IN DEFENSE OF THE CREDIT BUREAU

Daniel B. Klein and Jason Richner

Introduction

In the past year Congress considered more than 30 resolutions concerning credit bureaus. The bills were designed to expand control of credit bureaus. The House Subcommittee on Consumer Affairs and Coinage heard hundreds of stories from consumers claiming to have lost their jobs or been denied credit because of credit bureau mistakes.

The big credit bureaus—TRW Inc., Equifax Inc., and Trans Union Credit Information—realized that legislation was unavoidable and endorsed a bill by Rep. Esteban Torres (D-Calif). The Torres bill ("The Consumer Credit Reporting Reform Act") was the most likely to pass. The bill contained a "preemption provision" that would have given the federal law preemption over state regulation of the credit reporting industry. On September 24, 1992, after several hours of debate, the U.S. House of Representatives rebuffed an attempt by the bill's sponsors to remove the preemption provision (the provision that ultimately led to an endorsement by the credit reporting industry) by a 207 to 203 vote. Rather than go forward with the bill that retained the preemption clause, the sponsors pulled the bill, with the 49 measures it contained. Although the industry may have gained some respite, the 50 individual states may now act more aggressively to pass their own legislation, and Congress is renewing its efforts at present.

The result for consumers, supposedly represented by Consumer's Union and Ralph Nader's U.S. Public Interest Research Group (PIRG), may be more restricted credit, less attractive terms for credit (such as higher interest rates), and higher prices in general. As a

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Daniel B. Klein is Assistant Professor of Economics at the University of California, Irvine, and Jason Richner is a free-lance writer.

consequence of the crusade against credit bureaus, many consumers will be unable to get credit.

When Torres introduced the bill, he said the current law allows the private lives of consumers to be "an open book." "Sensitive personal and financial data is bought and sold without regard to privacy; consumer reports are riddled with errors, resulting in denial of credit, insurance and employment" (Herubin 1991, p. C1). To get an idea about what other lawmakers have been thinking, we need only read the comments of Rep. Bernie Sanders (I-Vt.) During the markup of the Torres bill, Sanders said that the subcommittee should not be debating amendments to the bill, but should be talking about whether credit bureaus should exist at all. (*Communicator*, April 1992, p. 6). Congresswoman Maxine Waters (D-Calif.) added, "It was outrageous for members to feel compelled to protect the credit reporting industry" (p. 6). The assault on the credit reporting industry may be just beginning.

In response to criticism from consumer groups, TRW Inc. decided in 1992 that it would provide consumers with a free copy of their credit report. The announcement came soon after TRW admitted to having made a mistake with records from Norwich, Vt. All 1,400 taxpayers were branded as delinquents when a part-time clerk went to Norwich to collect names of delinquent taxpayers. She mistakenly wrote down the names of everyone who paid their taxes. TRW's new policy put considerable pressure on its two rivals, Equifax and Trans Union, to follow suit. Equifax responded by saying that it expects to cut the price to consumers of obtaining a copy of their credit report. Trans Union was not as quick to give in, saying that providing free reports is an "extremely expensive solution." "We will continue to implement real solutions" said Trans Union, "rather than 'public relations fixes' " (Miller 1991b, p. B5). Since further legislation might hamstring the industry, credit reporting agencies seek to appease so-called consumer groups.

Critics claim that the industry has undergone so many changes in the last 20 years that existing legislation is obsolete. The industry seems resigned to the view that "it must support new legislation to win back the public's favor" (Miller 1991a, p. B1). The purpose of this paper is to show the social benefits of credit reporting and the foolishness of the campaign for tighter regulation. The practices and procedures of the credit reporting industry are examined and we respond to the concerns of Consumer's Union, PIRG, and others who favor aggressive legislation.

The Social Function of Credit Bureaus

Credit enables millions of consumers to buy millions of dollars worth of goods every day. Yet the value of credit extends beyond

the fact that using credit is safer and more convenient than carrying large sums of cash. Credit gives the consumer the ability to arrange a consumption plan better suited to his individual earning pattern. He can finance real-estate and consumer durables to smooth out his consumption over his life. Although many consumers do themselves a disservice by over-using credit, the fact that millions of consumers use credit everyday is strong evidence that it is a useful tool.

