Consumer Credit in Post-Communist Countries

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Abstract

The 1990s and early 2000s saw an increase in consumer credit world wide but nowhere was this rise as spectacular as in post-communist countries. Starting from virtually nothing under communism, consumer credit took off only after the institutions of a commercial banking system were put in place and the countries climbed out of the economic recession that followed the collapse of communism. Since then, consumer credit began to emerge as a new force undergirding social order. The paper describes the rapid rise and the current crisis of consumer credit and its social consequences.

Introduction

From the end of the 1980s, consumer credit grew at a rapid pace all over the world. In OECD countries, just in the last five years of the last millennium household debt as a ratio of household income rose from 78% to 96% (Christensen and Mathiasen 2002, Babeau and Sbanu 2003). The process, often referred to as the “democratization of finance” spawned new types of financial services and expanded credit to new and less affluent segments of the population. An extreme and ultimately disastrous example of this evolution was the subprime mortgage market in the United States that most likely brought to an end two decades of credit rapid credit expansion.

Consumer credit in the affluent part of the world became a crucial pillar of middle class prosperity. As the welfare state retreated to attending to only the poorest layers of society and withdrew its services from the middle classes, societies had to find new ways to redistribute money and wealth so that their consumer economies could still prosper. Middle class families who now had to pay for services previously provided by the state and whose incomes did not keep up with their rapidly growing expectations needed new ways of accessing homes, vacations, cars and expensive electronics. Just as the welfare state, the system of credit redistributes resources with strings attached. Credit, just as welfare, is a complex bundle of entitlements and constraints, rights and responsibilities, administered through a bureaucracy. In both cases, money of some part of the population is reallocated to others, but this time money is not taken by direct or indirect taxes but by deposits, investments and interests collected, and it is given out not as entitlement but as loan to be paid back with interest. Resources are not priced by policy makers but by markets or cartels of lenders, they are not distributed in welfare offices but in banks, and conduct is not monitored through forms citizens must fill out and submit periodically but by near-real-time information technology that can track millions of accounts and transactions. To build this new system of redistribution took time. Because it is less centralized than the welfare state, its evolution was more Darwinian selection through diversity than planned development. Because it grew in an incremental fashion it had to build on existing forms.

With the collapse of Communism, it seemed the age of the intrusive, behemoth state ended. Markets were advancing as the new solution to every conceivable distributional problem in society from education to healthcare, from environmental degradation to poverty. The retail credit market looked just exactly the kind of institution that the new era needed to replace state functions in the realm of economic redistribution.

The rejection of the welfare state and the embracing of the market were nowhere as dramatic as in the post-communist world, yet for reasons peculiar to the post-communist transition, retail credit markets found their footing only in the last years of the millennium. But once they did, they flourished with gusto. Until 2008, consumer credit in East and Central Europe was growing fast. In all major cities in the post-communist world, from Sofia to Warsaw, from Moscow to Bratislava, advertisements for mortgages, car loans, credit cards, and purchase credit were beaming from billboards. Even in post-communist Asian countries, such as China and Vietnam, consumer lending was seen as the new frontier in financial services.

The contrast is impressive. A few years ago, banks in post-communist countries were still complaining that their culture was hostile to borrowing. One of the pioneers of credit cards in Poland, when asked about the biggest obstacle she had to overcome responded this way:

"[Credit] is also a little bit against the -- not only Polish, because it's all Slavic countries, rather Christian countries, -- against this mentality, it is not like Protestant countries like the United States where it is normal to live on credit, so you work and earn to pay for your credit. In Poland this is the opposite. We live and earn to pay any expenses. … first money then expenses, and to change this mentality into more an American or English way, it's a quite difficult job, this is the most difficult job."[Interview Warsaw 04/22/04)

Whether it was rooted in religion or historical experiences with economic hardship or simply in general pessimism, the particular explanations for the anti-debt culture are less important than the widespread perception that there was a deep cultural resistance to debt. It took just a few years that the very same bankers began to worry about over-indebtedness (Duenwald et al 2005, Coricelli et al 2006, Backe et al 2006, Barrell et al 2009) as reluctance to borrow quickly melted away. While a large literature in economics is devoted to the sustainability of this credit expansion, there has been relatively little reflection on the way consumer credit reorganizes social relations between lenders and borrowers and in society in general.

We will first give a short review of the origins of consumer credit and the literature trying to tackle its social significance. Then we turn to the history of consumer credit in post-communist Poland, Hungary and the Czech Republic. We describe the current state of consumer credit these countries and explore how lenders make decision and build social order. Finally, we address the some of the social consequences of the new system of consumer credit.

Literature Review

While the consumer credit boom spread in the world in the last two decades its roots go back to the 1920s in the United States (Olney 1991, Calder 1999) where technological advances created a new form of consumption. As electricity became a normal staple of middle class households a series of new big ticket items appeared on the market from refrigerators to washing machines. Together with the mass produced automobile and new forms of housing construction, these consumer durables created a new lifestyle that required households not just to make ends meet but to make major investments into their own operations, just as companies do. The boom was cut short by the Great Depression but returned in full force by the post-World War II years. This was the time when a new form of consumer finance emerged. Until then, banks took deposits and gave loans for “productive investments,” mostly to entrepreneurs. Consumer credit existed primarily in its social form as people borrowed from friends and family or ethnic or religious societies and mutual aid associations. They could also take advantage of store credit or purchase credit from manufacturers who often offered installment plans on expensive acquisitions such as pianos or sewing machines. If all else failed, people turned for loans to the margins of society and sought out pawn brokers and loan sharks. One provider of consumer credit that was conspicuously missing from this list was the bank. Banks were preoccupied with lending to businesses engaged in production and considered consumer lending disreputable.

Nevertheless, the idea that production needed effective demand, and buyers were as important for a market to prosper as producers was one of the big lessons of the Great Depression. To create this demand a new system of consumer credit had to emerge. The novelty of this new system was the rationalization and impersonalization of credit with banks taking the lead role.

From the beginning, there have been speculations about the social consequences of consumer credit: one that focused on the abuse and use of new opportunities credit opened up for consumers, and another fixated on the new obligations incurred by borrowers. In the first category, a pessimistic, conservative stream castigated consumer credit as a force undermining the Protestant work ethic, paving the road to decadence and by corrupting social virtues the demise of capitalism (Galbraith 1958, Lasch 1979, Tucker 1991, Bell 1976). Ironically, this criticism echoed some of the concerns of Marxism that castigated mass consumption society for duping people into mindless individualistic materialism with relentless advertising and ideological manipulation, a critique regurgitated over and over by party ideologues in communist countries. The optimistic view of mass credit on the other hand, pointed to its equalizing, democratizing effects; the way borrowing can soften class boundaries in consumption and allow a large part of the population to join the propertied middle classes (Boorstin 1973). This sanguine approach perceived the new opportunities not as sinister seductions but as the economic fulfillment of democracy and was revived in recent years under the label of the democratization of finance (Shiller 2003, Greenspan 2005, see also Erturk 2007).

The obligations inherent in credit were the center of the second set of contributions (Manning 2000, Ritzer 1995, Galanoy 1980). Some authors have been concerned about unscrupulous lenders luring people into borrowing beyond their means and pushing them into a vicious cycle of debt (Medoff and Harless 1996). Others raised larger issues of social order and governmentality pointing to new forms of social control achieved through credit and creditworthiness (Langley 2007, 2008, Marron 2007, Leyshon and Thrift 1999) . Most of the theoretical literature wrestled with developments in the mature, capitalist, Anglo-Saxon world, namely, the US and the Britain. [1]

History

Consumer credit has had a peculiar history in post-communist countries. It is only a slight exaggeration to claim that consumer credit started with an almost tabula rasa after communist rule ended. Under communism, consumer credit was virtually non-existent. In the early years of extensive industrialization, all savings were funneled into production. The need for capital accumulation channeled as many resources as possible toward the creation of investment goods at the expense of consumer items. Asceticism was extolled, and consumption was acceptable only as a just reward of productive work.

