

CONSUMER LENDING BOOM AND SOCIALLY RESPONSIBLE CREDITING OF HOUSEHOLDS IN THE RUSSIAN FEDERATION

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The paper deals with the main features of the modern boom in consumer lending in Russia. The question under discussion is paid special attention in context of increasing risks both for households which obtain the credits and for financial credit system in whole. In Russia, 57% of consumers choose consumption as the key strategy of financial behavior under economic uncertainty. General purpose loans and credit card loans added together form the major part of consumer credits provided by Russian banks. Short-term loans and medium-term loans which imply high interest rates cause the monthly expenses to pay the household's loan to be about 20% of household's monthly income. Financial instability of households accompanied with inequality in income distribution, «conspicuous consumption», growth of loan debts, lack of official statistics and irrelevant monetarist policy may result in social instability of the country. The author focuses on the Financial Instability Hypothesis suggested by H. Minsky to prove that capitalist economy endogenously generates a financial structure prone to financial crises. Proceeding from H. Minsky's classification, the proposition that the speculative finance units together with «Ponzi» borrowers are the largest categories of consumer loan borrowers is put forth in the article. Support of socially responsible crediting (i.e., educational credits; credits for reconstruction of residential premises to increase energy efficiency; credits for development of entrepreneurship, personal household plots, gardening, horticulture, and for establishing work-from-home conditions for households with low income levels) provided for hedge financing units are considered to be an effective measure of counter-cyclical regulation which can reduce risks of financial instability in modern Russia.

Keywords: credit; consumer lending; socially responsible crediting; counter-cyclical regulation; the purpose of the loan; credit expansion; household; development finance.

JEL: B52, D11, E12, E20, G01, G21, Q56.

Modern boom in consumer lending in the Russian Federation, which emerged as an increase in volume and number of non-purpose loans and loans (credits and loans for immediate needs, current expenditures) issued by Russian commercial banks and microfinance organizations results in risk increasing both for households' welfare and for financial credit system in whole. Thus, the necessity for qualitative changes in consumer lending is obvious, including transformation of appropriate objectives and priorities.

The total amount of credit portfolio provided to individuals by Russian commercial banks has doubled for the period from 2009 to 2012 (from 3,5 trillion rubles as of 1.01.2009 to 7,5 trillion rubles as of 1.01.2013, net of credits to entrepreneurs); in 2012 it has increased by 44% (from 5,2 trillion rubles to 7,5 trillion rubles) (*The Central Bank...*, 2009a; 2012e; 2013b); from 1.01.2009 to 1.01.2013 there

was an almost twofold (from 3,7 trillion rubles to 7,3 trillion rubles) increase in the aggregate volume of small (up to 0,5% of bank's fund) credits provided to individuals, uniform in purpose and security type (*Provisions on procedure of formation.... Ch. 56, cl. 5.1*). In 2012 growth of this group of credits exceeded 43% (*The Central Bank..., 2009b; 2012a; 2013a*).

Due to upturn in consumer lending during the post-crisis period a decrease from 9,4% (as of 01.03.2010) to 4,8% (as of 1.02.2013) has been noticed in the number of loans overdue 90 days or more as it relates to the total number of loans to individuals, classified into portfolios of uniform loans; nevertheless, the amount of such credits, only based on official reports, net of off-balance and assigned credits (the data are not published by the Central Bank of the Russian Federation), increased during the period by more than 10%, given average consumer credit amount as of 01.01.13: general purpose loan – 166,570 rubles, credit card – 50,166 rubles, car loan – 484,935 rubles, mortgage credit¹ – 1,778,188 rubles) (*Kreditovik.ru; Express-survey..., 2012*).

It should be noticed that over 50% of consumer credits given by Russian banks are general purpose loans and credit card loans (as of October 2012 – uniform loans account for 94,6% of consumer credits, of which 57,3% are classified as «other consumer loans») (*The Central Bank..., 2012f. P. 30*). There are 426,6 billion rubles of retail loans that are 90 days or more past due in credit portfolios of Russian banks. In 2013, from January to May, their amount has increased by 92 billion rubles compared to 50 billion rubles increase over last year (*Biyanova and Voronova, 2013*).

Short- and medium-term loans (up to 3 years), predominantly obtained by Russian borrowers and high interest rates on consumer loans (as of 1.02.2013 the average nominal interest rate on mortgage and housing credits exceeds 12,5% per annum (*The Central Bank..., 2013c*), weighted average nominal interest rate on loans to individuals up to 1 year is 24,7% per annum) (*The Central Bank... 2012d. P. 43*) are two major factors causing the household's loan costs to represent on average 15 to 20% of household income, whereby in developed countries the current debt load index currently stands at 6–10% (*Noskova, 2012; The Central Bank..., 2012d. P. 41; The Central Bank..., 2012f. P. 32*).

