A Tale of Two Countries: Responding to Over-Indebtedness in France and the UK: 1985-2010: The role of interest rate ceilings

Iain Ramsay∗

* Professor of Law, Kent Law School, University of Kent, Canterbury. Draft for Dublin Regulation Conference. Not for quotation or citation. The discussion of interest rate ceilings at pp. 9-25 is substantially based on my article “‘To Heap Distress upon Distress?’ Comparative Reflections on Interest Rate Ceilings” (2010) 60 University of Toronto Law Journal 709.
Abstract

This paper explores why France but not the UK uses interest rate ceilings to protect consumer debtors against over-indebtedness. Does this difference reflect an “economic mistake”, the influence of ideology, the role of interest groups, or the effects of legal origins? The paper is part of a larger comparative study of the reasons for the distinct responses of France and the UK to the external shock of a significant growth in individual overindebtedness since the mid 1980s. Part I outlines the study, its rationales and objectives and Part II focuses on interest rate regulation outlining the history of and contemporary debates on interest rate regulation in France and the UK. I tentatively conclude that legal origins are not a compelling explanation for difference but that ideas and interest groups i.e. politics explains these differences. Consumer and industry groups oppose ceilings in the UK, whereas consumer groups in France support ceilings and there appears to be the absence of a strong industry lobby in favour of abolition. In addition, neo-classical/liberal economic ideas are influential within UK government departments and consumer credit was viewed as a method of fuelling economic growth and maintaining living standards. Such findings are relevant to European integration projects.
« Je veux protéger les consommateurs sans décourager le crédit à la consommation». Christine Lagarde, Minister of the Economy, discussing the 2010 Consumer Credit Reform Bill, March 24 2010.

“ Le crédit revolving, Cette pratique d’origine anglo-saxonne”. A Crédit! Le Monde (14 October, 2009)

“As a very general proposition, consumer law in this country aims to give the consumer an informed choice rather than to protect the consumer from making an unwise choice” Lady Hale The Office of Fair Trading (Respondents) v Abbey National plc & Others [2009] UKSC 6.

1. Introduction: The Study

This paper discusses one aspect of a comparative study of how two legal systems, England and France, with distinct legal origins (civil law/common law), addressed the external “shock” of a substantial increase in over-indebted individuals since the mid-1980s. Both countries have experienced substantial rises in formal indicators of over-indebtedness since the late 1980s. In France the number of individuals making application for relief to the over-indebtedness commissions increased from 70,000 in 1991 to 185,000 in 2008 (Banque de France 2009). In England and Wales, individual bankruptcies increased in the corresponding period from 25,000 to 106,000, along with the growth of a substantial number of private debt repayment plans.

Over-indebtedness is a significant social and economic issue in both countries, disproportionately affecting lower income groups (Department of Trade and Industry and Department for Work and Pensions 2004; Gloukoviezoff 2006; Banque de France 2008; Chatriot 2006). In both France and the UK measures have been introduced to prevent and treat over-indebtedness, but significant differences exist between policies in the two countries.

Key differences include:

1. The existence of a substantial private sector ‘over-indebtedness industry’ in the UK, including fee-charging debt management companies listed on the AIM stock exchange. There are approximately 100,000-150,000 private debt management plans commenced annually. In the early 2000s enterprising accountants adjusted a procedure intended for business debtors to create mass-produced methods of writing down debt (Walters 2009) and a private over-indebtedness industry of “one-stop shops” now exists alongside public advice. The private firms provide products

---

1 Scotland has a separate bankruptcy system.
2 Citizens Advice in a 2000 report on high cost credit comments “In 1980 the Annual Report of the CAB Service made no mention of debt. Any debt enquiries that were made were recorded within the category of ‘consumer, trade, and business’. In 1999/2000, the CAB Service answered over 698,000 enquiries on consumer debt and credit. Enquiries on consumer debt have increased by 46% since 1996/97 and now make up nearly ten percent of all enquiries.” Citizens Advice (2000). Daylight Robbery: The CAB case for effective regulation of extortionate credit. London.
3 Although there is substantial discussion on appropriate measures for defining and measuring over-indebtedness (The Griffiths Commission on Personal Debt 2005; European Commission 2008b; National Audit Office 2010).
ranging from consolidation loans to Individual Voluntary Arrangements (IVAs) and bankruptcy advice (Green 2009). Governments encouraged this privatization which reduced the costs of state provision of bankruptcy and debt advice (Walters 2009) and the most recent official review of over-indebtedness envisages an increased role for the private sector (National Audit Office 2010).

In contrast fee-charging debt management companies have been prohibited in France since 1985. Publicly financed over-indebtedness commissions operated by the Bank of France deal with over-indebted consumers. This regime, introduced in 1989, was modified in 1995, 1998, 2003 (Ferrière and Chatain 2006), and 2010.

2. Credit reporting. Positive credit reporting exists in the UK, negative reporting in France. The Bank of France manages the negative credit reporting system in France (also introduced in 1989) to ensure more responsible lending. In the UK private profit making institutions operate credit reporting in the UK and are regulated primarily through industry protocols and understandings with government.

3. Interest rate ceilings on consumer credit exist in France but not the UK. French policymakers regard ceilings as a protection for consumers from the dangers of high cost credit, over-indebtedness and potential social exclusion. In contrast, UK policymakers regard ceilings as creating financial exclusion and increasing illegal lending.

4. Home equity lending was until recently not possible in France and the structure of home mortgage lending differs between the two countries.

5. There are (probably) higher supply side barriers to entry for consumer credit lenders in France than the UK.

Perhaps as a consequence of these policies there is a substantially lower level of consumer and mortgage credit in France compared with the UK. At the end of 2008 the ratio of household debt to gross disposable income was 75% in France, 160% in the UK (Athling Management 2008; Economist Intelligence Unit 2009). The French level of consumer credit was approximately half that of the UK. In 2008 the home ownership rate in France was 57% (Lefebvre 2008) compared with 72% in the UK.