It is crucial to realize that consumers can get credit precisely because credit granters can identify which consumers are likely to pay their bills. Without credit bureaus, businesses would have a tough time accumulating the payment histories of individual consumers and would not give credit, except in special circumstances. Punishing a consumer who defaults would be an expensive and time consuming process. Historically, when credit reporting is absent, so is consumer credit (Cole 1988, pp. 184–185). When credit reporting is in place, consumers have an extra incentive to pay their bills. They are eager to keep their credit report clean, for otherwise they may lose the benefits of credit. Besides creditors, apartment managers and prospective employers sometimes consult credit records. By enhancing accountability, credit bureaus help turn consumers into responsible individuals.

The ability of creditors to receive information about individual consumers has far-reaching benefits. If credit granters did not have the knowledge gathered by credit reporting agencies, then creditors would be forced to make up for the losses caused by defaulters. Prices would have to increase, harming all consumers. Faithful bill-paying consumers would not be rewarded for their good behavior.

According to the President of Associated Credit Bureaus, Walter Kurth (1991, p. 2), "The mission of the consumer reporting industry is to serve as an objective third-party provider of information to the companies and consumers involved in credit transactions. Our members are libraries that make it possible for credit granters to provide consumers with the credit opportunities they seek." Additionally Kurth (1991, p. 2) points out that "150 million credit active Americans benefit from the opportunities made possible by credit extension." Almost one billion credit cards are in use in the United States and millions of Americans finance homes by a mortgage. Credit is made available to anyone in the United States who can show that he or she has the ability to pay loans as agreed. "American citizens's access to housing, cars, televisions, clothing, household appliances, travel, education, and medicine is understandably the envy of the world" (Kurth 1991, p. 3).

The Credit Bureau as a Mechanism of Social Control

Adam Smith said the following in 1763 in a lecture entitled, "The Influence of Commerce on Manners,"

> Of all the nations in Europe, the Dutch, the *most commercial,* are the most faithful of their word. The English are more so than the Scotch, but much more inferior to the Dutch. . . This is not at all to be imputed to the national character, as some pretend; there is no natural reason why an Englishman or a Scotchman should not be as punctual in performing agreements as a Dutchman. It is far more reducible to self-interest, . . . (which) is as deeply implanted in an Englishman as in a Dutchman. A dealer is afraid of losing his character, and is scrupulous in observing every engagement. When a person makes perhaps twenty contracts a day, he cannot gain so much by endeavoring to impose on his neighbors, as the very appearance of a cheat would make him lose. When people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they lose by the injury which it does their character [Smith (1763) 1964, pp. 253–54; italics added].

Credit bureaus help to turn consumers into Dutchmen. The credit bureau provides the links between the relationships the consumer has with various creditors. This linkage gives the consumer a reputation, or in Smith's words, a "character." The possibility of black marks looms large if the consumer attempts any "smart tricks." One of the first threats that a creditor makes to a delinquent is to report the matter to a bureau (Cole 1988, p. 246).

In a small community members know each other and exert social control through informal means such as gossip. Reputations are made, stored, and transmitted by gossip. The term gossip is used by anthropologists and sociologists to encompass the idea of community information transmission achieved through group meetings, correspondence, local newspapers, leaflets, word of mouth, and so on (Merry 1984, pp. 275–79). In contrast, people in a larger society are mainly strangers and cannot rely on informal reputational means. Man stands, as Adam Smith ([1776] 1937, p. 14) put it, "at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." Credit reporting agencies are a formalized system of gossip that help overcome the gaps in knowledge about particular individual consumers. Without the credit reporting system that makes possible consumer reputations, the consumer could simply default at one business and then apply for credit at another. Foreseeing the likeli-

hood of default, businesses would not give credit. When businesses share their information through a credit bureau, promise-keeping is encouraged through reputational enforcement by credit granters.

Researchers have shown that cooperation often prevails in situations without a policeman wielding a night-stick over deviant behavior. There are two main reasons for this: First, because norms are internalized; people develop the habit and taste for cooperating (Elster 1989). Second, even though real community interaction is haphazard, information concerning performance travels through the community. People gossip.

American society, however, is filled with countless needs and wants that are difficult to handle and control. Gossip alone cannot handle the requirements for maintaining social order. One could simply leave town to make a new name and reputation for oneself. So, how could proper conduct be promulgated in the Hayekian vision of an extended, anonymous, and flourishing society (Hayek 1973, 1976, 1979)? Institutionalized gossip (such as credit bureaus) can help create the rewards in an extended society the way gossip does in the small community.

By drawing a parallel between credit reporting and gossip we run the risk of playing into the hands of the critics of credit reporting. Although gossip does serve useful functions, as described by Merry, it is often malicious and intrusive. That is precisely how critics portray credit reporting. For example, the Consumers Union study is entitled "What Are They Saying about Me?" (29 April 1991). We must emphasize *in this respect credit reporting is remarkably unlike gossip.* Gossip may be unsubstantiated and anecdotal, it may be exaggerated and peculiar, it may be malicious and manipulative. In contrast, a credit report is the result of professional, standardized, and impersonal procedures.