In 2012 the main purpose of the funds borrowed by individuals in banks of the Russian Federation was repayment of previously obtained credits (according to Chief Economist of Alfa-Bank, Natalia Orlova, ~80% of increase in retail general purpose lending) (*Kreditovik.ru*) and purchase of imported consumer goods (*Interregional Banking Council..., 2012*).

It may be assumed, therefore, that the fact that over a half of Russian consumers (57%) choose consumption as the key strategy of financial behavior in a state of economic uncertainty (*Russian Public Opinion Research Center, 2013a; 2013b*), favors for consumer lending risks to enhance. Furthermore, the latter is also caused by the fact that a little more than three per cent of households are concerned with long-term financial planning (*FOM-Media, 2011*).

Credit organizations, forced, under scarcity of long-term sources of income, to increase volumes of short-term consumer loans in order to maintain profitability and liquidity, increase the risks, too.

In a situation of credit and consumer boom, given the lack of proper legal regulation, banks and microfinance organizations utilize the tools of crippling (predatory) lending. In particular, rapid growth of bad debts as a consequence of aggressive unsecured crediting, including fancy with risky borrowers (*Borisyak, 2013*). Though in 2012 the Central Bank of the Russian Federation had warned commercial banks about unsecured consumer lending, the overdue loans are still increasing in two first quarters of 2013 (*Plotonova, 2013b*).

Financial inequality, which has reached critical level in the Russian Federation, is of particular importance in assessment of risks related to consumer lending. For

¹ Mortgage credits are, according to the author's approach, considered to be the part of the total amount of consumer credit portfolio (*Lavrushin, 2012. P. 185*).

example, according to Global Wealth Report, 1% of the richest Russians account for 71% of all personal assets in Russia (*Guriev and Tsyvinsky, 2012; Credit Suisse. Global Wealth Report 2012. P. 53*): as of 1.10.12 decile fund index was 15,7 (*Russian Federal State Statistics Service, 2013*).

It is reasonable to assume, that in such conditions an irrational, socially inefficient and irresponsible crediting of households followed by spending on «conspicuous consumption» (*Veblen, 1902. P. 68–101*) generates a colossal risk for the state, as well as for regional economies, companies, and households themselves. «Conspicuous consumption», being of great importance both for the rich as well as for the poor, is the psychological reason why the poor can turn to consumer lending too frequently, trying to enhance self-appraisal and to maintain the social capital. Government, along with banks, can stimulate consumer lending to improve economic performance. But, when the enforcement measures become tougher, mostly the poorest suffer (*Editorial..., 2013*).

Financial instability of households against the background of inequality, «conspicuous consumption», growth of loan debts has caused social instability in a number of countries. As an example, growth of risks connected with household lending expansion in the USA (up to 127% of the aggregate disposable annual income of households in 2007, up to 290% of the US GDP in 2009 (*Barr, 2009; The Economist, 2008; Wolf, 2009*)), has resulted in increase in civil activity in 2011–2012 under the slogans of global financial system unfairness (Occupy Movement) (*The 99% Declaration, 2012*).

Furthermore, the IMF experts conclude that economic growth that is primarily based on lending to low and medium income households in increasing income inequality conditions is very unstable (*Berg and Ostry, 2011*).

For example, R. G. Rajan (*Rajan, 2010*) notes inefficiency of political and economic pressure, contributing to increase of savings of high-income individuals, on the one part, and stimulating growth of debts of low-income individuals striving to maintain the consumption level.

Reports of Euromonitor International experts also confirm the risk increases as it relates to a consumer lending trends exceeding income growth rates of citizens of the Russian Federation, with extremely inefficient planning of personal finances by Russian borrowers (*Euromonitor International, 2013*).

It should be noted that regulatory authorities and bank community of the Russian Federation took specific measures to reduce possible negative consequences, related to consumer lending boom: restrictions on international travel were introduced for debtors enforced through executive documents, legislation on credit reference bureau activities and on protection of rights of consumer financing units was improved. Moreover, for many years the Russian parliament and bank associations have been discussing the necessity of adoption of laws on consumer credit, collection activities and individual bankruptcies (*Interregional Banking Council..., 2012; Meeting of the Interregional Banking Council..., 2013*).