5 There are a number of negative reporting systems in France. The FICP is triggered either by an application to the over-indebtedness commission or by a period of default (e.g. 60 days on revolving credit). The period of listing lasts five years. There is also the FCC (Fichier central des chèques) which lists individuals who have been subject to a prohibition on passing cheques (dating from 1955) and individuals whose credit cards have been withdrawn for abusive usage. The review of the fichiers in 2008 indicates that in 2006 the FCC contained 1.8 million individuals and 0.66 million had credit cards withdrawn and 2.3 million were on the FICP. Creditors are not under an obligation to consult these directories before granting credit. The 2008 EC Consumer Credit Directive also does not impose an obligation to consult credit databases. Although it will often mean a refusal of credit, consolidation loan companies “rachats de credit” may still grant a loan to a person on the FICP. This will be one factor in the assessment of risk. The report of the Inspection Générale des Finances and the Inspection Générale de la Banque de France concluded that an obligation to consult might result in financial exclusion. The obligation to consult needs also to be considered in relation to the judicially imposed obligations of creditor vis-à-vis debtors (see cour de cassation..) and the possibility of the overindebtedness commissions taking into account the manner of granting credit when drawing up a repayment plan (see art. L331-7). See Inspection générale des Finances/Inspection Générale de la Banque de France (2008). Rapport sur l’évaluation du fichier de remboursement des crédits aux particuliers. Paris.

6 In the UK the private Credit Reference Agencies are licensed under Part 3 of the Consumer Credit Act 1974 and must meet the standards of the Data Protection Act 1998.

6 The Lefebvre report (2008) notes that (a) the level of mortgage debt in France is substantially lower in France than the UK or Spain (b) most mortgages are at fixed rates without an initial teaser period (c) Home equity credit is much more constrained in France. The introduction of the hypothèque
The central research question is to understand why these countries adopted distinct approaches to regulation of over-indebtedness. The following reasons indicate the value of answering this question. First, in both countries recent official reports have questioned the effectiveness of existing over-indebtedness strategies. (Cour des Comptes 2010; National Audit Office 2010; Public Accounts Committee 2010) and there is the possibility of comparative policy learning. Second, legal origins (e.g. French civil law versus English common law) have been associated with ‘different styles of social control of economic life’ (La Porta, Lopez-de-Silanes et al. 2008). Comparison of French and UK regulation of consumer credit and debt provides the opportunity to assess this argument. Third, the EU wishes to develop an integrated capital and credit market and to combat financial exclusion (EU Commission 2005; Ramsay 2010). Although the EU has taken steps towards establishing a common set of ground rules for consumer credit markets, consumer credit markets remain stubbornly national and we need to understand whether national barriers to achieving an integrated approach to credit and overindebtedness are cultural, institutional or political. Finally, the UK government has assumed the superiority of the “Anglo-Saxon” model of maximising access to credit and consumer choice in a “free and fair market”—thereby promoting growth and living standards—over what was perceived to be paternalistic protection by the state of consumers from the credit market. Regulation would, in the Anglo-Saxon model stimulate confidence in increased use of credit. This model of consumer protection can be traced to the Crowther report in 1971 and the UK has promoted the Anglo-Saxon model at the EU rechargeable in 2006 was intended to encourage home equity lending but still restricts the extent of equity withdrawal and has been modestly used. Moreover the structure of home lending in France is distinct with extensive use of guarantees.

The report argues that a sub-prime mortgage market does not exist in France because of (a) approaches to risk (b) pricing and refinancing practices (c) legislation which excludes high risk debtors (d) a culture of lending which focuses on the income of the debtor rather than the value of the property. http://www.assemblee-nationale.fr/13/rap-info/i0744.asp Usury laws are the central legal regulation preventing the creation of a sub-prime mortgage market. The Report indicates that this constrains lenders from lending to individuals who do not fit the “standard profile” but that it prevents the development of a sub-prime industry. (Report at 26). The Report recognises that the usury laws restrict home ownership to individuals with secure, regular incomes.

The Report also argues that there is a different culture of relationship lending in France where lenders often view a home mortgage default as reflecting badly on their reputation and contrasts with the originate and distribute model of sub-prime lending in the UK and US.

There is not a culture opposed to home-ownership in France. The Report notes that nine out of ten French would like to be home owners and the government in 2006 had the objective of achieving a 70% home ownership rate. The class distribution of housing is reflected by data indicating that 70% of high earners own their home, 46% of the middle class and 33% for those of modest income. In 1980 this distribution was 51%, 45% and 46%.

7 The EU Consumer Credit Directive of 2008 is one step towards a common set of market ground rules, requiring “full” harmonization (i.e no higher or lower protections) of those credit law provisions directly linked to promoting a competitive market. The EU has not however pursued full harmonisation of regulation of debt-adjustment procedures, preferring to rely on the development of “best practices” and a mutual learning process (similar to the open method of co-ordination)/European Commission (2008b). Towards A Common Operational European Definition of Over-Indebtedness, Directorate General for Employment, Social Affairs, and Equal Opportunities.
level. The model of the economy where consumer credit drove increased growth, even during periods of downwards pressure on wages and the sustainability of a “loans for wages” model of the economy have been questioned by the credit crunch. (Barba and Pivetti 2009).

Existing literature suggests several possible explanations for regulatory differences in credit and debt regulation.

First, popular accounts argue that there are different ideologies towards consumer credit markets in France and the UK with greater emphasis on consumer protection in the former country and consumer choice in the latter (Whitman 2008). This is often conflated into a cultural argument that the French have a different attitude towards credit—“[t]he French tradition …protects the consumer against himself” and “the majority of French society is distrustful of credit (Taffin and Vorms 2007) – and there is "an entirely different culture of money and borrowing and debt" (Lanchester 2010) in France (Athling Management 2008; Office of Fair Trading 2009; Vorms 2009; Lanchester 2010).9 Culture might therefore be embedded within the institutions of regulation. Culture is hypothesized to account for differences in bankruptcy law. Research conducted for the UK Office of Fair Trading, for example claims that there is a “deep resentment and distrust held by French and German citizens toward lenient consumer bankruptcy law” (Office of Fair Trading 2009). However culture is a difficult topic to analyse and measure and I have outlined elsewhere some skepticism about cultural arguments and credit.

Second, the relative influence of neo-liberalism may distinguish the UK from France. Neo-liberal policies have not however been restricted to Anglo-Saxon countries and have often been adopted by parties of the left in Europe (Mudge 2008). Since the mid 1980s neoliberalism has influenced the opening up of the French financial sector so the question is why there should continue to exist significant differences in regulation of credit and over-indebtedness between the UK and France. There are undoubtedly varieties of neo-liberalism or capitalism (Hall and Soskice 2001; Schmidt 2009) so that France may represent a more “state influenced” form of neo-liberalism (Schmidt 2009).