From the outset, anti-consumerism of these regimes lived in tension with the big promises of improving living standards for the working people. In the early years of Soviet and Chinese communism there were concerted efforts to develop an alternative model of communist consumption based on collective appropriation favoring communal living over family homes, public transportation or a municipal car rental system over individual car ownership (Hunter 1966), organized vacations for work communities over individual and family tourism etc. (Gorsuch 2003). Yet these efforts failed and communist economies did not succeed in developing a radically different and viable alternative. By the 1960s in East and Central Europe and three decades later in China, socialist leaders resigned themselves to delivering

[1] Recently, there has been several studies investigating the link between civil society and credit, with a focus on public debt or the flow of credit between countries (Ferguson 2001, MacDonald 2003, MacDonald and Gastman 2001, Centeno 2002).

their population a material life style not radically different from the one in advanced capitalist countries, one that revolved around home ownership and consumer durables, such as housing, cars, furniture, televisions and refrigerators.

Housing, the pivotal consumer good around which most other consumer activities are organized, was a central concern for the socialist state, one that it struggled hard to manage (Szelenyi 1983). The industrialization of these countries required to move masses of people from the countryside to industrial centers, which coupled with the devastation of World War II created an enormous housing shortage. Housing became distributed in two separate systems: in the countryside, most people owned and built their house with their house often with their own hands and help from family and friends (Sik 1988, Kenedi 1980). In cities, the state was erecting rental units that it distributed by bureaucratic criteria. Those participating in this second system did not need credit. Those in the first one could not afford it.

The appearance of individually appropriated household consumer durables brought with it well –known technique of installment payment extended by the state run retail chains although people were still encouraged to save first and buy later. There were personal loans some companies provided for their employees on extraordinary occasions (death in the family, sickness) or for certain special purposes (housing). But by and large, consumer credit was unusual, most people never borrowed except through family and friendship ties. As state socialism progressed, differences among countries became accentuated in terms of the role political elites allowed consumerism to play in the daily lives of their citizens. By the 1980s, Poland and Hungary were the most liberal in this respect, even if post-Solidarity Poland was scarcely a consumer paradise. Czechoslovakia, with its strong traditions in manufacturing, still had many goods to offer compared to countries like Romania, Bulgaria or the Soviet Union. More importantly, by the last year of communism the three Central European countries conducted over half of their foreign trade with capitalist economies (Rodrik 1992), while other communist countries traded primarily with their socialist brethrens. This created a measure of economic openness in Central Europe that brought in foreign goods and life styles. By the 1980s, travel from communist Hungary and Poland was much easier than from the other countries in the Soviet Bloc. Taking advantage of their privileges Hungarians and Poles would routinely travel on shopping trips to neighboring Western countries (Borocz 1996, Wessely 2002).

Banking

Yet, at the core of socialist consumerism was to buy goods with money already earned. One made money first and paid the purchase in full. Consumer credit was therefore rudimentary and this was reflected in the simplicity of socialist financial services. All financial services were in state monopoly. Each country had its own large mono-bank, which had various specialized branches attending to particular tasks in the financial system. One branch handled foreign trade, the other large investment projects, yet another would attend to residential services. These branches were coordinated by the central bank. The central bank was also in charge of the domestic currency and the accounts of state firms. The financial system was strongly controlled by the state and it was subordinated to the needs of central planning.

Banking for individual citizens was managed by the state savings bank. The only form of investment available for individuals was through savings accounts in the bank that paid a modest interest determined by the state [Kornai 1992 p. 134]. Consumer credit the bank provided was very limited. One could apply for a housing loan or in some countries for credit for installment purchases of such consumer durables as cars or furniture. Interest rates were set centrally, and payments were deducted from one's pay if the installments were not delivered in time. Because both the bank and -- in most cases -- the employer were state companies this was easy. Collecting payments involved transferring money by the state from one of its pocket to another. Households unlike state enterprises that could always ask the state to lend them more money had to live under hard budget constraints (Kornai 1980).

The creation of a new financial system began in Central Europe in the last years of communism. The mono-bank was broken up and a two-tier system was built with the central bank being the first tier and a large number of commercial banks forming the second. The new commercial banks were born with enormous millstones around their necks. They all had a large amount of bad debt from socialist firms that had been doing poorly even before the collapse, but were taking an even bigger dive during the transition.

Credit in the first decade

Creation of Commercial Banking

In all three countries the post-communist retail market began with the dominance of a single giant communist savings bank. The savings banks originally the retail arm of their respective socialist mono-bank, became independent as each country began its bank reforms in the waning years of communism. In socialist Hungary the bank that managed domestic banking for individuals was the Országos Takarékpénztár (National Savings Bank) or OTP. For most Hungarians the word OTP was synonymous with the word "bank." A bank account was an OTP account, bank credit was OTP credit and older people still use it today in this sense even if their account or loan is now with a different bank. Commercials for OTP in the 1970s and 1980s were public service announcements exhorting people to save. OTP was not a business but a government agency with both management and educational functions installing proper financial habits in citizens. Similarly, in the Czech lands of communist Czechoslovakia it was Česká spořitelna (Czech Savings Bank) or CS and in the Slovak lands its sister bank Slovenská sporiteľňa dominated the retail market. In Poland, Powszechna Kasa Oszczędności (General Savings Bank) or PKO, was in charge of most of retail banking. In Poland, however, there was a second, albeit much smaller bank, Bank PEKAO, that played a limited but important role as the foreign currency bank and developed a network of offices in all the major cities in the country serving a sizable clientele.

Reflecting the history of agricultural collectivization under socialism, Hungary and Poland also had a sprawling network of rural credit coops that survived during communist rule. In Poland, credit coops were unified in 1975 under a single organization named Bank Gospodarki Zywnosciowej (BGZ) while in Hungary they remained local until 1989. Yet these rural savings and loans had a particular clientele. Their typical customers were peasants and agricultural workers whose financial service needs centered on agricultural production and residential construction. After 1989, sitting on a special, loyal and mostly older clientele, rural coops were under no pressure to venture into new areas of financial services even if a few local branches did show some entrepreneurial spirit on a small scale.

In 1989, the three giants, OTP, CS and PKO, had the vast majority of the residential accounts of their respective countries, which offered them a large amount of information that newcomers did not have. Their customers were also captive by sheer inertia. People were used to the state savings bank and trusted it because of its size and because of the general belief that the state stood behind it. Size also meant convenience. Through their large network of branches the giants could provide access that was easier than what small upstarts could offer. In all three countries, initial bank reforms aimed to eliminate this monopoly but shrinking the immense advantage of the giants turned out to be more difficult than expected.[2]

Finding a foothold next to the national giant was difficult. Between 1995 and 1999, industry concentration measured as the total assets held by the top three banks was 72 percent in the Czech Republic, 57 percent in Poland and 53 percent in Hungary. Yet, this understates the strength of these banks. In Hungary, OTP was by far the largest and the second and third (K&H and MKB) followed at a distance. In the Czech Republic, the top three banks (CSOB, CS and Komercni) were closer in size; hence the three had a larger share of the total. [3] This concentration has been slowly eroded by privatization and the entry of foreign owned banks with deep pockets but it took time for that to happen.