The current strategy of bank regulators and public authorities in numerous countries involves shifting priorities in consumer credit regulation and development towards timely prevention of excessive lending volume increase (counter-cyclical buffer to avoid excessive lending growth (*Basel Committee on Banking Supervision, 2010. Ch. IV*) and protecting rights of individual financing units as financial services consumers (in the EU – consumer directives, in Australia – consumer credits protection, in Japan – new scheme of consumer lending, in the USA – the Wall Street Reform Act and the Dodd – Frank Act).

In order to reduce growth of risks caused by booming consumer lending, the Central Bank of the Russian Federation amended Provisions 254-II (*The Central Bank..., 2012b*), issued Instruction 139-II (*The Central Bank..., 2012c*).

These amendments in practice increase the requirements of capital stock for the banks dealing with lending to individuals.

Simultaneous change in bank capitalization and liquidity requirements along with unilateral and often populist interest rates control as a part of anti-«predatory lending» campaigns tend to, in most cases, have a negative impact on credit availability to low and medium income households, who usually borrow at higher interest rates and for shorter periods due to lack of collateral in the form of liquid real estate (*Noskova, 2013*).

At the same time, regulatory measures and monetary policy tools are viewed to be the means of reducing negative credit bubble side effects by most researchers: Selim Elekdag, Yiqun Wu (*Elekdag and Wu, 2011*), Dell Ariccia (*Dell'Ariccia, Igan and Laeven, 2011*), Adolfo Barajas, Andrei Levchenko (*Barajas, Dell'Ariccia and Levchenko, 2008*), Gerard Caprio (*International Monetary Fund, 2004*), Daniela Klingebiel, D. Nakonthab, Balázs Égert, Peter Backé, Tina Zumer, Wanvimol Sawangngoenyuang).

Currently implemented measures for counter-cyclical regulation proposed by most researchers are in essence exclusively monetary measures; in fact, those who recommends them ignores pro-cyclical «human nature» (namely, individual behavior) which is needed to be corrected by means of institutional state policy, as it has been proven by the outstanding economist, one of the founders of post-Keynesian school, Hyman Philip Minsky.

H. Minsky's approach is based on «the speculative financial paradigm, on the image of a banker doing business on Wall Street» (*Minsky and Keynes, 1975*).

This approach appears to be of high relevance concerning the modern «money managers» activity, with financial markets being followed by most households, and institutional investors being key players in these markets (*Minsky and Whalen, 1996–1997*).

H. Minsky has proposed the Financial Instability Hypothesis, which proved that capitalist economy endogenously generates a financial structure prone to financial crises (*Minsky, 1992. P. 6*). He described a financial structure as «market interactions between borrowers and lenders, and balances of nonfinancial firms, intermediaries and households depicting such interactions» (*Minsky and Whalen, 1996–1997. P. 97*).

According to H. Minsky, the Financial Instability Hypothesis is a theory of debt impact on the state of financial system, defining assessment method for the justified debt amount (*Minsky, 1992. P. 6*).

Viewing the boom in consumer lending in the Russian Federation from H. Minsky's standpoint, it may be assumed that less and less consumer loan borrowers may be classified as hedge financing units, able to fulfill all of their liabilities using discretionary income, which is the amount of an individual's income that is left for spending, investing or saving after taxes and personal necessities (such as food, shelter, and clothing) have been paid (*Investopedia. Definition: «Discretionary Income»*).

At the same time one can assume that numerous consumer loan borrowers in the Russian Federation should be categorized according to the similar H. Minsky's classification as speculative financing units, able to repay current liabilities by the means of discretionary income, but have no abilities of repaying the financial debt under current conditions without rolling it over.

It appears that discretionary income of most consumer loan borrowers in the Russian Federation is not even sufficient to cover the interest rate payment on obtained credits in full. In order to service and repay credits such borrowers have to sell assets or borrow again. H. Minsky classifies such borrowers as «Ponzi» (*U.S. Securities and Exchange Commission...*), which are borrowers, who form and service their liabilities using the pyramid principle.

Unfortunately, it is currently impossible to analyze the extent of household credit dependence in the Russian Federation based on the methodology introduced by H. Minsky through the shortcomings of the currently established credit bureau system, which underestimates borrowers' liabilities under the credits (loans) obtained (*Starostina, 2012*) and lacks interaction with tax and pension fund authorities to account for actual borrowers' discretionary income vs. their liabilities for relevant income

periods.