Third, legal origins provides a further potential explanation. In a series of papers La Porta et al argue that differences in styles and strategies of legal regulation of economic and social life can be explained by legal origins (La Porta, Lopez-de-Silanes et al. 2008). “[C]ommon law stands for the strategy of social

8 [documentation] The White Paper which preceded the 2006 Consumer Credit reforms noted that “the current reform process could be very influential on the European debate. Our analytical research into the key drivers for reform of the largest and most dynamic credit market in the EU means that our conclusions as to the right level of regulation and consumer protection will provide a clear direction for the UK at an EU level”. (DTI: ‘Fair, Clear and Competitive: the consumer credit market in the 21st century at 4.14. (2003).

9 Gelpi and Labruyère in their history of consumer credit claim that “Great Britain—with its hardsell marketing and powerfully established actors: banks, retailers, financial houses and also credit bureaus—is often seen as a counter example by French consumer credit moralists…Britain is a sort of United States within easy reach of Europe, but without the attraction of the frontier”. Gelpi, R. and F. Julien-Labruyère (2000). The History of Consumer Credit Doctrines and Practices. Basingstoke, Palgrave: Macmillan at 133.
control that seeks to support private market outcomes, whereas civil law seeks to replace such outcomes with state-desired allocations” (La Porta, Lopez-de-Silanes et al. 2008). Their latest work (2008) edges towards a cultural approach. Drawing on Zweigert & Kötz (Zweigert and Kötz 1998) they assert that legal origins reflects a ‘style of social control of economic life’, with England and France developing “very different styles of social control of business and institutions supporting these styles”. In their view, the French civilian tradition is less hospitable to facilitating credit, more willing to protect debtors and more likely to intervene in market failures with centralised regulation. In moments of crisis, “when the market system gets into trouble…[the] civil law approach is to repress it or to replace it with state mandates while the common law approach is to shore it up”. Although legal systems are not “hard wired” to particular solutions, La Porta et al suggest two important normative conclusions derived from their analysis of legal origins: (a) legal systems may apply inappropriate solutions because of the influence of legal origins (b) rules introduced during a crisis may not be abolished after the crisis. The legal origins argument has generated substantial controversy and criticism (Michaels 2009). The legal origins thesis has not been systematically examined in relation to the regulation of consumer credit markets.

A comparative study of over-indebtedness seems at first sight to be congruent with the legal origins hypotheses. France reacted to the phenomenon of over-indebtedness through the introduction of state financed over-indebtedness commissions throughout France, which gave a central role to the Bank of France, a unique role for a central bank (Cour des Comptes 2010). England left much to private negotiations, permitting existing public and private intermediaries to play a role. England and Wales did modify insolvency legislation in 1986 and 2002 but these reforms were not enacted in response to consumer over-indebtedness or consumer interest groups (Skene and Walters 2006; Ramsay 2006a). However the UK government did develop an over-indebtedness strategy in 2004 which was preceded by an over-indebtedness “summit” (2000) and task force. The strategy engages several Ministries (DBIS, DWP, Ministry of Justice) and a large number of initiatives intended to achieve responsible lending and borrowing.

Fourth, interest group analysis might account for distinct regulatory approaches. Early public choice literature suggests that diffuse groups such as consumers are unlikely to be successful in the market for regulation (Olson 1965; Trebilcock 1975; Wilson 1980; Ramsay 2007). Wilson developed a political theory of regulation where success for groups depends on the distribution of the costs and benefits of particular

10 “Le dispositif de lutte contre le surendettement institué en 1990 et complété en 1995, 1998 et 2003 se distingue par son caractère profondément original au sein du droit français, dans la mesure où il instaure une coopération d’un type tout à fait particulier entre l’autorité administrative, en l’occurrence, la commission de surendettement chargée essentiellement d’un rôle de conciliation, et le pouvoir judiciaire qui peut donner force exécutoire à une solution préparée par la commission ou ouvrir une procédure de rétablissement personnel.” Banque de France Note d’Information No 134 À substituer à la note d’information n° 119 Le Surendettement des particuliers at 8. (2009).

policies. (Wilson 1980). Issues of debt and credit often throw up tragic stories and the media may highlight them creating a political demand for action (Kuran 1999). Financial crises or sudden increases in levels of overindebtedness may create political demands and political opportunities for groups. Governments have created and financed consumer groups and agencies to represent consumers, and industry players may have an interest in regulation which will increase overall demand for credit and/or disadvantage competitors. The configuration and influence of industry and consumer interest groups may therefore affect the shape of credit and consumer law. For example consumer groups in the UK are in general opposed to ceilings: in France they support ceilings.

Finally, path-dependency provides a further possible explanation for differences between legal systems’ responses to social and economic problems. Like legal origins this suggests that once regulation is established in a certain pattern it will cast a long shadow over future regulation. Stephen Breyer argued this as a general proposition about regulation and James Whitman has recently suggested a form of path dependency for legal systems based on the ideal-type distinction between consumerist and producerist legal systems (Whitman 2008), contrasting the consumerist model of the US and UK with producerism in France and Germany. These accounts which focus on the patterning effects of earlier choices in regulation act as a counterpoint to the idea of the “state as a billiard ball”, responding to different interest groups(Hall 1986).

The study will examine the persuasiveness of these accounts in explaining the distinct approaches to over-indebtedness regulation in the two countries over the period 1985-2010. In this paper I focus on one aspect: the role of interest rate ceilings as a mechanism of regulation. Part 2 discusses the general issues concerning interest rate regulation. Parts 3 and 4 discuss the historical development of usury regulation in the UK and France including contemporary debates in both countries on the role and value of interest rate ceilings. In the UK the government rejected the introduction of interest rate ceilings “in the face of the strongest campaign against moneylending charges since the 1920s” (O’Connell 2009). The UK Competition Commission also rejected the introduction of ceilings in the “home credit” market, a high cost form of low income credit in the UK. France proposed to modify its ceiling regime in 2010 but did not seriously consider abolition. Part 5 provides a brief discussion and conclusion.
Table 1: Cases before French over-indebtedness commissions and English insolvency statistics 1990-2008


2. Controlling the price of credit

Usury ceilings are a pervasive and controversial form of contemporary regulation of consumer credit markets. Neo-classical economists generally argue that ceilings are counterproductive and fail to achieve their intended objective of protecting vulnerable consumers. They are anachronisms within a ‘modern’ economy with workable competition in credit markets.\textsuperscript{12} Ceilings do not exist in the UK but France, Germany, several other European countries and Japan have ceilings (Kozuka S. and Nottage L. 2009). A criminal interest rate exists in Canada\textsuperscript{13} and provinces have introduced controls on the price of payday loans with Quebec prohibiting payday loans through its effective interest rate ceiling of 35\%\textsuperscript{14}. Certain US and Australian states have ceilings. About forty developing and transitional economies have introduced some form of interest rate ceiling.\textsuperscript{15}

