatively easy to win over inflation, given a correct investment strategy. However, when suspicious laws begin to appear there is only one defence, and is to transfer finances to goods, usually to gold, art objects or real estate.

This seems needlessly discouraging or threatening at the first glance, but Smrčka warns us that all developed states or, more precisely, almost all developed states can find themselves in a situation that is at least distantly reminiscent of that of the Roman Empire or the Weimar Republic. Post-war inflation in Germany and Russian hyperinflation during the civil war left tens of thousands of real physical victims and tens of millions of pauperized people in its wake.

As far as shares are concerned, the only thing that can be said about them with absolute certainty is that their value will fluctuate in the future. Shares copy the GDP or, perhaps more precisely: the GDP copies shares. Shares therefore grow in the long term, as does the GDP, but are subject to similar cycles that accompany the economy as a whole. Smrčka doubts that shares are neutral to inflation. Shares are a defence against hyperinflation, but not against mild inflation.

Smrčka's analysis of indebtedness is the most prophetic. Lending (to families) in our sense of the word (*i.e.* accepting credit as something absolutely normal which does not deviate from daily norms) is a new phenomenon which the developed democratic world has known only since the Second World War and, in countries of the former communist bloc, since the 1990s. One of the greatest mistakes, according to Smrčka, is to assume that incomes will always grow.

According to the author, there is a difference between a loan intended for investment, *i.e.* for future productive activity, and a loan for consumption – for the purchase of goods, for a quick raise of one's living standard, *i.e*. an unproductive loan. The idea of a consumer loan as a sin is not at all bad – quite the contrary. It is for shame that entire masses of inhabitants in Europe and the USA have not conducted themselves according to this guideline in the past few decades.

Perhaps the growth of economies in the last few years would not have been in any way dazzling or remarkable, many tens or rather thousands of flats and homes might not have been built, but the general development of the world economy would have been more systematic, logical, and we might not have had to experience the global economic crisis, at least not in this form. There is something to the adage, "We buy goods which we do not need for money which we do not have".

The book brings forward numerous insights into family finances, as well as to public finance. Governments will have to repay not only their old debts, of which a great many were still prior to the crisis, but also new liabilities, which entails the necessity of savings in expenditures as well as the amount of incomes. These incomes will to a certain extent be generated by the growth of the economy, which must come; besides this, however, the necessity to repay will elicit pressure on the increase in taxation.

Smrčka holds that democratic capitalism is undergoing an identity crisis which lies in the demographic crisis, the pension crisis and the crisis of trust in the system. Indebtedness is always a problem. A paradoxical situation emerges, in which states where there was always practical certainty that they would meet their obligations are now creating debts so enormous that they cannot be repaid and the repayment of which cannot realistically be expected even by the creditor. We should read Smrčka's book carefully.