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[2] One early entry to this market in all three countries was the Postal Service that created a Post Bank. Posta Bank in Hungary, Investiční a poštovní banka (IPB) in the Czech Republic and Bank Pocztowy in Poland were launched to take advantage of local post offices as an instant nationwide system of bank branches. The Post Office had already handled many financial transactions. It delivered pensions and welfare payments to the population and most payments by the population not discharged in person from utility bills to subscriptions. In Poland, to create Bank Pocztowy the Polish Post joined forces with none else but PKO as a minority owner. Bank Pocztowy has remained a small player in Polish retail banking. In the other two countries, the Post Banks stayed independent and grew but each eventually failed spectacularly, even bringing their entire national banking system to the verge of collapse, and were bought out eventually by other banks.

[3] The concentration looks more pronounced if we look at retail banking. In Poland, PKO has 35% share of the retail market, followed by PEKAO with 18% and BZ WBK with 9% is a distant third. In Hungary, OTP has 38% of household loans and 44% of all deposits followed by K&H with 10% and 14%.

Privatization

The central policy of the market transition was privatization. Turning over property owned by the state to private owners seemed the best way to get a market economy off the ground. The privatization of the banking sector happened differently in the three countries but in the end, each emerged with a banking system owned predominantly by foreign financial institutions. Hungary, that piled up a large foreign debt under the last two decades of communism, privatized by selling its newly created state banks to foreign financial institutions and used the revenue to pay off its debt. By the end of the 1990s, two thirds of Hungary's banking assets were in foreign hands and in a few years, all major banks were foreign owned except for the largest one, OTP, that was taken to the Budapest Stock Exchange and still has a large domestic ownership share.

Poland also had to contend with a large foreign debt but had the option of renegotiating much of it, and consequently, the pressure to sell was less urgent than in Hungary. The Poles took their time and by the late 1990s their banking system was still dominated by domestic banks. In 2000, however, just in one year, the share of foreign ownership rose to over 70%, after PEKAO was sold to an Italian and Austrian consortium and another bank, BZW, was purchased by an Irish investor. In 2004, PKO, just like OTP, was taken to the stock market but the state treasury kept 51% of the shares.

The Czechs initially took an altogether different route. Their banks were partially privatized through their voucher privatization program. This handed tiny packets of shares to hundreds of thousands of Czech citizens. The state, holding on to a large share of these banks, took over their bad debts and deposited them in a new "bad" bank (Konsolida*ční* Banka) created as a dumpster for toxic assets. The Czech banking system was considered the best and healthiest in the region until 1997 when it got revealed that the banks were saddled with new bad loans that had been covered up by accounting tricks. A series of bank failures that followed brought about a second wave of privatization which started in 1998 when the collapse of the

IPB forced the Czech government to sell it to a Japanese investment firm.[4] This opened the door to what earlier Czech governments wanted to avoid at all cost, the transfer of all the major banks to foreign financial institutions. Soon, all the other big banks, CS, Komerční and CSOB, were put up for sale as well. In 2000, CS was bought by the Austrian Erste Bank which also owns the Slovak savings bank, the Hungarian Post Bank and a major bank in Croatia.

The arrival of foreign banks brought new capital and know-how to consumer credit and forced the post-communist giants to innovate. For understandable reasons, the giants tried to hold on to their initial advantages as long as they could. They dragged their feet on most measures that required cooperation if that gave their competitors some advantage. For instance, the creation of a bankcard infrastructure was hampered by the fact that each national giant wanted to be the main operator charging others as users. The creation of a credit registry was delayed by the reluctance of OTP, CS and PKO to share information about their large clientele with other, smaller banks. The duration of this lack of cooperation in the three countries was a direct function of the relative size and strength of market leader. The Polish giant, PKO was the first to abandon its strictly competitive position partly because its market share was smaller than that of OTP and partly because state ownership put pressure on it to agree to cooperative measures that seemed necessary from the perspective of the Ministry of Finance that had to consider the health of the entire banking system. CS became largely autonomous from the state thanks to voucher privatization and was uncooperative until it was acquired by its foreign owner. OTP held out the longest. Like PKO, it managed to avoid being sold to another bank, but at the same time, its chief manager, who originally was appointed by the government as a caretaker also succeeded in cutting loose from the state as an owner as it expanded aggressively, acquiring large banks in Bulgaria, Slovakia, Serbia, and Romania and smaller ones in the ex-Soviet Union.

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4 The Czech Post Bank was ultimately taken over by CSOB which by then was in the hands of the Belgian KBC.

Valley of Tears

The lack of cooperation among banks in creating the infrastructure of financial services was only one reason why consumer credit did not emerge for several years. There were strong, macro-economic reasons that retarded the growth of consumer lending as well. The collapse of communism ushered in a period of severe economic hardship. In peace time these countries did not see a recession this deep since the Great Depression of the 1930s. Hungary, the Czech Republic and Poland lost 15, 12 and 7 percent of their GDP respectively.[5] Poland returned to its 1990 level by 1994, it took the Hungarians eight years, the Czechs ten.

Unemployment, virtually unknown under communism shot up after 1990. In Poland, it was in double digits for most years ever since. The Czech Republic and Hungary also suffered from high unemployment but kept it under 10 percent. Yet these numbers are misleading. The job loss was bigger than unemployment figures suggest because many people were let go into early retirement (Vanhuysse 2006), others just fell out of the official economy, yet others postponed entering the labor market by extending their time as students (Nesporova 2002). During the first decade of the transition, wages for those lucky enough to keep their jobs did not increase much either. Inflation was high except for the Czech Republic. Declining real incomes, high inflation and increasing economic insecurity were serious impediments for the consumer credit markets.

From 1990, the three countries followed different paths but the dynamic of the transition overall has had a common pattern. After the initial decline, we see a turnaround at the middle of the first post-communist decade. Economic growth began to slowly trickle down to the population in the form of higher wages. Along with wages, inflation was also brought under control and unemployment stabilized. Without these positive developments, consumer borrowing would have not emerged. Yet the general upward trend covers great inequalities as not everyone shares in the fruits of economic growth. Entire regions are left out of the improving living standards. In all three countries, the eastern regions have experienced much

[5] There is some debate about how the accounting system used under socialism can be made comparable to the calculations used now and based on market prices, therefore the exact numbers are in dispute. What is, however, not in dispute is that there was a large drop in the GDP.

less growth than the Western parts or the areas around the capital cities. Certain age groups fell behind. People who were in their late forties in the 1990s and lost their jobs were unlikely to find commensurate jobs in the new economy. Unless they could take early retirement, they found themselves in dire straits. Some ethnic groups, most importantly the Romas, missed out on increasing prosperity and stability entirely. National politics with its strong left/right populist parties in all three countries reflects the unevenness of economic growth and so does the consumer credit market.

Consumer lending

Consumer lending grew everywhere in the region and the upturn happened between 1998 and 2001 (Figures 1,2). The countries have moved in unison rising slowly first and then growing at an ever faster pace. Hungary has the largest household debt to GDP ratio, Poland the Czech Republic follow with similar figures. In all three countries lending began with consumer -- mostly car and other purchase --loans but soon, mortgages began to dominate (Figures 3,4,5). Much of the expansion in the last few years was led by housing loans but consumer loans remained an important part of a household's growing debt portfolio.