\textsuperscript{13} Criminal Code, R.S.C. 1985, c. C-46, s. 347(1). Section 347 has been subject to much criticism. See, for example, J. Ziegel, ‘Does Section 347 Deserve a Second Chance? A Comment’ (2003) 38 Can. Bus. L.J. 394.
\textsuperscript{14} Quebec will not licence lenders charging interest rate levels above 35\%.
prohibits usury. We do not seem to be progressing to ‘The End of History’ on interest rate ceilings as nations converge on a ‘modern’ understanding of what many economists would argue to be the futility of ceilings. A more pertinent thought is Eric Posner’s comment in 1995 about the ‘fantastical survival of usury laws despite almost incessant controversies over hundreds of years and in many different countries.’ (Posner 1995). Political pressure for ceilings increases with wealth inequality and during economic downturns.16 Both conditions currently exist in many countries.

Interest rate ceilings may take many forms and be premised on a variety of rationales. There may be a single ceiling or a range of ceilings for different types of loans as currently exists in France. Ceilings may be linked to market prices, or be established as a fixed rate. They may be based on the total cost of credit (e.g. £17 per £100) or a percentage rate. Some ceilings include only interest charges while others, as an anti-avoidance strategy, include all costs. This latter approach will inevitably result in a high interest rate for small short-term loans. Ceilings are sometimes established at a level intended to mimic the market. In other cases they are established at a much higher rate than the market as a method of policing the outlier transaction.

There are several rationales for ceilings. These include: (1) a response to behavioural mistakes where individuals are perceived to underestimate the risks of high cost credit, (2) the provision of a bright line rule substantially above the market rate reducing the high costs of proving fraud or exploitation in credit markets, (3) addressing problems in competition in a market which leads to supra normal prices, (4) preventing externalities from high cost credit such as state costs of support for individuals who become over-indebted, (5) ensuring a ‘fair’ price in transactions (6) providing cross-subsidisation of higher risk individuals by lower risks, representing social solidarity.

The economic criticisms of interest rate ceilings are well known. They are a blunt and over-inclusive instrument since not all high interest loans are necessarily unfair or result in over-indebtedness and not all consumers may underestimate the risks of high cost credit. Ceilings may be circumvented through the charging of ‘fees’ or insurance and may have undesirable substitution effects where individuals are forced into less convenient, more costly and less transparent forms of credit. They may result in cross-subsidisation or credit exclusion for some consumers where suppliers withdraw from the market. Ceilings may hurt most low income consumers who are often the intended beneficiaries of the ceilings. Jeremy Bentham argued that ceilings heaped “distress upon distress”. For these reasons other policy instruments such as more competition, better information, more warnings, debiasing interventions, broad judicial standards of unfairness or ex ante controls on producers are proposed. More focused interventions might be used to respond to behavioural mistakes such as restrictions on cash advances at gambling casinos. Better social programmes rather than attempted market redistribution might reduce the poor paying more.

3. Usury in the UK: The Benthamite Heritage

Adam Smith thought that price ceilings would ensure that funds did not go to ‘prodigals and projectors’ but English economic opinion since Bentham has generally opposed ceilings. John Stuart Mill thought that the usury law had ‘been condemned by all enlightened persons since the triumphant onslaught made upon it by Bentham in his Letters on Usury.’ The general usury laws were abolished in 1854 although controls remained on the price of pawns described as ‘the poor man’s bank.’ However, by the 1870s there was concern about high cost moneylending and predatory lending through the use of security on household goods (Bills of Sale). The 1898 Select Committee on Moneylenders considered but rejected the idea of ceilings, based partly on analysis of US experience of rate ceilings. The arguments outlined by the Committee against ceilings are remarkably modern: (1) high interest rates do not necessarily equate to unfairness, (2) different conditions are applicable to different types of loans and interest rates may not be the best measure of the cost of small loans, (3) the ceiling would become the norm, (4) they would be circumvented. Instead it proposed to confer almost unlimited discretion on judges to hold a bargain to be unconscionable. In 1927 there was substituted the presumption that an interest rate over 48% was unconscionable. However the courts did not use this as a binding price ceiling and upheld higher charges unless there was evidence of advantage taking. During the twentieth century the main working class form of credit in the UK was hire-purchase which was not subject to the usury laws. Consumers often paid high interest rates and were unable to obtain the tax deductions available to wealthier consumers who had access to loans and overdrafts.

The influential Crowther report in 1970 established the “post-war orthodoxy on credit” (Borrie 1986). This report, chaired by an economist and former editor of The Economist argued for a “competitive environment which will ...offer every incentive for innovation and experiment”. The starting point for the report was that the “state should interfere as little as possible with the consumer’s freedom to use his knowledge of the consumer credit market to the best of his ability and according to his judgment of what constitutes his best interests”. The first principle of social policy should be to treat the users of credit as “adults capable of managing their own financial affairs” and not to limit their freedom of access “in order to protect the relatively small minority who get into difficulties”. The second principle should be to reduce “the number of defaulters, including those who set out to defraud their creditors”.

According to Crowther, consumer protection legislation would address information asymmetries through truth in lending, some controls on market terms, modernization of credit licensing to achieve fairness and a limited distributional

---

goal of protecting low income consumers who would have difficulties in protecting themselves through individual litigation. The Committee endorsed some risk and loss spreading in protections for defaulting debtors but it was concerned that this risk spreading should not go too far since it would result in the “good customer” subsidising the “bad customer”. The Committee concluded that there was little that consumer protection policy could do for the poor except provide protection against hardships caused by repossession and the enforcement of judgments.

There were differences of opinion within the Committee on the role of interest rate ceilings. The initial draft of the section of the report, prepared by Roy Goode, proposed their abolition. Goode put forward four reasons for the abolition of interest rate ceilings: (1) They would create serious problems for the low income borrower who would be unable to obtain credit and driven to obtain credit from illegal lenders (2) Control of abuses would be better achieved by a licensing regime rather than reliance on occasional prosecutions (3) High charges may be justified because of the risk. He cites the example of an interest charge of 100% which may not always be exorbitant and decisions under the Moneylenders Acts where the courts upheld interest of 166 and 177% (4) A ceiling would become a standard rate. The section concluded that “no useful purpose would be served by seeking to set an arbitrary limit on a rate which must obviously depend on so many variable factors”.