Contrary to the impression given by the so-called consumer groups, there is a great deal of simple information that credit bureaus do not know about individual consumers. They do not know

- where one went to school and what degree one has,
- an individual's driving record,
- whether one has pets,
- who one's relatives are, except sometimes the spouse,
- one's religious, political, or cultural views.

Although the credit bureau knows that a consumer has a mortgage and a credit card, and may know his place of employment, its knowledge includes a very small part of the basic facts about a consumer's existence, facts that a casual acquaintance might know.

A notorious feature of all social control mechanisms is that individual accountability must be weighed against privacy. A social control mechanism attempts to punish wrong-doers; first, it must *determine* who did wrong and what wrong was done. Questions must be asked, and information must be passed. *All mechanisms of social control collide with privacy.*

Again, gossip is a useful tool for spreading knowledge about the character of individual persons. For instance, a baby-sitter who abused children would not be able to maintain a favorable image for very long as news about his practices spread through town. To guarantee by law that this baby-sitter have an absolute right to privacy (in effect, banning conversation about him) would be both an injury to the public welfare and an egregious infringement on the liberty of *others*. The welfare of those being abused and the liberties of those engaging in communication must also be recognized.

But this is not to throw out the idea of privacy, it is to admit that trade-offs must be studied and judged with care. Viewed against the performance of other mechanisms of social control, one finds that the credit bureau is remarkably respectful of privacy. Compared to the sensational tactics of the press, the entrapment and wiretapping practiced by police, the taintedness of gossip, and, as illustrated by the Clarence Thomas hearings, the disclosure of public testimony, credit reporting must be deemed a precise and unintrusive means of social control. It deals with standardized, automated information, and utilizes only the most relevant information and transmits it to only the most relevant parties. Credit bureaus are discreet and impersonal when gathering and storing information precisely because it is in their best interest to act this way. They serve an important social purpose and clearly are less intrusive than other social control mechanisms that we accept without a moment's thought.

What Do Credit Bureaus Do and How Do They Work?

Most of the 1,000 automated credit bureaus operate on one of the three on-line data processing systems: Trans Union, TRW, or Equifax. But nearly 500 of these automated credit reporting agencies are owned either by private independent parties or a non-profit merchant association, purchasing information from one of the three giants (Kurth 1991, p. 1).

A credit bureau provides a report of a consumer's credit history. The reports contain a list of open credit lines (such as a Mastercard account), of outstanding credit balances (such as how much is owed

on a car), and a history of payments. Credit reports detail delinquent payments and note any liens against a consumer. The reports contain the individual's address and Social Security number. This information is gathered from creditors, who supply their records either directly to the three giants or indirectly to local bureaus. Trans Union, TRW, and Equifax enhance their database by obtaining information from county, state, and federal repositories relating to bankruptcies, court judgments, and liens.

The Fair Credit Reporting Act (1971, p. 2), which regulates the activities of all consumer reporting agencies, defines a credit reporting agency as

> any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

The Fair Credit Reporting Act requires each agency to keep accurate records and investigate consumer complaints about information on reports. If a contested item is confirmed by the credit granter, the consumer is entitled to file a brief statement setting forth his version of the story. When a consumer is denied credit based on information in an agency's report, the consumer is entitled to receive a free copy of the report.

It is crucial to realize that answering consumer complaints is an inherent part of the credit reporting industry. There are standard practices the industry follows based on both legal necessity and sound management. It is in the best interest of the industry to maintain accurate records and be responsive to consumer complaints. Input from consumers is precisely the way that credit bureaus check the reliability of their procedures and improve the quality of their product.

The third parties, who receive reports, are usually credit granters (banks and retail businesses), but employers, landlords, and insurance companies also have an interest in the reports. Businesses which subscribe to a credit bureau pay a monthly fee to the credit bureaus and they pay a unit price per report. "Each bureau establishes its own price" (Cole 1988, p. 196). Credit granters that choose not to subscribe have to pay a great deal more for reports and go through more trouble to get them.

Most credit granters give the information concerning their consumers to at least one credit reporting agency. "The contract credit granters sign to become bureau subscribers specifies that they provide their ledger experience promptly and accurately" (Cole 1988, p. 190).