In Poland and the Czech Republic the housing market kept pace with economic growth. In Hungary, the mortgage boom began in 2001 with a set of policies by the center right government that included interest rate subsidies for mortgages along with grants for young couples with children to build, expand or buy housing, a VAT relief for new housing and stamp duty waivers. These policies were substantially curtailed by the next, socialist government at the end of 2003, but the boom continued as borrowers discovered foreign exchange (FX) denominated loans that carried lower interest rates. Around that time, borrowing in foreign exchange, mostly in Euro, Swiss Franc and USD became wide spread practice in Poland and the rest of the region except in the Czech Republic and Slovakia (Figure 6.). While foreign denominated loans were cheaper they created an additional risk for borrowers that few of them fully understood: the risk of an adverse change in the exchange rate between the domestic currency and the one in which the loan is denominated. Indeed, both Poland and

Hungary experienced a steep devaluation of their currencies. The Hungarian Forint dropped 20 percent in a few days in October 2008 as the international financial crisis reached the region. The Polish zloty also saw a decline in its value.

Housing prices have been falling in the entire region, and while loan delinquencies are rising, an American style collapse is unlikely because mortgage lenders have been a lot more conservative by requiring much higher down payments and by generally shunning home equity loans.

The distribution of the loans by income groups reveals that in the Czech Republic and in Hungary, people in the higher income deciles carry about the same debt burden as a proportion of their income as those in the poorer groups (Figures 7,8,9). That means that rich people receive more consumer credit from banks than poor people. In Poland, rich people take out smaller consumer loans relative to their incomes than poor people, which implies that the credit system there redistributes more credit to the worse off.[6]

Tiers of credit

The consumer credit market has three segments. The largest and dominant segment is operated by banks.[7] Below this, one finds the "fringe" with two layers: legally operating payday lenders and criminal loan sharks.

Formal Banking

VIP customers vs. normal customers

While banks operate a highly formalized and rationalized system of credit, each bank has a narrow circle of elite customers, who are handled through personalized private banking. These privileged clients usually hold large accounts with the bank, and do their transactions

[6] Loans to households also include credit to the self-employed. This might partially explain why Poland is different. It still has an agricultural sector that although shrunk since the end of communism, still is one of the largest in the EU and dominated by small private farmers who are poor but need loans for running their farms.

[7] We also include here leasing companies but for the sake of simplicity, we will limit our discussion to banks.

with the help of special personnel assigned to their case. Some clients are included on the VIP list because of their political power or celebrity status. The list can also include top managers of important corporate clients. For members of the VIP list terms are always negotiable, exceptions are possible and decisions are tailored to the specific circumstances. They do not have to stand in line, fill out forms or argue with tellers. Their special assistant will meet them at the private client's convenience.

The vast majority of bank clientele participates in a different world of bank credit and they are processed through a highly impersonal, bureaucratic and rationalized system. The regular client applies through providing standardized information by completing various forms. In some banks, the lending officer fills out the form after interviewing the applicant. The information is then partially verified using direct checking (e.g., calling the person's work place to find out if she really works there), cross checking (e.g., looking for inconsistencies in the information supplied by the applicant), and by obtaining authorized documents (e.g., paystubs) and by consulting external data bases.

Identifying

Each application form has two parts. One part is necessary to identify the applicant as a unique individual who is unlike anyone else and therefore can be found and held accountable for the loan. Identification tries to establish the unique characteristics of an individual. It looks for a set that has only a single element: the applicant. Identification makes the individual available for surveillance and sanctioning. All modern states have some form of identification for their subjects from passports and driver's licenses to social security cards and birth certificates (Torpey 1998, Rule at al. 1983). Before the French Revolution, people were identified by lineage, residence, status, i.e., various measures of belonging. Names, family and surnames, also follow this same approach. Modern state IDs, on the other hand, make an attempt to tie identity to biological characteristics of the body. The picture ID produces a likeness of facial features, height, weight, eye and hair color are noted, along with age (date of birth). None is unique individually, but in combination, they are likely to fit only one or very few individuals. Fingerprints, and more recently, iris and DNA recognition (features that require instrumentation to detect) have been added to the arsenal. Physical identification is useful only if the person is present but we don't know who he is. Modern states have a large network of contact points from airports and traffic checks, to offices like the department of motor vehicles or housing registries, through which people are constantly passing through. Those who show up then can be identified with the help of physical markers.

Credit files rarely contain pictures of borrowers and application forms never ask for eye color or height. Physical markers are unimportant, because the lender has a different type of identification problem. When there is trouble the borrower is unlikely to show up at the bank and the lender must find the delinquent customer. Under these circumstances, belonging is a better form of identification because it allows the bank to track down the missing borrower through his connections. Hence the importance of one's address and lenders prefer owners to renters because owners have a more permanent connection to their place of residence. This is why phone numbers are collected and why land lines are better than cell phones. And this is the reason to get the exact location of one's work place and why large and more permanent organizations are favored. This form of identification prizes the stability of the identifying relationships.

Sorting

The second part of the form is necessary to sort the client, to place her with similar others by looking for commonalities. This is crucial to establish the creditworthiness of the applicant. It happens by looking at the behavior of other members of her group who already have some payment record. Here the banks must use commonly accepted and recognizable systems of classification. Occupation, industry and education of the applicant are recorded with the aid of broad statistical categories. Income is entered using common assumptions about the way people receive monetary compensation. It is assumed, for instance, that there is certain temporal regularity in people's income flow (monthly or annual) and that monetary compensation is the only important measure of their income.

These assumptions matter. They matter for the applicant because the same person can end up paired with very different people depending on what system of categories and assumptions are used. An economist teaching at a university and consulting on the side with irregular but substantial additional income, can be sorted as a white collar worker, or as a teacher, or as a professional and his last monthly income may say little about his finances. The assumptions matter for the lenders as well. The better the sorting the better the lender can estimate the applicant's future behavior. In principle, the lender could devise its own, optimal categories but that would require precise instructions and definitions that the applicant would have to follow making the application unwieldy, long and error prone. Moreover, the lender would lose the ability to use data from other sources that mostly use conventional classification systems. To find out unemployment rates by occupational categories, the lender has to be able to match its occupational groupings with the ones used in official statistics.

Once the applicant is properly sorted there is a second sorting that takes place. With statistical tools, the bank establishes if the person is creditworthy or not, it sorts her into the "deserving" or the "undeserving" category. This is done by applying weights for each piece of information gathered about the applicant, and calculating a weighted sum expressing the likelihood that the applicant is deserving, and using a certain threshold above which the decision is positive.

Creating reputation

Dealing with people with whom one has not had sufficient personal experience requires a system of reputation. Reputation systems serve two purposes. They punish/reward bad/good behavior committed in the past and help others to avoid/seek out bad/good characters in future dealings. Historically, the information that built one's reputation was circulated through social networks (Landa 1995, Olegario 1999). In small communities, gossip, rumors, various forms of public branding (scarlet letters, pillory, special cloth etc.) transferred information about the character of certain people. These systems were always contested, and contained inconsistencies, conflicting and competing information, and there was rarely full agreement on who was good and who was unworthy.

Reputation systems are always about information sharing and collective memory. The reputation system in contemporary lending is embodied by the credit registries (also known as credit bureaus). Unlike in earlier reputation systems, the information in these registries is highly consistent. There are two kinds of consumer credit registries in Central Europe: those that collect and share solely negative information, and those that include the full performance record of borrowers. Because banks are competitors, information sharing about customers is not a simple matter. Information about clients is a valuable commodity that banks often acquire at a cost. Knowing who is good and who is bad risk is crucial for the bank's success in lending. Handing this information to other lenders cuts the bank's competitive edge.