The final draft, in contrast, after noting that 100% might not “yield an excessive profit”, concluded that “such a borrower should not be eligible for loans from the private sector.” The Committee also recognized that very high interest rates (over 100 percent) could be “socially harmful”, that the current Moneylenders Acts protections were ineffectual, and saw the solution in better welfare provision. The Committee would however have extended the presumption in the Moneylenders Act that an interest rate of 48% was unconscionable to all credit lending and conferred power on the proposed licensing commissioner to monitor and sanction persistent charging of excessive interest. In a later chapter they argued for consumer education (financial literacy), the promotion of credit unions, and government guarantees of approved low cost loans.

The 1974 White Paper on Reform of the Law on Consumer Credit proposed the abolition of statutory maximum rates of interest. The primary reason given was the difficulty of applying one rate to the great variety of short and long term credit transactions. Whether a rate was excessive depended on all the circumstances of the case. Instead they proposed to confer a power on courts to extend to all consumer loans the power to set aside a bargain if it was harsh and unconscionable. This became the “extortionate credit bargain” test of ss137-140 of the Consumer Credit Act 1974. The law had therefore returned to a situation not dissimilar to that which existed in 1900 with the passage of the Moneylenders Act (Deparment of Trade and Industry 1972-73).

The extortionate credit bargain test had almost no regulatory bite, provided little protection against high prices in the sub-prime credit market and was subject to criticism throughout the 1980s and 90s. However, although there was a consensus

21 “in considering which of two relatively innocent parties should bear the greater loss, it is much easier for the business creditor to do so than the individual debtor.”
22 National Archives BT250/116.
among regulators (OFT) and academics that ss.137-140 were ineffective (Ramsay I., 1989; Office of Fair Trading 1991; Howells, Crow et al. 1992; Kempson E. and C. 1999) no reforms were undertaken during this period. In addition the limited nature of the licensing regime coupled with its extremely broad scope and consequently high administration costs, undercut its effectiveness. Most reform proposals were primarily deregulatory and a review of the Act in 1994 commented that

perhaps the greatest strength of the Act is that it does not seek to meet its objectives through interventionist actions such as interest rate capping or direct control of the substance of contracts. Rather it explicitly endorses freedom of contract within a framework designed to ensure openness: consumer protection is attained in large part through measures to ensure that full and truthful information about credit contracts is available to consumers. [OFT, 1994]

The major beneficiaries of the Act were middle class consumers who used credit cards and could take advantage of the very strong connected lender provisions of the Act to hold companies liable for defective purchases.

3.1. New Labour and ceilings

In response to concerns about high cost credit and alleged predatory lending practices (Citizens Advice 2000) the New Labour government had promised in its 2001 manifesto to ‘tackle loan sharks’ and several groups proposed interest rate ceilings as a mechanism to address the growing problem of over-indebtedness. A private members bill to establish ceilings was introduced in 2004 and during the Parliamentary passage of the Consumer Credit Act 2006 there were calls to introduce ceilings. Again during the passage of the Financial Services Act 2010 an amendment was proposed to confer power on the OFT to introduce ceilings if a market was behaving non-competitively. All these initiatives to introduce ceilings failed.

The UK government did promise to keep the issue of ceilings under review. However it argued that the new ‘unfair credit relationship’ provision, replacing the previous extortionate credit bargain provision, along with a more effective credit licensing system, and the extension of the Ombudsman service to credit disputes, would be a more effective provision than ceilings to address the problems of high cost credit.

---

23 Most notably Debt on Our Doorstep (DOOD) a coalition of Church and credit union groups.
27 See U.K., H.C., Hansard, vol. 434, col. 1412 (9 June 2005) (Gerry Sutcliffe, Undersecretary of State, DTI). ‘I am very confident that the unfairness test and the ADR will work and that there will be no need for interest rate caps, but we will always keep that option open.’
All major political parties in the UK supported the government position. In addition, mainstream consumer groups (Citizens Advice, Which) wrote a letter to the relevant House of Lords Committee during the passage of the 2006 Act, urging them not to recommend the introduction of ceilings. The letter (21 October 2005) written on behalf of “a wide range of organisations that are expert in the field of financial inclusion and represent, or work with, low-income and vulnerable consumers” expressed “deep concern about the possible introduction of amendments that may lead to the introduction of an interest rate ceiling in the UK”.

A central document relied upon by the government to oppose the introduction of ceilings was a study commissioned by the DTI (now DBIS) in 2004 on the effects of ceilings in France and Germany (Policis 2004). This study concluded that (1) There is a consistent cross-country irreducible need for credit among low income consumers. (2) There is a higher level of illegal lending in France than in the UK. (3) The existence of interest rate ceilings in France means that there is a less diverse credit supply. The study argued that one consequence of ceilings was that lower income French consumers often used mainstream credit products such as revolving credit which was not appropriate to their needs. Credit card companies served these consumers by levying high charges for missed payments possibly adopting a ‘sweatbox’ model of lending (Mann R. 2007). The study claimed that home lending (see discussion below), a UK form of high cost low income lending, was more suited to the payment rhythm and needs of low income consumers.

The study’s findings and methodology became a focus of controversy. The most systematic critique was made by the New Economics Foundation in 2009 (New Economics Foundation 2009). This made the following points: (1) The report provided no methodological appendix outlining the nature of the survey, how respondents were chosen, or the questions asked. (2) Important tables in the study provided no indication of the number of the responses to each question. This was crucial where it was clear that the question was applicable to a sub-sample within the total sample. It was not possible to compare across countries the number of individuals falling into this sub-sample. (3) The study made strong cross-cultural assumptions about the nature of “illegal” lending and did not probe whether substantial difference existed between the “illegal” market in Germany and the UK. (4) The study failed to explore other explanations for limits on credit availability. Establishing a lending institution has traditionally faced substantially higher entry costs compared with the UK. Supply side limitations might therefore account for alleged credit rationing. (5) Demand for credit may be specific to a country’s regulatory framework; levels of state social support affect demand. (6) Market credit may not be the only alternative available. After the publication of the NEF report in 2009—five years after the publication of the initial Policis research—a “technical

28 See U.K., H.C., Hansard, vol. 434, cols. 1405-06 (9 June 2005) (Gerry Sutcliffe, Parliamentary Undersecretary for Trade and Industry); col. 1415 (Charles Hendry, Shadow Minister for Trade and Industry); col. 1434 (Norman Lamb, speaking for the Liberal Democrats).
29 The study’s methodology and findings were critiqued by Debt on our Doorstep. See online: Debt on our Doorstep, <www.debt-on-our-doorstep.com>.
30 The relevant question was: “Have you or someone in your household every (sic) borrowed from unofficial lenders or unlicensed loan sharks”. It is not clear how this was phrased in French since the French version of the question is not available.
appendix” appeared on the Policis website as well as the relevant government department which had commissioned the research.