There are two types of firms that contribute computerized data from their accounts receivable ledgers: (1) businesses that subscribe to a bureau in the same geographic area and use the bureau to obtain consumer credit reports, and (2) national firms, such as Sears, Texaco, and VISA, which may buy reports directly from one or more of the giants. Most local and national credit granters give their data to the three giants. These three agencies contain roughly the same information.

TRW publicizes the fact that it maintains credit information on more than 133 million consumers, and that more than 8,000 businesses regularly contribute their accounts receivable data to TRW. Trans Union says it maintains 170 million credit files, covering about 80 percent of all U.S. households (Cole 1988, p. 202).

The consumer has several reasons other than the preservation of his credit record for responsibly paying his department store credit card bill: continuing relations with the business, the fear of legal recourse by the business or a designated collection agency, or just a sense of honesty. The defaulting consumer could, however, just begin using cash or a bank card at the business. And as for legal action, collection agencies find that beyond nasty letters, it is not practical to go to court for receivables below a certain amount. Thus, for small amounts, a consumer pays his bill to maintain a clean conscience and a clean credit report.

Who Is at Fault for Errors in Credit Reports?

The frequency of errors committed by credit bureaus is the main focus of the critic's attacks. The credit bureaus are held solely responsible for errors, but it is imperative to realize that many forces are involved in the credit reporting process.

One cause of errors that is often overlooked is the United States Postal Service (USPS). The failure of the USPS to forward mail promptly and properly often leads to problems. When a bill is not forwarded the inevitable result is that the consumer will be reported delinquent. The credit bureau is not involved in any way; it only records the information as it is received.

Credit granters are a bigger part of the credit reporting process. Credit granters turn their information over to the credit bureaus. Any errors in the information sent unavoidably becomes part of the credit bureau. The source of credit transactions begins with the consumer and the credit granter. The credit bureau merely records the information as it is received.

Consumers also play a vital role in maintaining accurate reports, and consumers can make mistakes as well. Bills can be misplaced, personal checks may not be recorded and memory fails, out-going mail can fail to find its way to the mailbox. If a consumer fails to pay the amount owed (purposely or otherwise), a black mark will eventually end up on his report.

Errors can also arise from public records consulted in compiling credit records. Any misinformation in these records will turn up on credit reports. Because credit bureaus are the most visible and centralized component of the credit reporting process, they bear the brunt of complaints. Rightous consumer advocates point the accusing finger at the mysterious credit bureau because that pantomime creates the greatest sensation. They rarely point the finger at the thousands of other institutions involved in the process. Although credit bureaus do occasionally err, for the most part they merely record the information as it is received.

The Error Correction Procedure

A major criticism of the credit bureaus has been that they are slow or even refuse to correct mistakes. Consumers and critics alike must realize that a credit bureau cannot change a consumer's record on the basis of a complaint made over the phone. If the process were this simple, every defaulter would crowd the phone lines with stories of malpractice. When a consumer makes a complaint that a credit report contains false information the credit bureau seeks to verify immediately their information with the credit granter. According to Kurth, reverification usually takes place within two weeks. Additionally, although the law does not require it, it is industry practice to delete derogatory information in 30 days or to explain to the consumer in the next two weeks why it has not been deleted. Credit bureaus have procedures to respond to inquires, and laws are not necessary to mandate responsive behavior. The chain of communication involved—from the consumer to the credit bureau to the credit granter and back—makes any blanket requirement of less than four weeks unfeasible. Mail delivery on three pieces of mail may take two weeks alone. Finally, when a credit granter does verify a delinquency, the consumer can make a statement saying why he thinks the credit granter is at fault, and the statement is included in the report.

Credit granters often give the customer some leeway when making payments. If a customer has shown a good payment record the credit granter often extends the amount of time allowed for the consumer

to pay. In other words a consumer may be late, but not reported as delinquent. However, this lack of uniformity also leads to errors. Kurth emphasizes that the industry needs to work together on the computer tape format and the reporting delinquency period. Correcting errors is a major concern of, and in the interest of, all parties involved. Of the many players that take part in this process, the credit granter and the consumer must share some of the responsibility for accuracy.

The Consumers Union Study: "What Are They Saying About Me?"

According to a 1979 study by the Credit Research Center at Purdue University, most consumers have at best a dim awareness of what credit bureaus do (Dunkelberg 1979, p. 6). This point should be kept in mind when thinking about the informal surveys conducted by Consumers Union and PIRG.