Black lists and full records create different incentives for clients. The black list is an invitation for malefactors to switch identity and thus erase their record. The list contains only negative information, so getting off the list or not being recognized as being on it carries only benefits. Individuals can forge their documents or find proxy applicants for loans to free themselves from the burden of their history of bad conduct. Black lists make no distinction between applicants with perfect record and those with no previous experience. Full records, on the other hand, provide a full picture of past behavior and thus encourage people to "build" their reputation. This means that people must invest into their histories and cannot escape their past without penalty even if their change of identity goes undetected.[8] With the black list, "no information" is good information, with the full list, no information is not much better than bad information. Full records not just impose a different relationship to history on would-be borrowers than black lists, they also push actors to take on loans. Building a record means borrowing; building a *good* record means borrowing and paying promptly. So one must borrow (and pay) not just to afford a purchase but also to be able to borrow in the future. An additional advantage of full records is that they also allow banks to evaluate the total debt exposure of their clients.

[8] Unless, of course, they steal someone else's identity and history with it.

Full information credit bureaus for consumers are very hard to develop in transition countries because retail banking is highly concentrated. Big banks like OTP, CS or PKO have a lot to lose by sharing their vast amount of information with new, smaller banks which have very little to contribute to the credit bureau. Big banks would rather keep the information they have about clients and use it to their own advantage. Releasing information on good clients would be an invitation for the other banks to poach. Moreover, good clients could take their shining reputation and force banks to compete for their business driving the price they pay for their loans, and consequently the profits of banks, down. Information sharing about bad clients has a slightly different calculus. While there is some advantage for the big bank to withhold information about its old bad customers and see its competitors lose money lending to them,[9] there is also the benefit of punishing non-payers by shutting them out of the entire market by alerting other lenders. As a result, most transition countries have black lists, but only Poland and the Czech Republic managed to build a working full reporting system.

One law originally designed to address different concerns but that nevertheless has a strong effect on credit is the law on protecting personal data. Most, but not all, transition countries have strong laws to protect the privacy of personal information. Created in the aftermath of the collapse of Big Brother state socialism, people were eager to shelter themselves from an all-knowing state. Blanket data protection laws thwart the creation of credit bureaus because they prohibit the release of personal credit information to any registry without the explicit permission of the client. In all these countries, banks argued successfully that non-payment is such a gross violation that it forfeits the borrower's right to data privacy.

In Poland and the Czech Republic, where full record credit bureaus operate, and where banks joining forces, were able to circumvent privacy regulations the credit bureau collects not just information on payment behavior but also "socio-demographic" data that include income, occupation, family information etc.. In fact, very soon these credit bureaus will be able to produce a detailed life history for each person who has been in their system long enough. These credit bureaus, just as their US counterparts, also register the history of inquiries to each

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[9] Big banks will know about more bad customers than any smaller bank.

account. As this is available for other lenders making their own inquiry, the history can influence their decisions. The general wisdom among lenders is that too many inquiries without loans extended are a warning sign. Even if the record does not contain negative information otherwise, it must indicate that previous lenders "know" something unfavorable about the person that is not apparent in the record.[10]

Quantification

Reputations are expressed not just through standardized narratives as presented by the credit record in the registry but Polish and Czech credit bureaus also offer a single number or credit score that summarizes the person's creditworthiness. Numbers are powerful not just because of their air of scientific objectivity but also because of their ultimate simplicity, easy communicability and instant comparability. This quantification of creditworthiness has had enormous consequences in the United States where credit scores are now used not just in gauging creditworthiness but as a general measure of character and reliability.[11]

The enormous power of quantification of one's reputation which covers up human judgment and discretion in the decision making process, however, can cut both ways. While banks can legitimize their selection process by pointing to its scientific nature making challenges to their decisions difficult, the very same numbers can empower customers with high scores to demand better terms from banks in a competitive market place.

"Fringe" banking

Not everyone is served by the banks. There are also "fringe" credit institutions that offer consumer credit for the poor who usually have no bank accounts and would not qualify for a loan from a bank. One such company is Provident International, a British company that

[10] This, of course discourages people from shopping around with various lenders for the best deal. In the US, there is a 14 day bundling rule. Inquiries within a 14 year period are considered as a single inquiry.

[11] Credit scores are used in setting car insurance premiums, consulted by prospective landlords and employers and even some electricity companies set their rates on the basis of their customer's credit score. This expansive power of quantification is akin to what happened to IQ. A measure, originally designed to gauge learning difficulty in school became a widely used measure of cognitive ability of any kind. It is no coincidence, that some companies request SAT1 scores along with credit scores from applicants to judge ability and character.

specializes in payday lending.[12] Provident is active in Hungary, Poland, the Czech Republic, Slovakia and Romania. It offers short term, unsecured personal loans with an APR between 200 and 500 percent. The loans are administered by loan officers who visit the applicants in their homes and build a personal relationship with them. After their first visit, they make an assessment and if the decision is positive, the money is handed to the applicant physically on a second visit to their homes. Collection is also done in person at the home of the client at mutually agreed upon times.

The loan officer usually lives in the vicinity of the applicant and has local knowledge about the applicant's circumstances. In Hungary, Provident claims to employ over 4,000 officers, 13,500 in Poland and 5,000 in the Czech Republic and Slovakia (http://www.providentfinancial.hu/pages/szervezetunk). Ironically, Provident's services in some ways are similar to the treatment regular banks offer to their elite customers except here, at the bottom of the economic hierarchy, the personal attention acts as a strong form of control and all the costs of this labor intensive lending are pushed onto the client who is typically destitute with little education.

Provident while skirting predatory lending, is a fully legitimate operation and is preferable to loan sharks who are numerous, especially in economically depressed regions. There is no systematic study of loan sharking and usury in post-communist Central Europe but there is plenty of anecdotal evidence that especially in poor Roma communities loan sharks are often the only source of credit poor locals can turn to (Bjerkan and Huitfeld 2004, Orszag-Land 2000). For instance, in a small village in Northern Hungary, where registered unemployment stands around 20 percent, the majority of the residents subsist on welfare. Loan sharks lend a small amount of money to the person in need at a very high interest and in no time, the loan shark will have a permanent claim on the welfare check of his victim. Each time the debtor goes to collect his welfare payment the loan shark or one of his henchmen escorts him to the welfare office and collects his cut. Physical intimidation is an important part of loan sharking.

[12] Another one is Beneficial Kredyt, a subsidiary of Household International owned by HBSC. Beneficial Kredyt operates in Poland.

Social Consequences

The emerging dominant system of mass consumer credit prizes stability. People who are employed by large companies for a long period will be preferred. The system discriminates against the self-employed who maybe rejected even if they earn more than do employees simply because their income flow is less predictable. The new system rewards people with educational credentials regardless of content or value and thus discriminates against those without formal degrees. Availability of the applicant is rewarded, so anyone who lives in an area where telephone landlines are hard to come by, such as people in the countryside will be at a disadvantage.

New consumer credit strongly discriminates against old people. Most lenders have an upper age limit --usually between 60 and 65 -- on eligibility to apply. One Czech bank decided to offer credit cards to university faculty to find out that many of the top professors did not qualify. They were too old. In fact, credit benefits most the younger age groups. At the beginning of their life cycle they must invest into their household: buy a home, furnish it, purchase appliances etc., yet they have little savings. Not surprisingly, they are among those most interested in borrowing (Toth and Arvai 2001).