An amendment to introduce ceilings was proposed in the recent debates on the Financial Services Act 2010. Again the government opposed the introduction of a ceiling but indicated that a review of high cost credit, and the role of ceilings was underway by the Office of Fair Trading:

…[T]he Government share his concerns about low-income and financially vulnerable consumers, who can struggle to obtain cheaper credit from high street banks and building societies. That is why we welcome the review that the OFT is conducting into the high-cost consumer credit sector, which has a particular focus on whether competition in the high-cost credit market is effective in current conditions. The review will examine, among other things, the experience of other countries that have introduced a cap on the cost of credit, which should help to establish the effectiveness of such tools as a form of consumer protection.

My hon. Friend will be aware that this issue has been previously considered, and it has been concluded that such measures could be detrimental to consumers—a view shared by leading consumer groups…I stress to him the independence of the consultants who were commissioned by those at the then Department of Trade and Industry who considered these issues.

Government intervention in pricing clearly has the potential to create distortions such as cross-subsidy in related sectors. It could constrain supply and ultimately lead to higher prices for consumers, and damage industry.

Hansard 25 January 2010 Column 572.

Interest rate ceilings were also highlighted during the 2010 election. The Labour Manifesto stated that it would 'clamp down on the interest rates and other fees charged by instant loan companies and payday or doorstep lenders, tackling the very high cost lending that hits low-income communities hardest'. The Conservatives would “ban excessive borrowing rates on store cards” and The Liberal Democrats promised to “impose maximum interest rates for credit cards and store cards, following consultation with the financial industry and consumer groups”. The new coalition government promises to confer power on “a regulator” to establish price caps for credit cards and store credit cards.

The introduction of interest rate ceilings remains therefore a live issue in the UK but relevant government departments such as DBIS and the OFT are not enthusiastic about their introduction. The economic narrative accompanying the DBIS 2009 White Paper, “A New Approach to Consumer Credit” presents as “key facts” the findings from the Policis study (Department of Business Innovation and Skills 2009) on the adverse effects of ceilings and The Office of Fair Trading review of high cost credit is unlikely to recommend the introduction of price ceilings. Its interim review argues that experience in other countries such as Canada, Australia and the US illustrate the counterproductive nature of ceilings (Office of Fair Trading 2009).

3.2. Competition Commission and Low Income Consumers: The Home Credit Investigation.
A central UK institution in the provision of low income credit is home credit. This is used by low income, generally female, consumers in social categories D and E (categories range from A-E) who represent 5-6% of the population. Individuals borrow small amounts which are collected in weekly instalments by agents who often live in the same area. These agents with local knowledge reduce the information asymmetries that suppliers face and the weekly visit provides significant monitoring and selling opportunities. These characteristics make it similar in some respects to many microfinance initiatives in developing countries. In 2005 the industry lent £1.3 billion to about 2.3 million consumers. This might be compared with the £620 million lent by the public social fund to individuals for crisis and budget loans. Provident Financial, the major UK provider, has expanded its home lending model to Central and Eastern Europe and Mexico.

Although doorstep credit dates from the late 19th century, home lending developed significantly from the 1970s. O’Connell attributes its growth partly to the rise in inequality and the growth of lone-parent families (O’Connell 2009). The average loan is about £300 and loans are usually repaid within a year. Suppliers expect individuals to be irregular payers and the loan is sold at a fixed price: there are no default charges. The credit charges are therefore relatively transparent to the borrower. Lenders rarely use the courts to pursue bad debts, relying on the discipline of the weekly visit. Repeat business and renewals of loans (resulting in higher costs than a new loan) are common. APRs generally exceed 100% and loans over six months often exceed 300%. The Total Cost of Credit varies from £30 per £100 borrowed for short term loans to over £100 per £100 for some of the longest. Six large lenders accounted for 90 percent of the market with one large lender (the Provident) accounting for 60 percent of the market. The bad debt levels of large lenders compare favourably with losses incurred by some mainstream or sub-prime credit providers.

The high cost of loans in the home credit market resulted in criticisms by consumer groups. The National Consumer Council made a ‘supercomplaint’ to the Office of Fair Trading in 2004 that there were competitive failings in the market for home credit resulting in detriment to consumers, resulting in a Competition Commission investigation. The Commission concluded that the major companies had been earning excessive returns and that the price of home credit was high in comparison with other products such as credit cards. They found weak price competition, partly based on consumers’ insensitivity to price, potential barriers to large scale entry through adverse selection, and incumbent advantages. Competition focused on lending to existing customers, on availability rather than price. The Commission introduced several remedies: data sharing of consumer repayment patterns; greater transparency in price through a dedicated website permitting

---

32 About 2.9 million individuals applied for crisis loans in 2008/09.
33 Competition Commission, Home Credit, supra at 7.
34 Provident has home credit operations in UK, Poland and elsewhere in Central Europe, and Mexico.
35 The details of this procedure are regulated under Enterprise Act 2002 (U.K.), 2002, c. 40, s. 11.
36 In proposing remedies the Commission has a statutory obligation to ‘achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effects on competition.’ Enterprise Act 2002, ibid. at s. 134(6).
borrowers to compare the costs of lenders in their area, and better contractual information. Lenders are now required to refer to the price comparison site in periodic statements to consumers.37

The Commission considered price controls as a possible remedy. These included caps on total cost, rate ceilings and the possibility of a threshold above which a lender would have to justify their prices to the Office of Fair Trading. The Commission ultimately rejected ceilings. It considered the Irish experience where there is an effective cap of 200 percent APR on moneylenders and where prices charged by the leading UK company were lower than in the UK. The Commission found that home credit lenders operated profitably in Ireland while charging on average lower rates and with a lower default rate.38 However it concluded that a cap might reduce credit to riskier consumers, and reduce short term loans (which make up about 10% of loans). There was also no existing regulatory structure to implement ceilings in the UK and they might be circumvented.39 The Commission concluded therefore that no general ‘price cap in the home credit market could be implemented that achieved a significant reduction in the customer detriment but did not at the same time have an adverse effect on a substantial number of customers which might outweigh its benefits.’40 This relatively cautious conclusion reflects the underlying empirical uncertainty. The conclusion was based primarily on responses it received from interest groups to its proposed remedy notice.