For the last year, the part of borrowers who have to pay loans from more than five lenders has increased from 6% to 19%. For this category of borrowers, the total sum of debt exceeds 500000 rubles per person. Meanwhile, annual income per capita in Russia was approximately 245000 rubles in 2012 (*Biyanova and Voronova, 2013*). The disproportion between consumer credit portfolio growth dynamics and actual cash income increase in 2012 was stated by the Auditor of the Accounts Chamber of the Russian Federation, Professor V. Goreglyad. In his opinion, about 10% of Russian citizens, including children and retirees, have debts under executive documents to be recovered by bailiffs (*Interregional Banking Council..., 2012. P. 38*).

Such statistics indirectly proves that numerous consumer loan borrowers in the Russian Federation may be classified as speculative and «Ponzi». Consumer lending is at risk, inasmuch as many of the borrowers had overestimated their financial resources. Besides, the banks themselves didn't put any obstacles for so-called «overload crediting» (*Biyanova and Voronova, 2013*). Still, the Russians continue to borrow actively: the retail credit portfolio has increased in July by 2,8%, that is, up to 9 trillion rubles (*Plotnova, 2013a*).

According to H. Minsky, the larger the share of speculative and «Ponzi» finance in economy is, the more likely it is for the economy to become unstable in such crediting mode. Moreover, H. Minsky proved that after a long-term period of economic welfare, economy shall shift from financial relations featuring stable system functioning to financial relations contributing to system destabilization (from economy featuring hedge financing units to the one dominated by speculative and «Ponzi» borrowers).

Having applied the Financial Instability Hypothesis by H. Minsky to the issues related to consumer lending regulation in Russian Federation, given the current boom conditions, one can conclude that taking into account larger number of households being Ponzi and speculative consumer borrowers, risks of financial instability in Russia increase (*Minsky, 1992*).

In this regard it seems insufficient to analyze the consumer credit expansion scope given only on the ratio of the aggregate consumer debt under credits obtained from banks to the GDP, cash income and savings of consumers, as proposed by numerous Russian and foreign scientists (*Balls and Lavrushin, 2013. P. 60–61*).

According to author's opinion, the level of financial instability and risks as it relates to consumer lending, should be assessed based not only on the average current debt load dynamics analysis, but also on dynamics analysis of the average current low and medium income household debt load. Unfortunately, official statistics lack data on the average current debt load of household groups according to income levels (including low and medium income households).

According to H. Minsky (*Minsky, 1985*), feasibility of such instability may be reduced by institutional state policy, aimed at:

- reduction in financing of long-term investment projects, which utilize short-term credit resources;
- restriction of speculative and «Ponzi» lending;
- stimulation of changes in production technology supporting less capital intensive consumer goods production.

Moreover, in his joint work with C. J. Whalen, H. Minsky insists on the fact that «capitalism may succeed only if its institutional structure reflects the circumstances where people have limited tolerance to uncertainty and unreliability» (*Minsky and Whalen, 1996–1997*).

Therefore, taking results of H. Minsky's research into account, one can conclude that among the major causes of credit boom's negative effects is low effectiveness of the state policy aimed at increasing of long-term credit resources of financial credit institutions which reduce unreliability and uncertainty of households in their credit relationships with banks, and stimulating targeted consumer lending for acquisition of goods and services, produced with minimum capital investments.

Based on the findings of John Morangos, the post-Keynesians recommended active public interventions in aid of institutional development, the main purpose of which was lining up private interests with civil values to support civilized capitalist society development (*Southern Cross University*).

It should be noted that Russian researchers Lavrushin O. I., Larionova I. V., Olkhova R. G. also conclude that consumer lending is connected with increased risks due to individual psychological characteristics of borrowers. These researchers consider credit booms (namely, mortgage lending boom) not only as a consequence, but also as an accelerator for cycle shift in financial markets. According to Larionova I. V. and Olkhova R. G., in order to understand and develop counter-cyclical tools, one needs to address to four groups of problems (*Lavrushin, 2012. P. 185*):

- offering of underlying assets, which serve as lending collateral;
- consumer income sufficiency and motivation of households to obtain credit;
- financial market maturity, long-terms resources availability, value and refinancing opportunities for these;
- legal support of consumer lending.

In this regard, it is vitally important that the state policy measures aimed at reduction of expensive general purpose short-term consumer loans are primarily implemented through extension of socially responsible consumer credits to households supported by the state, financial regulators, and local authorities.