Credit comes with strings attached. The installments must be paid regularly. If one becomes unemployed even temporarily, debt makes job loss even more painful (just as saving can cushion its impact). Anyone, who is fired, leaves a job voluntarily, or gets sick and carries a mortgage or a car payment, will find it difficult not just to hang on to her house or car, but to avoid getting on some black list of bad debtors.[13] This increases the employer's power over his indebted employees. By verifying employment and income, employers play a role in helping their employees getting the loan but once the loan is secured it acts as a disciplinary force serving the employer. The obligation to the bank increases the worker's commitment to her job, which enhances the employers' powers.

[13] Some banks offer insurance against sickness and unemployment but it is usually expensive and debtors rarely buy it.

With the ability to take bank loans, people depend less and less on the financial support of their family and friends. With a vigorous mortgage market, young people can move out of their parental home sooner and more easily. Bank credit, therefore, weakens family ties and the extended family loses one of its reasons for being. Still, borrowing from kin might be preferable as relatives are less likely to be inflexible in case some difficulty arises and ask no or little interest. But because this type of lending is embedded in a complex set of obligations, one may have to pay for the loan in circuitous ways.

Credit also forces people to be more rational and calculative. They must draw up a budget and plan ahead. They must wrestle with time as money in the form of interest and depreciation (or appreciation), and meet payment schedules punctually. In transition countries, consumer credit may introduce some of the very same bourgeois values that Western critics accuse credit to destroy. But consumer credit indeed abets a consumer culture fixated on material goods. Credit is always advertised as the key to the glorified life style of consumption and instant gratification. Yet, it would be a mistake to place the primary blame for consumerism on consumer credit. In transition countries, rampant materialism had been firmly in place well before consumer credit emerged. Consumer credit is as much a result of materialism as it is its cause.

The explosion of consumer credit in post-communist Central Europe has introduced a new form of redistribution. At the same time, it began to reconfigure social relations, started to build a new system of social control, and set out to construct new social identities. How this project will continue after the global crisis of finance remains to be seen.

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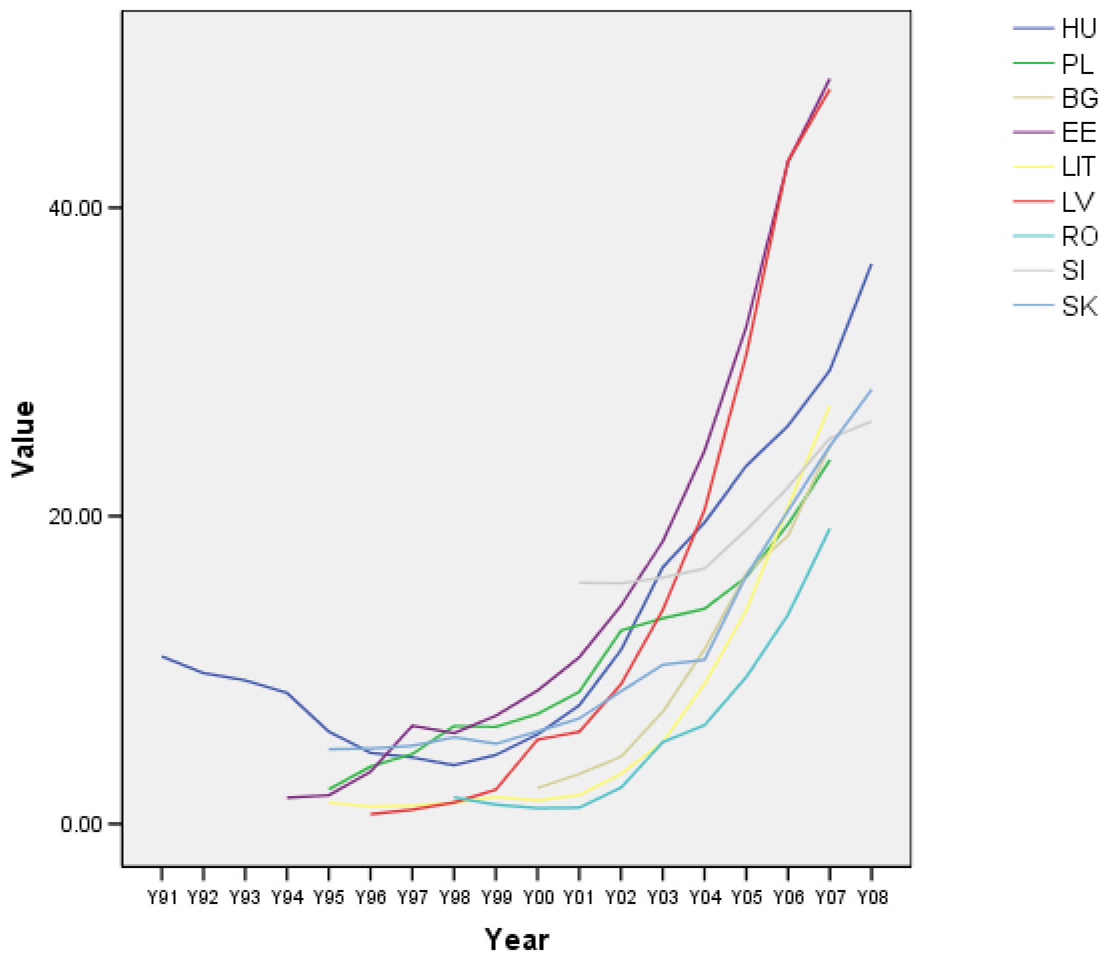
Figure 1

Household debt as the percentage of the GDP for post-communist EU member countries (with the Czech Republic missing[14])