The extensive data gathered by the Commission during the inquiry provided valuable information on the users of home credit. The Commission identified the following types of home credit users: ‘novices who needed a loan and found home credit more approachable but had not considered alternatives: impulse borrowers financing a “live now pay later lifestyle”; crisis borrowers e.g. who had not received their benefit: occasional borrowers who used it in a disciplined way to finance specific needs; habitués who maintained a home loan to keep up a relationship with their agent; home credit leavers who were winding down their home credit borrowing.’ The top two reasons for borrowing were a special occasion (birthday, Christmas) and crisis borrowing.

These profiles suggest a mix of ‘rational’ choosers and ‘behavioural’ consumers who may have time inconsistent preferences. The information remedies proposed by the Commission might not be effective for all groups. They might cause greater search by ‘novices’ but might have little effect on the ‘impulse’ borrowers or ‘habitues.’ The Commission assumed that if a sufficient margin of consumers use the price comparison site then this would stimulate competition and lower prices. Some caution might be expressed here given the fact that many home credit consumers stressed availability over price.

The Commission concluded against the introduction of a ceiling because of its potential exclusionary effects on certain groups. Exclusion was regarded as bad per se so that the Commission did not pursue the potential consequences of the exclusion. Ceilings could result in some substitution for crisis borrowers to the Social Fund

---

38 Competition Commission, Home Credit, supra at 3-10-3-11.
39 Ibid. at 9-28.
40 Ibid. at para. 9.139 [emphasis added].
which offers interest free crisis loans. Ceilings might prevent ‘welfare opportunism’ among those groups living a ‘live now pay later’ lifestyle. Substitution towards another form of credit such as a credit card might be detrimental for low income consumers who are more likely to miss payments and suffer penalty charges.\(^{41}\) However almost a third of respondents in a survey of home credit borrowers indicated that they would not borrow if home credit was not available. There is therefore the possibility of benefits as well as costs accompanying exclusion from home credit.

A central fear raised by a ceiling would be substitutability to illegal lending. UK evidence suggests that there is some substitutability. One in five home credit users admitted to having used an illegal loan and in a study of illegal lending about half had taken a home credit in the past year.\(^{42}\) The assumption is that this level would increase if ceilings were introduced. However, the high costs of using the illegal system may deter individuals from using illegal lending. The Competition Commission concluded on the basis of empirical studies of home credit customers that ‘illegal lending does not appear to pose a competitive constraint on home credit. It is perceived as a last resort, unlikely to be embarked upon as a result of a small change in home credit prices.’\(^{43}\) Research on illegal lending in the UK argues that it is significantly different from licensed lending being both higher in cost and much more exploitative of the consumer. Illegal lending is also concentrated in the most deprived geographical areas [areas of multiple economic deprivation] and ‘[t]he communities in which illegal lenders operate are often both close-knit and self-contained, in some cases effectively ghettoised.’\(^{44}\) Individuals not living within these communities who use home credit might be less likely to turn to illegal lending.

The report of the Competition Commission indicates the empirical uncertainties of the costs and benefits of ceilings. The general UK position on ceilings is justified primarily by the finding of a greater use of illegal lending in the French and German systems of credit. This assumes “a cross cultural irreducible need for credit among low income consumers” which is thwarted by ceilings. But one might want to probe further these findings. The socio-economic profile of users of illegal lenders in the UK is much worse in socio-economic terms compared with France and Germany. Only about 20% are in work compared with 55% in France and almost 80% in Germany.\(^{45}\) The study of illegal lending notes:

[U]sers of illegal lenders in France and Germany are more up-market than users of illegal lenders in the UK, being more likely to be male, to be in work or to be short term unemployed. Users of illegal lenders in the UK are more likely to live in conditions of entrenched poverty and are overwhelmingly long term unemployed, with the profile of illegal lenders users having a strong female bias, often being single mothers living in social housing.\(^{36}\)

\(^{41}\) In 2004, 27 percent of Provident consumers had a credit card increasing from 17 percent in 1997. But this increase seems to have stopped in 2004 as mainstream providers tightened their lending criteria in recent years.
\(^{42}\) This was based on study of a small sample (100) of users of illegal lending. The study of illegal lending in the UK estimates it to be about 165,000 or 0.44% of the population. Average amounts lent in the UK illegal lending market are £250. U.K., Department of Trade and Industry, Personal Finance Research Center & Policis, Illegal Lending in the UK (London: DTI/PFRC/Policis, 2006) at 76.
\(^{43}\) Competition Commission, Home Credit, supra at para 4-11-12.
\(^{44}\) Policis, Illegal Lending, supra at 48.
\(^{45}\) Ibid. at 24.
\(^{46}\) Ibid.
These data suggest that the nature of illegal lending may be quite different in Germany and France. This was the issue pursued by the NEF in its 2009 report. More individuals who are not at the bottom of the social ladder in France are excluded from the legal credit market. However, there is no study of the illegal lending market in France or its causes. As outlined earlier, legal lending is more circumscribed in France than the UK because lending institutions must be licensed as financial institutions in France, a significantly higher barrier to entry than the historical English test of obtaining a licence to lend from the Office of Fair Trading. The existence of higher social benefits in France might also have an effect on the demand for credit among those who have a similar profile to the UK users of illegal credit. Without further data on the economic, social and cultural context of the individuals being compared caution might be suggested before drawing broad conclusions about the cross country effects of interest rate ceilings.

A central problem in the UK for many home credit consumers is poverty and the ceilings debate may be a sideshow to this issue. Bridges and Disney in a longitudinal study of low income and debt identified the source of substantial debt arrears as low income and economic inactivity (Bridges and Disney 2004). The problems for this group were housing costs and the rising costs of utilities. The policy implications are that measures ensuring predictable housing, utility costs and stable employment may reduce debt problems for low-income consumers (Rowlingson K. 1994).