In 1991, Consumers Union (CU) conducted a survey of 161 credit reports for the three credit-reporting giants. CU conducted its survey among *its own employees and acquaintances*. Rather than choose a random sample, CU chose 57 consumers who, were "either employed by Consumers Union (CU) or were acquaintances of CU employees" (p. i). The respondents were asked to describe "the accuracy, completeness, readability, and confidentiality" (p. i) of the reports. We hazard to suggest that the 57 employees and their friends were fully aware that CU was hoping to find errors in the data. Furthermore CU says, "CU worked individually with participants who had questions in interpreting their reports in filling out the questionnaire" (p. 1).

CU determined that "the credit reports reviewed were riddled with errors" (p. i).[1] In the "Executive Summary" of the report, CU (p. i) lists the following as the three most central findings on inaccuracy:

1. 48 percent of all the 161 reports reviewed contained inaccurate information. Many reports contained more than one inaccuracy.

[1]It is interesting to compare credit bureaus to other major social institutions in the United States in terms of errors and accuracy to put things in perspective. According to Associated Press, "The food-stamp program cost an extra $1 billion in 1990 because of mistakes, fraud and checks lost in the mail, Agricultural Department documents reveal." Additionally, "Just $84 million of that was recovered, say officials at the USDA's Food and Nutrition Service" (*Orange County Register*, 15 December 1991, p. A40).

2. 19 percent of all the reports reviewed contained a 'major' inaccuracy—i.e., one that could aversely affect a consumer's eligibility for credit.
3. One CU employee was actually denied credit during the course of the study because of inaccurate adverse information in her credit report.

These claims deserve examination. The 48 percent of 161 reports that contain an "inaccuracy" are claims made by the participants. These claims may be true or false. For the second finding, a "major" inaccuracy is defined as one that could adversely affect a consumer's eligibility for credit. We are not told what exactly CU means by "could adversely affect credit" eligibility. What is the exact nature of the "inaccurate information"? Is it wrong addresses, wrong Social Security numbers, or misspellings? Is it false reporting of a delinquent payment or mere incompleteness? We are never told. CU gives the following example, "If a credit report showed a 60 day late payment, and the participant identified that as inaccurate because he or she made the payment on time, CU included the 60 day delinquency as a 'major inaccuracy' for purposes of this report" (p. 4). Do the respondents have a clear recollection of when they posted their payments, or do creditors, who employ a staff to record payments received, have the reliable information? CU does not follow up on and substantiate the claims of the respondents.

For the third finding, even if taken at face value, it is important to realize that credit granters deny credit for a wide variety of reasons. Furthermore, the alleged error may not be the fault of the credit bureau. CU does not indicate the source of the error. As we have discussed, the credit reporting agency is not the only source of errors.

Another example of a CU staffer's misfortune occured when a "department store failed to record her new address" (p. i). CU says the bill was sent to her old residence and the post office never forwarded it. The consumer is responsible for notifying all necessary parties about the change of address. How can we be certain that she has? This is simply a mail forwarding problem. The fault lies with either the postal service, the department store, or the consumer, not the credit bureau.

Another case of misfortune is provided by CU in a footnote. One of the CU staffers "had closed several credit card accounts last year by cutting up the credit cards and returning them to the issuers" (p. 3). She was concerned because TRW reports do not clearly indicate when an account is open or closed. But does cutting up your credit cards constitute closing your account? The credit card industry is

plagued by scams, and they must follow careful procedures concerning the opening and closing of accounts.

CU gives another example where an attorney "was delinquent in paying a $19 balance on a department store credit card that she cut up and returned to the department store 5 years earlier" (p. 5). Did her account have a zero balance when she returned her card? CU never investigated the matter. Also, even if the department store is at fault, there is no cause for blaming the credit bureau.

CU goes on to divide the major inaccuracies into two categories: crossover of consumer files—due to identical names, records are sometimes entered to the wrong file—and "information indicating that the participant was late in making payments when, in fact, the participant made the payments on time or was not obligated to make any payments" (p. 5). Yet, not a single major inaccuracy described is clearly the fault of a credit reporting agency.

Another example involved a staffer who was mistakenly billed for medical services she never received. "Although she cleared up the problem with her doctor—who acknowledged the mistake—her doctor never cleared up the problem with the credit bureau" (p. 5). If a doctor never contacts a credit reporting agency with one of *his* mistakes, one can hardly blame the credit bureau. In its discussion, CU fails to give a single clear case of credit bureau malpractice.

Participants were also asked to judge "whether their reports listed all their current credit accounts" (p. 6). The participants reported that 49 percent of their reports were not complete. Sometimes mortgage loans were absent from reports. Again the question of who is at fault should be posed. Credit granters are responsible for reporting new accounts to credit reporting agencies. Banks are responsible for reporting mortgage loans. Furthermore, credit bureaus do not claim to have a complete record of the individual's credit activity.