According to author, socially responsible consumer credits are those, whose purpose, provision, servicing and repayment conditions initially don't decrease the welfare of the borrowing households, but rather, given efficient credit use by the borrowers, improve their financial situation. Primarily through synchronization of lending purpose with development of local communities socially responsible credits stimulate socio-economic development of urban areas (local communities), where borrowers of such credits reside. Besides, according to H. Minsky's terminology, socially responsible household credits include those provided to hedge financing units. Therefore, it may be concluded that such socially responsible credits are counter-cyclical.

The following purposes of socially responsible consumer credits can be listed:

- educational credits;
- credits for reconstruction of residential premises to increase energy efficiency;
- credits for development of entrepreneurship, personal household plots, gardening, horticulture, and for establishing work-from-home conditions for households with low income levels.

As a part of this research it would be interesting to analyze dynamics of consumer lending by Russian banks for purposes directly related to possible future income acquisition by borrowing households (educational credits, credits for personal household plots development and for other forms of informal employment: work from home, gardening, horticulture), and for purposes directly related to possible household budget expenses reduction (e.g., energy efficiency increase of residential premises, installation of gas service, seasonal fuel reserves). Unfortunately, the statistics published by the Central Bank of the Russian Federation are insufficient to determine the share of consumer credits based on their purpose.

Moreover, it appears that consumer lending policy implemented by the Central Bank of the Russian Federation does not stimulate lending by banks to households for the purposes listed above, as well as the other purposes, which promote expenses reduction or additional income for the households. Among other things, the Central Bank of the Russian Federation provide for lower standards as to formation of reserves for potential losses on consumer credits, secured by real estate and motor vehicles, which without doubt leads to increase in consumer lending for residential property and car purchases (*Consultant Plus. Table 3*).

Increase in socially responsible credits has a potential of stimulating changes in aggregate demand structure, and to increase the share of socially responsible consumption. It promotes changes in goods and services production technologies,

supports less capital intensive production of consumer goods and services production, and also leads to additional income and expenses reduction of the households.

It is important to promote socially responsible crediting which would help to develop social capital and infrastructure, for these are the dynamic criteria of efficiency (*De Soto, 2008*) of economic evolution which imply, in fact, long-term planning horizons and understanding of the necessity that institutional environment must be taken into account during economic research (*Volchik and Oganessian, 2012*). Proceeding from the dynamic efficiency criteria, the fallacy of misinterpretation of the competition as predatory, injurious and destructive, is pointed out in: (*Volchik and Oganessian, 2012*). In particular, the financial unit should not, driven for benefits only, take unsecured commitments or liabilities, or lend money in the absence of any insurance arrangements.

But, shifts in priorities of consumer lending would have been effective only if discretionary income of households corresponded to their payment liabilities. This, in turn, requires risks reduction for the socially responsible lending, along with long-term credit resources (preferably the target-specific ones) expansion in the credit system. It would result both in prolongation of credits and in reduction of households' monthly payments to cover previously obtained credits.

It appears to be reasonable therefore to study experience of various social institutes, which may be helpful to develop measures of increasing consumer lending social efficiency.

Thus, in order to restrict speculative and «Ponzi» lending it seems to be appropriate to support banks' business models valuing Relationship Banking over Product-Centric Banking (*Reinventing Retail Banking Series, 2009*).

Of special interest is the experience of foreign social banks demonstrating good results in accumulation of financial resources from socially responsible depositors, investors and government authorities for socially responsible consumer and corporate lending (*The Global Alliance for Banking on Values...*).

Even pre-revolutionary Russia practiced socially responsible lending for small commodity producers to support development of local communities («zemstvo») (*VEP Agency...*).

As it appears, a special attention deserves measures to increase consumer socially responsible lending and activities of the following institutes :

– regional guarantee funds, established with participation of the Government of the Russian Federation, to assure availability of financial resources for small and medium-size businesses (*Ministry of economic development...*);

– Russian Housing and Mortgage Finance Restructuring Agency, established as a part of crisis management measures of the Russian Federation Government, to support mortgage borrowers in hard situation; the Agency gained wide experience managing borrowing households' liabilities, and assuring that it meets the actual financial capabilities of a household (*Housing and Mortgage Finance Restructuring Agency...*);

– municipal microfinance organizations, such as small business and local development funds, established to stimulate creation of new jobs and assure job security, including jobs for former miners as a part of the coal industry reorganization program (*The Government of Rostov Region...*).

Development and implementation of counter-cyclical measures to increase social efficiency of consumer lending considering existing positive experience of consumer lending application as a social development tool, shall reduce impact of such factors as «uncertainty and unreliability» for households making a decision on funds borrowing and repayment.

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