Source: EUROSTAT

14 Eurostat did not have data for the Czech Republic.

Figure 2

The Czech Republic

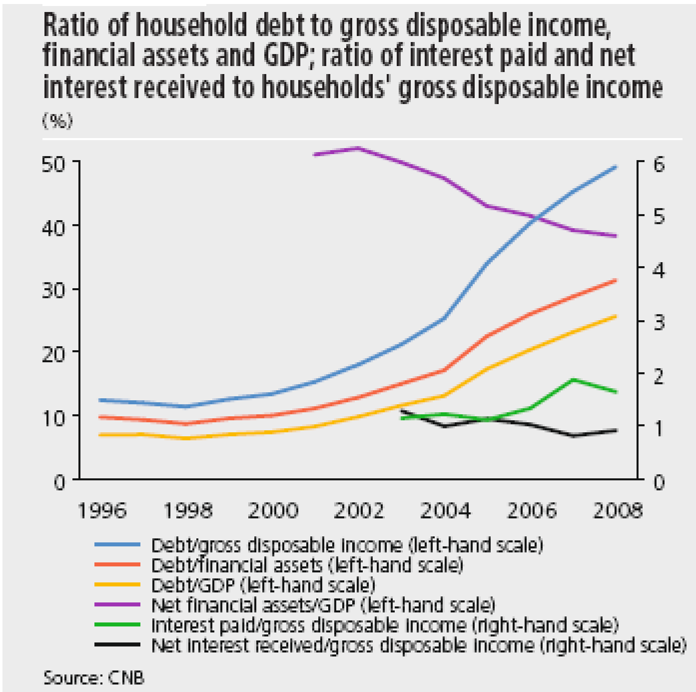
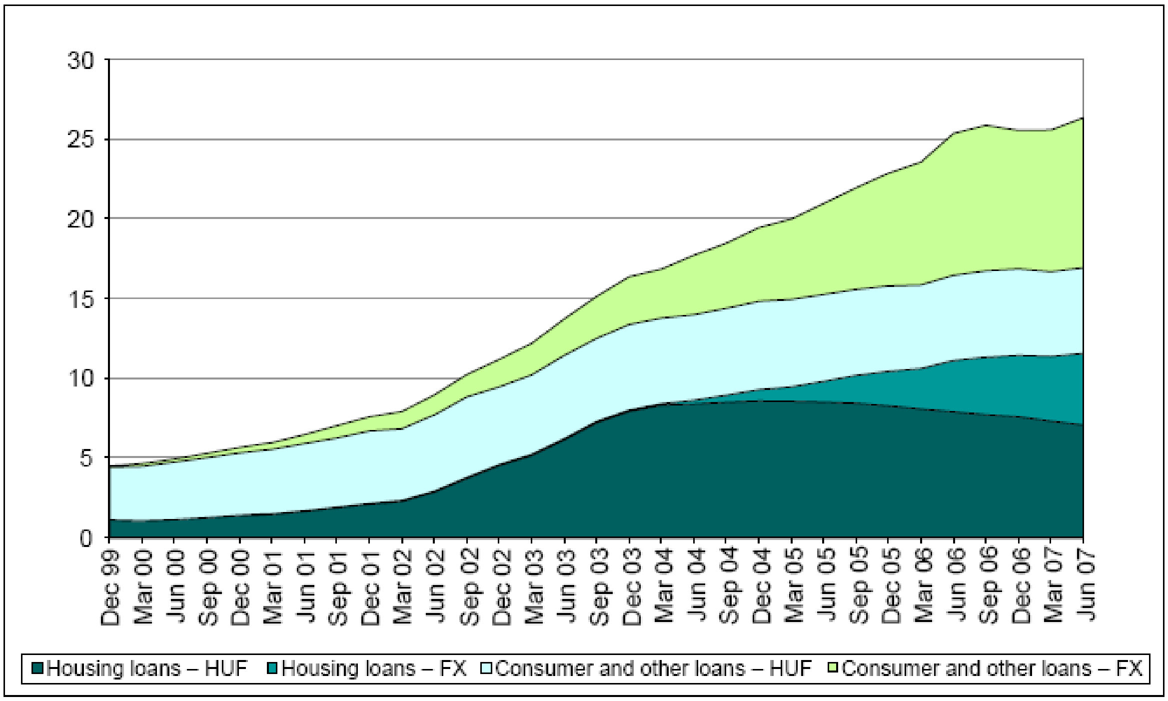


Figure 3

Growth and composition of household loans in Hungary (as a percentage of GDP)



Sources: Magyar Nemzeti Bank; national accounts.

Figure 4

The Czech Republic

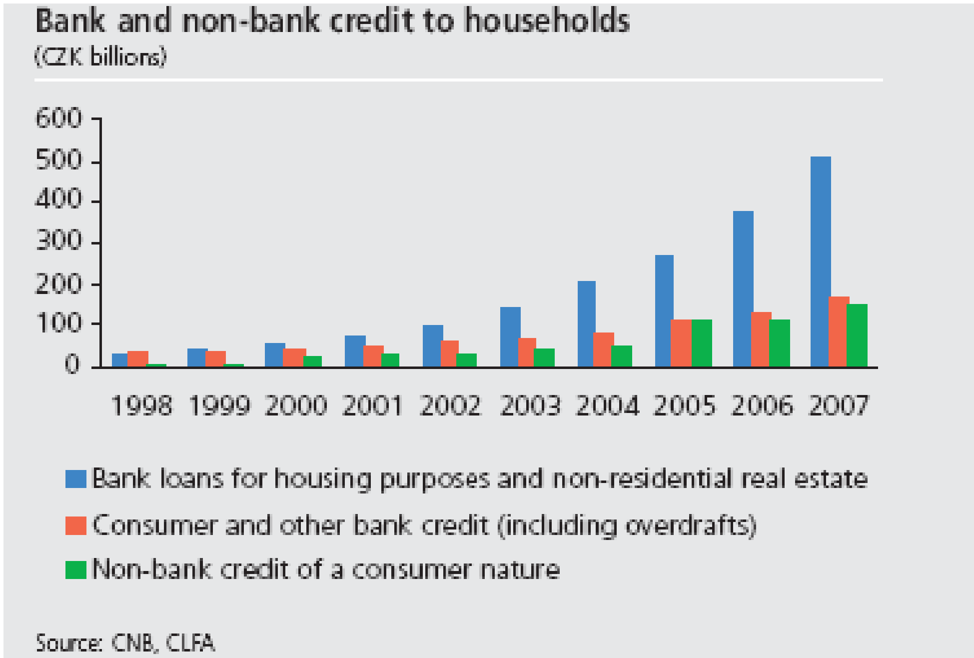
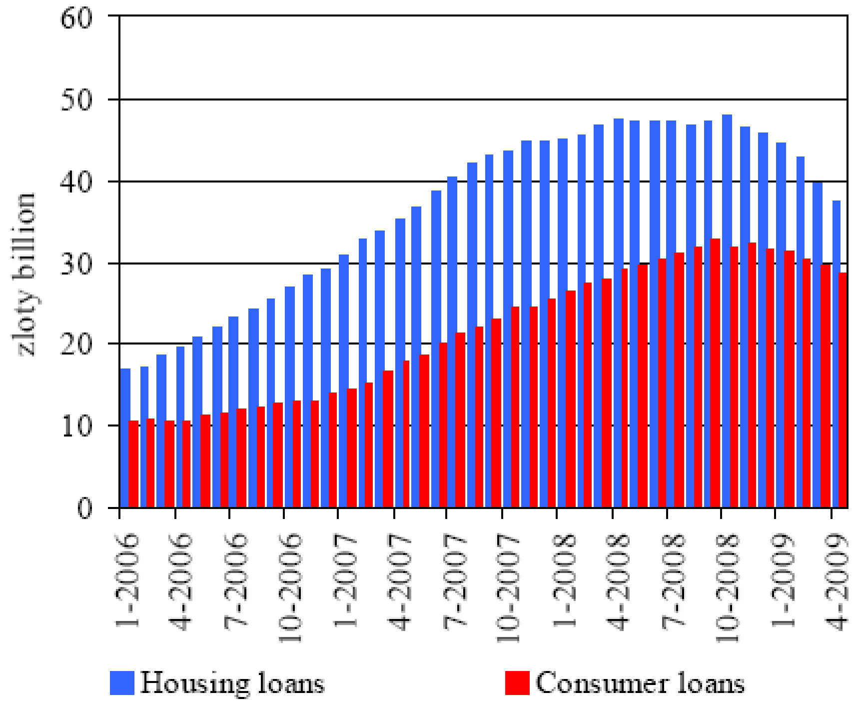