At one point CU says, "many participants also indicated that their reports omitted past credit accounts that had been fully repaid—information that could enhance a consumer's eligibility for future credit" (p. 6). Credit reporting agencies do not list every account that has ever been held by a consumer. After a certain period of time, information is often obsolete or irrelevant to the credit granter. By updating reports, credit reporting agencies are not bound to punish repeatedly a consumer for an old delinquency.

Finally, CU examined whether participants found their credit reports readable. A multiple choice format was used with the choices representing various degrees of readability. CU offered choices ranging from "Easy to read and understand" to "Extreme torture." From the results CU concludes "that many participants found the credit

reports difficult to read and understand" (p. 7). Yet, CU's own graph shows that the "Moderately easy to read and understand" category tallied the most responses. But more significantly, credit reports are designed to transmit information concisely to professional parties with a legitimate interest. It is a specialized trade that necessarily employs a specialized format.

In sum, the Consumers Union study is replete with flaws (both semantic and statistical), not the least of which is CU's decision to involve only their employees and friends and to assist them in filling out the survey. The primary goal of the Consumers Union seems to be to inflame opinion against the credit reporting industry, which enables millions of credit active consumers to make purchases they need and enjoy.

PIRG's Study: "How the Credit Bureau Ruined My Life"

Ralph Nader's PIRG also indicts the credit bureau in a study documenting consumer complaints. The study, released on June 12, 1990, examines individual complaints against credit bureaus.

The initial claim PIRG makes is that "credit reporting agencies fail to correct mistakes and fail to properly guard personal credit information" (Mierzwinski 1990, p. 1). This study describes "five case studies examining the worst problems found" (p. 1). PIRG claims that approximately 43 percent of credit reports contain serious errors. PIRG wishes to have the Fair Credit Reporting Act, which it calls a "dinosaur" (p. 1), revised because it fails to protect consumers from a variety of significant problems. The number of errors and the difficulty consumers have correcting them seem to be the major thrust of PIRG's document. PIRG relies on quotes from consumers to support its cause for regulation, such as, "To state that the credit bureau ruined my life would not be an understatement" (p. 2), the malapropism PIRG borrowed from when titling its report.

PIRG lists individual complaints representing the most severe horror stories they could find. One consumer says, "*no one I have contacted* has any idea how to cure this problem" (p. 5). PIRG does not inform us whom the person contacted. Another complaint reads, "Early part of last year I was denied because of wrongful report. . . . I was furious as this was to be corrected the first time. . . . *There are exactly seven accounts that do not belong on here and I want them removed for good*" (p. 5). This is another case of the consumer's word against the agency's. Another consumer claims that a credit reporting agency "refused to correct its errors" (p. 5). All of these

claims have one thing in common: they are unsubstantiated and the reader is asked to take them at face value.

"Associated Credit Bureaus (ACB), the trade association for the three repositories, argues that in 1988 'only' about 9 million consumers requested a look at their files" (p. 9). Of these 9 million, 3 million inquiries resulted in an amendment to the report. Three million of 9 million is one-third. On this basis, PIRG suggests that of the 400 million credit reports kept annually, one-third, or 133 million are faulty. The original sample of 9 million consumers, however, hardly constitutes a random sample. The 9 million consumers who paid money to look at their reports probably had reason to do so. Although many consumers undoubtedly bought their reports to satisfy their curiosity, the majority of these 9 million most likely believed that their reports contained controversial information. Thus, to extrapolate this non-random finding over the entire population of 400 million reports is irresponsible.

PIRG recommends that consumers should be able to obtain a free copy of their report every year—a recommendation that TRW has already given in to. Credit reporting agencies charge very little for credit reports as it is; and by law they provide a free report upon request to those denied credit because of adverse information on credit reports.

Another section of PIRG's report concerns "Incorrect Information Not Corrected By All Repositories" (p. 4). One consumer exclaims, "I am appalled to know that there are three universal credit reporting agencies who exchange negative information, but do not share beneficial resolutions" (p. 4). Yet, current anti-trust law forbids credit reporting agencies from exchanging corrected data. PIRG admits that "this is an issue" (p. 4). Furthermore, PIRG concludes "that consumers like Jane Doe are the ones who suffer from bad credit reporting" (p. 4). PIRG fails to recognize that errors, after all, also hurt credit bureaus and the credit granters which rely on credit reports.

