

Other Voices

Views from beyond the Barron's staff ■ by Bozena Leven

How Poland Saved Itself

AS THE WORLD NOW KNOWS, EXCESSIVE risk and opaque financial instruments are dangerous. Their misuse substantially damaged the global economy. Would less financial risk have reduced the likelihood and intensity of the damage? The unique experiment conducted in Poland suggests this is so.

In 2009, Poland was the only European Union nation to see gross-domestic-product growth. Polish growth was 1.7%. Every other EU member experienced negative GDP growth, and the average shrinkage was 4.5% for the year.

What explains this startling difference? Broadly speaking, Poland enjoyed a happy confluence of relatively strict bank practices, tight government fiscal policy, an insulated labor market, fortuitous currency fluctuations and a more cautious approach to personal debt. Fundamentally, the national economy benefitted from less risk.

Perhaps the most straightforward example is Poland's housing market. Declining real-property prices were and continue to be at the heart of the debacle in most countries. Yet the Polish housing market, while under great stress, managed to protect wealth instead of destroying it.

Poles entered the financial crisis with household debt approximating 16% of GDP. Contrast that figure with the 2008 numbers for Bulgaria (32%), Hungary (79%) and Latvia (137%).

Poland's housing stock grew rapidly after the breakup of the Soviet bloc. But in the absence of a developed mortgage industry, many houses were purchased with cash from personal savings. The Czech Republic and Hungary also experienced rapid growth in housing supply and an immature secondary-mortgage market. But their mortgage markets matured quickly, as if with growth hormones. By 2008, mortgages constituted 18% of GDP in the Czech Republic and 20% in Hungary, versus just 10% in Poland.

The lower appetite for debt among Poles was encouraged by their bankers, including the predominant bank in Poland, UniCredit, which maintained tight lending standards and rejected subprime lending.

The structure of the Polish labor market

also helped. More than 25% of Poles are employed in the relatively recession-proof farming and agro-industrial sectors, which continue to receive significant EU subsidies. Another 27% of Poles work in the public sector. Thus, more than half of all Polish workers enjoyed secure incomes, jobs and consumption.

Low debt levels, careful lending practices, and stable incomes can generally be expected to help stabilize real-property values. In the first quarter of 2009, Poland's real-estate price declines ranged from 3% in Warsaw (the country's most expensive and fastest-growing housing market) to approximately 9% in Krakow.

Poles also strengthened their country's financial sector with individual discipline, as total deposits grew even in the midst of the crisis, averaging 18.6% growth between June 2008 and 2009. The banking capital-adequacy ratio dropped only slightly from 11.5% to 11.1% by July 2009, allowing banks to remain profitable, averaging 8.4% in 2008 and holding on at 2.7% in the first quarter of 2009.

This mix of factors also reduced loan defaults. Indeed, the percentage of nonperforming loans in Poland remained roughly stable, at 4.5% of loans, during the tumultuous period between the summers of 2008 and 2009. By contrast, the average decline in real-estate prices exceeded 15% in the Czech Republic, and was almost 30% in Hungary. Moreover, throughout Eastern Europe the number of nonperforming loans, on average, more than doubled.

It is easy to document these economic results, but more difficult to explain the human behaviors underlying them. For example, what accounts for the lower appetite for debt among Poles? Was it financial acumen, or a national ethos of fiscal conservatism? The simple, nonscientific answer is "no." Poles avoided debt because they don't trust it. And they don't trust it because for most of the post-World War II period, debt was unavailable to them.

During the first decade of transition to a Western-style economy in the 1990s, virtually all housing purchases by Poles were in cash from savings, because a mortgage market and the legal and financial systems

needed to support it didn't yet exist—and they then were slow to develop. The same slow development of the mortgage market also characterized Poland's foreclosure and bankruptcy procedures.

Thus, Poland's bankers were faced with a population whose credit expectations were quite modest, in a real-estate market that discouraged ready lender access to collateral.

We can't say that low-risk loans and a low debt baseline enable families to meet mortgage payments. However, we can say that when millions of families owe relatively less money and enjoy relatively high creditworthiness, the likelihood of a real-property meltdown under pressure is substantially diminished.

In the end, it wasn't so much that Poland behaved a lot better than its neighbors. It just happened to have been stuck for longer in a time when affordability and creditworthiness mattered more than derivatives. And for that reason Poland, only recently an uncertain stepchild of the developed West, unexpectedly reminds us of a simple market truth: Sophisticated financial systems disconnected from economic fundamentals can destroy more than they create; adherence to basic risk models matter and can serve a national economy well.

This, incidentally, used to be an idea as American as apple pie. ■

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In 2009, Poland was the only European Union member that boosted its gross domestic product. The fundamental difference between it and other EU nations? It took on less risk.