Figure 5

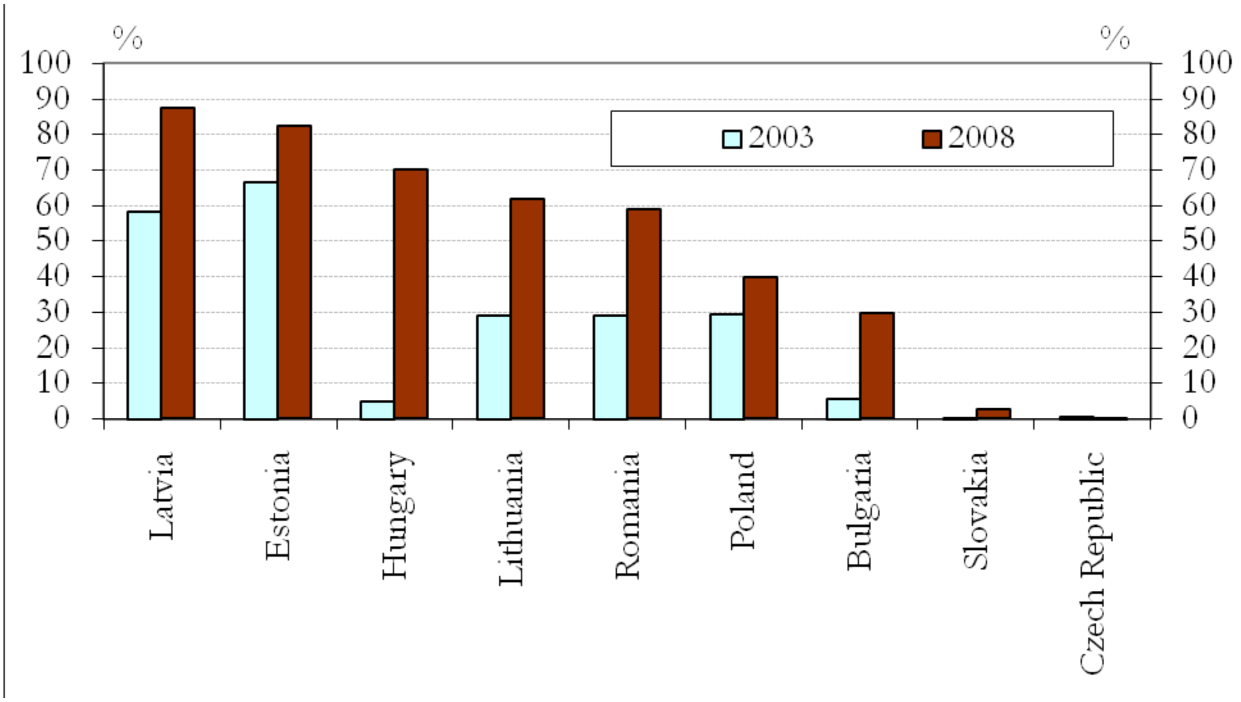
Annual changes in the value of loans to households in Poland



Note: data after excluding the impact of exchange rate movements.
Source: NBP.

Figure 6

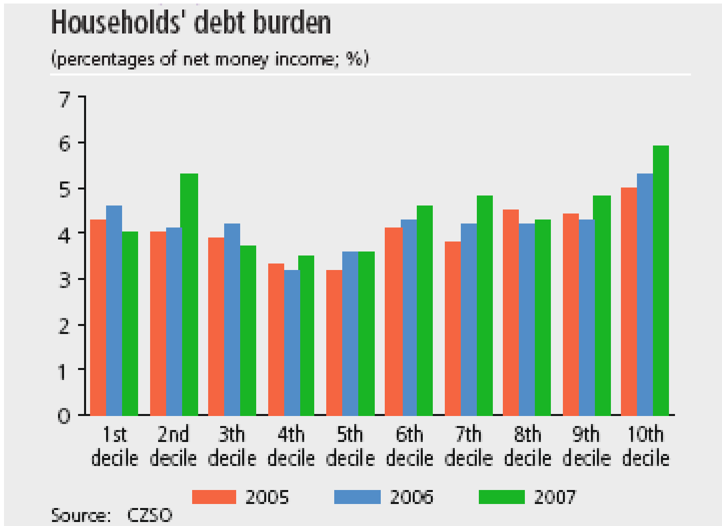
Share of foreign exchange loans within the banks' household loan portfolio in international comparison



Source: Magyar Nemzeti Bank

Figure 7

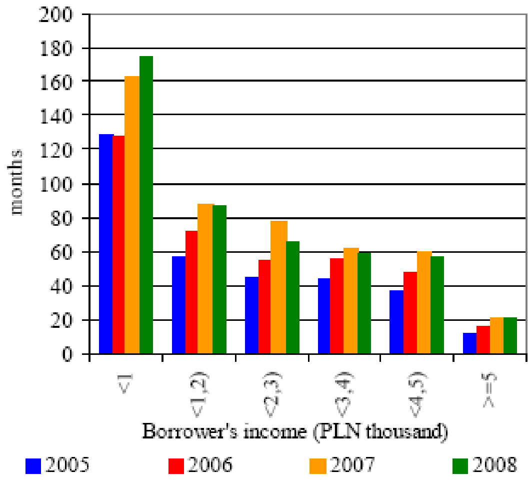
The distribution of consumer debt by income deciles in the Czech Republic

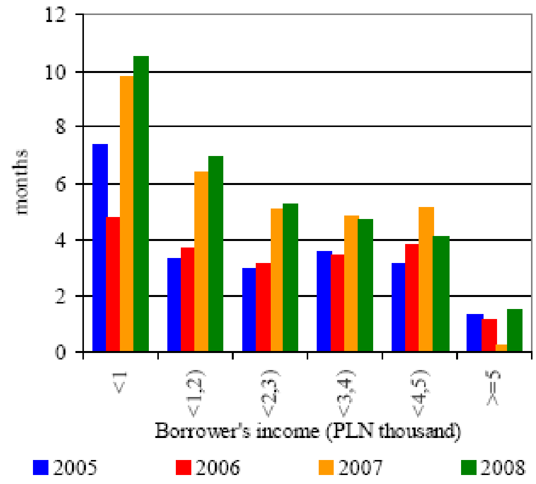


Source: Czech National Bank 2009 p. 30

Figure 8

Average ratio of the value of loan to monthly income of the household taking out the loan: housing loan (left-hand panel) and consumer loan (right-hand panel)

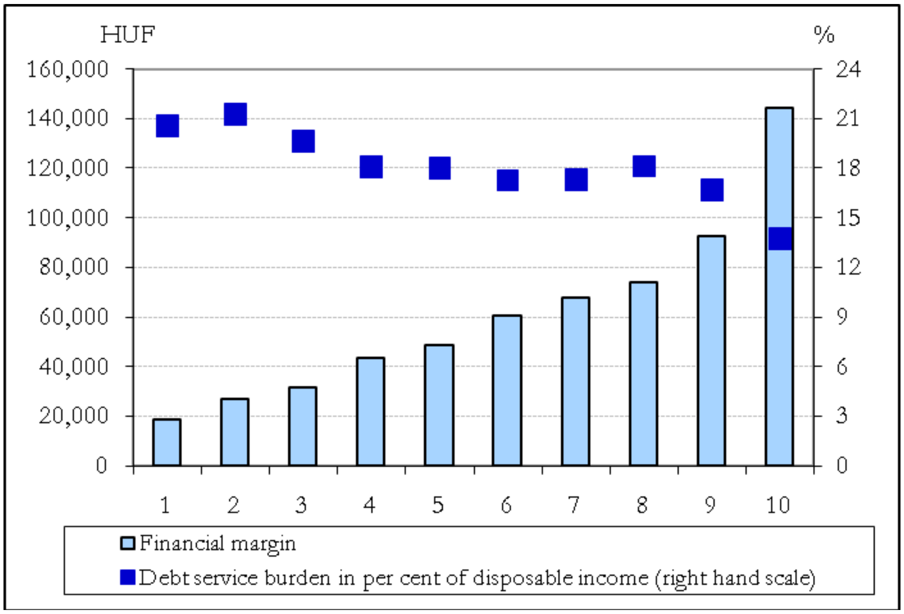




Source: Polish National Bank 2009 p. 46.

Figure 9

Debt service burden of indebted households in certain income deciles and their average financial margin [15] in Hungary 2007



Source: Hungarian National Bank

[15] Financial margin means the income that remains after the basic costs of living (housing, public utilities and food) and instalment payment deducted from the disposable income and that is available to cover the potential increase of the instalment payment.