The follow up to PIRG's original study is entitled "Don't Call; Don't Write; We Don't Care" (Mierzwinski 1991). PIRG is nothing if not bold. Similar to the language in the first study, PIRG says, "the consumers in this study are trapped in the nightmare on credit street. As this report shows, for many of them the nightmare never ends" (Mierzwinski 1991, p. 1)."

The study profiles 155 "credit report complaints" (p. 2). In numbering its major points, PIRG left out the integer 5—the points are numbered 1 through 4, 6 through 9. Another error on the same page is significant. A bar graph shows the number of "Times Consumer

Contacted Credit Bureau By Phone Or Mail Or Visit." Sixty-three percent of consumers are shown to have contacted a credit bureau 5 or more times, while 27 percent of consumers contacted a credit bureau less than 5 times. No one at PIRG noticed that 63 percent and 27 percent add up to only 90 percent. The second figure should have been labeled 37 percent, and from the calibration of the axis one can see that they meant 37 percent. These errors found in the 1991 PIRG report show that we all make mistakes. In operations like the credit department of a store, the U.S. Postal Service, or a credit bureau, hundreds of people are employed full-time to record and transmit trillions of bits of information. PIRG has demonstrated that it is unreasonable to demand infallibility.

The study claims, "63 percent of consumers had contacted the *credit bureau 5 times or more* before contacting the government" (p. 2). PIRG claims that "this is a conservative number, because U.S. PIRG rounded all contacts greater than 5 and converted 'numerous' or 'many' to 5" (p. 11). By automatically converting "numerous" or "many" to 5, PIRG is hardly being a generous opponent.

Finally, PIRG asks (pp. 3–4), "Why should a consumer who has never done business with a firm be saddled with the hassle, and it *is a hassle, of removing someone else's negative information* from his or her credit report?" This question has a simple answer. It is vital for a consumer to contact the firm because that is the only way errors can be corrected. A credit bureau can not correct errors it does not know about. Usually, errors exist because the credit bureau has been supplied misinformation. There is no way for a credit bureau to recognize a discrepancy without the help of the consumer.

The central issue of the debate is *the accuracy of the credit reports*. Both the Consumers Union and Nader's PIRG arrive at their estimates by rigging the procedure. The two so-called consumer groups use outlandish and sensationalized language to push their crusade.

The Arthur Anderson Study

Juxtaposed to the histrionics is the study by Arthur Anderson & Co., an internationally recognized accounting and consulting firm commissioned by Associated Credit Bureaus in June 1991 to discover how frequently credit errors cause negative credit decisions (Arthur Anderson 1992). Anderson & Co. studied a random sample of 15,703 consumers that had been denied credit based on the credit granter's scoring system that used credit report information. Anderson & Co. determined that from this sample, 1,223 consumers (or 7.7 percent) requested their credit report from the issuing credit

bureau. Of this group, 304 consumers disputed the information on the report. Each dispute was reinvestigated and then all 304 resulting reports (some revised and corrected, others simply confirmed) were returned to the credit granters that originally denied credit to the consumer. The credit granter was then asked to reevaluate the credit application. As of the date of the study, 267 of the 304 cases had been reevaluated. In only 36 of these cases was the original credit decision reversed to a positive decision.

The results are telling, but a definitive and exact measure of the frequency of errors cannot be inferred. Consider two cases, the first is the worst case scenario, the second a reasonable guess scenario.

Case 1: Assume that consumers with errors on their report are *no more* likely, after being denied credit, *to request their credit report or to contest information* than consumers without errors. In this case, the 267 reevaluated reports would constitute a random sample of those denied credit, and we would simply divide the 36 decision reversals by 267 to arrive at the estimate that 13 percent of credit rejections result from errors on credit reports. Even though this figure is based on wildly implausible assumptions slanted against the credit bureau, this figure makes the estimates of error frequency of Consumers Union and U.S. PIRG look excessive.

Case 2: A responsible estimate from the Anderson information would of course take into account the fact that someone with an error on his report is more likely to request the report and more likely to contest the information. Suppose that a person with an error were three times as likely as a person without an error to request a report, and four times more likely to contest information. Then the percent of credit rejections due to errors on reports would fall to about one percent. The assumptions here seem like reasonable guesses.

In brief, the study conducted by Arthur Anderson & Co. gives lie to the dramatic claims about error frequency promoted by the so-called consumer groups.

The Issue of Marketing Lists

The issue involving mailing lists is one that feeds on the paranoia of consumers. "What Are They Saying About Me?" is a typical example of tapping the fears of consumers rather than advancing understanding. Merchandisers buy mailing lists from the three largest credit reporting agencies. They buy these lists hoping to find consumers that might have an interest in what they are trying to sell.

It is important to understand how TRW sells mailing lists to marketers. A marketer requests a list of names of individuals that exhibit

characteristics specified by the marketer. For example, the characteristics may be estimated income, zip code of residence, or positive payment history. The marketer sees *only the final list of names and addresses that is compiled, not the information in the files of those individuals.* TRW does not wholesale its consumer information—to do so would be to share freely its stock in trade (Bibas 1992).

Some people undoubtedly regard mail-order catalogs as a nuisance, but if more people did the practice would probably stop. Yet, it is not only businesses that benefit from these transactions. When consumers shop at home by mail-order they save time. Furthermore, they stay off roads and thereby diminish congestion, consumption of gasoline, and auto emissions. The individual consumer is served because catalogs are sent that cater to his or her taste. Without the use of marketing lists, businesses would be reduced to sending out catalogs more randomly or not at all. Consumers Union acknowledges in *Consumer Reports* (October 1991, p. 644) that "readers said they enjoy receiving catalogs from different companies." Also, "when catalogers narrow the market, they reduce mailing costs, raise the percentage of sales, and make a higher profit. That knowledge has spawned some 10,000 specialty catalogs, selling everything from apples or automobiles to waders or wine. There are catalogs for tall people, short people, left-handed people, people with physical limitations, and people who wear uniforms" (p. 643).

Again, credit reporting agencies are not the only player involved in marketing lists. It is far more reasonable to think that unhappiness with junk mail points to a failure of the postal service. The United States Postal Service (USPS) should perhaps be blamed for not having developed a way for the individual to forestall unsolicited lesser-class commercial mail. If the USPS were more responsive to recipient demands, it could arrange for pre-approval to receive such mail. Under this arrangement individuals would have to think seriously about the information/opportunities versus nuisance of direct mail, and then decide. The vast majority would probably choose to accept such mail. After having been able to make a choice, a consumer would feel less indignant about finding his mailbox stuffed with catalogs.

Another route for individual approval is better awareness that one's name will be used in mailing lists. The suggestion of critics (Consumers Union, PIRG, and others) that marketing firms receive individual approval for every name is obviously too costly. This mandate would, in effect, eliminate direct mail altogether.

Now it should be asked which principles will prevail in the matter of mailing lists. Are individuals to own information about them-

selves? How could this principle find boundaries that avoid absurdities? How would the media report the news? When a business writes down what a person buys to keep track of inventory, is this a violation of privacy? A mailing list is just ink on paper, both of which are the property of the marketing firm.

Conclusion

Credit bureaus are a service to all consumers who use credit responsibly. The agencies serve as a hub of information, efficiently transmitting information to its members. At the same time the credit bureau creates incentives for consumers to alter their behavior. In other words, credit bureaus reward moral actions. For maintaining accountability and honesty in a vast society like the United States, the fundamental principle behind the credit bureau can be of great importance. Essentially, credit reporting agencies play the role that can no longer be played by community reputation. And as a mechanism of social control, credit bureaus are remarkably discreet. There are many institutions involved in the credit reporting process, all of which can be at fault for errors that exist in credit reports. Credit bureaus try to resolve discrepancies, but it is necessary that we recognize credit granters and consumers as important factors in this process.

The Consumers Union and PIRG's reports are rife with irresponsible methods and blatant sensationalism. Consumers Union based all of its findings on the reports of 57 of their own employees and friends. Even with this obviously biased sample, CU fails to point out one error that is clearly the fault of a credit reporting agency. CU does nothing to prove that the mistakes made by credit reporting agencies are above a reasonable level. PIRG's reasoning and statistics also are dubious and sensationalized. In addition to making numerous mistakes in its own report, PIRG surmises that if everyone checked their reports, approximately 133 million reports would contain errors. The reasoning behind this estimate was shown to be unfounded. The study by Arthur Anderson & Co. shows the so-called consumer groups to be grossly mistaken and that serious errors are rare.

The credit reporting industry is a somewhat mysterious entity—one that the average citizen has almost no contact with. This "behind the scenes" aspect makes the industry vulnerable. This paper provides a closer examination of the industry and throws light on the enormous good achieved by credit bureaus, the natural incentives to avoid errors, and the impracticality of expecting infallibility. To

the extent that the critics prevail in influencing laws to hamstring credit bureaus, consumers will benefit very little, but will find credit harder to obtain and available on less attractive terms.

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