One preliminary interpretation of contemporary UK policy making is that it represents the triumph of expertise over populism. Evidence based policy, as represented by the Policiis and Competition Commission study, resisted “populist” pressures for interest rate ceilings. It suggests the success of “better regulation”. However, the English experience also suggests that there is some uncertainty as to the empirical effects of ceilings concerning low income short term credit, and that the poor will continue to pay more even with low income competitive markets. Of course there is always empirical uncertainty and so issues of burden of proof for or against change become important.

It is also possible that notwithstanding the apparent dominance of expertise over populism—and the Competition Commission investigation is a careful study—Benthamite ideas on usury and the presumption in favour of consumer choice place a high burden on proof on those proposing interest rate ceilings. One wonders also about the ideological edge to this “evidence based” analysis, given the influence of neo-classical/liberal economists in the relevant government departments.

One might expect technocrats to adopt the apparent neutrality of neo-classical economic analysis but the opposition by consumer groups to ceilings indicate a wider support for economic liberalism. And of course the industry, in particular Provident the largest provider, lobbied hard against ceilings both in relation to the DBIS and the Competition Commission.

The early evidence of the effects of the policy alternatives proposed to ceilings, in particular, the broad “unfair credit relationships” test, suggest that the courts are unlikely to use it as a robust mechanism of price control and that it may
have little more regulatory bite than the extortionate credit bargain test. Whether the competition commission proposals to make the home market more competitive succeed remain to be assessed.

4. France: Usury and interest rate ceilings

Turgot, a liberal economist in 18th century France had, like Bentham, denounced the pre-revolutionary usury laws. The revolutionary law of 12th October 1789 abolished usury and Article 1905 of the Code Civil recognised the freedom to ‘stipulate interest on a simple loan.’ However this freedom was quickly circumscribed by article 1 of the law of 3rd September 1807 which established interest at 6% in commercial matters and 5% in civil. The public justification for the law cited excessive interest as a cause of agricultural misery and the ruin of families. It may also have reflected the political concern that private credit should not crowd out public credit. The decree created a criminal sanction of usury where there was a pattern of contraventions.

The ceiling was criticized by economists during the 19th century, may have been sporadically enforced, was subject to circumvention, and was abolished in commercial transactions in 1886 and civil transactions in 1918. The major development of French consumer credit in the late 19th century associated with coupon credit for department stores, and the credit model of selling sewing machines, escaped usury laws, but not condemnation for similar reasons to those aimed at hire-purchase in the UK. In 1935, during the depression, ceilings were reintroduced under a décret-loi which sanctioned loans which were more than 50% above the average rate for similar loans. This contextual standard permitted the courts to take into account the risks associated with the loans so that high cost loans might not be struck down if there was significant risk attached to them. It was not dissimilar to the approach adopted in England by the courts under the Moneylenders Acts.

As the costs and benefits of consumer credit began to be debated in the 1950s and 60s so did the effectiveness of the usury laws and the law was revised in 1966 to provide a sharper standard. This law created objective ceilings—which included a ceiling of double the commercial bond rate and included fees as well as traditional...

47 In Robert Shaw and Nine Regions (Log book loans) Ltd (Queen Bench, 18th December 2009, MR Justice Evans) a “logbook loan” of £3000 was provided to a consumer to finance a vacation at an APR of 119.6 percent. The court held that this rate was not unfair as it was similar to the charges of some pawnbrokers and others operating in this market. In Nine Regions Log book Loans v. Sadeer (2009) it was held that the higher risks of this market justified an interest rate of 384.4% APR.
50 Hoffman et al., Priceless Markets, supra at 21.
interest in the calculation. This single ceiling which did not recognise distinct types of credit, and was tied to a rate not linked to the costs of consumer credit supply, created difficulties and various temporary modifications occurred throughout the inflationary era of the 1970s.

The French financial system was substantially deregulated in the 1980s, part of the general rolling back of the dirigiste model under the influence of neo-liberalism. The lifting of central government controls on the credit market stimulated growth in consumer credit and by the late 1980s public debate focused on the topic of consumer over-indebtedness. The French banks had embraced the new freedom to lend but had blundered in their initial foray, making poor risk assessments and incurring substantial bad debts(Kilborn J. 2004-05).

In 1989-90 three mechanisms were introduced to address the problem of over-indebtedness: (1) a national register of delinquent consumers operated by the Bank of France (2) the introduction of over-indebtedness commissions in each French département with the Bank of France effectively managing them and (3) reform of the usury laws. Interest rates were established at one third above the market rate for different types of loan. The crucial question concerned the determination of the categories of loans. A variety of financial interests pressed to recognize the particular risks of their business. Ultimately the Commission National de Credit divided loans by size and type, recognising the distinction between revolving credit, credit sales and loans. The different levels of ceiling in late October 2008 were 9.92% for unsecured loans over €1524, 21.32% for loans under €1524 and 21.11% for the distinct categories of overdrafts, revolving loans, and instalment sales over €1524. The level of €1524 has not been changed since 1989. For loans secured on real property the usury rate was 7.8%. The French usury rates are therefore ‘floating’ rates related to different markets. The recognition of revolving credit as a distinct type was important in facilitating the increased penetration of this form of credit to working class consumers.

Table 2 indicates some of the different forms of revolving credit in France offered by the banks, specialized credit institutions and credit linked to suppliers such as stores or catalogue selling. Many of the specialized institutions are subsidiaries of the banks. Banks are generally less expensive although they are clearly exercising risk based lending. The Athling report suggest that the amount available from the specialized credit institutions is typically €4000-€6000. Some revolving credit is linked to a credit card but may resemble in other cases a continuing line of credit

---

56 The loi Neiertz of 31 December 1989 also introduced the possibility for consumers to reschedule their debts: Loi n° 89-1010 du 31 décembre 1989, J.O., 2 January 1990, 18.
57 Art. L.313-3 Code de la Consommation.
58 See Le Monde (5 May 1990).
(linked to a bank account) which could also protect consumers against passing an NSF cheque which carries a substantial penalty in France.

Table 2 France: Different Forms of Crédit Renouvelable 2008

<table>
<thead>
<tr>
<th>Banks</th>
<th>Ceilings on credit</th>
<th>Interest Rates</th>
<th>Annual fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>BNP Paribas</td>
<td>Provisio: €21,5000</td>
<td>12-18%</td>
<td>€24</td>
</tr>
<tr>
<td>Credit Agricole</td>
<td>Open:500-16000</td>
<td>15%</td>
<td>€10</td>
</tr>
<tr>
<td>Société Générale</td>
<td>Alterna: to €21,500</td>
<td>13.65%-17.60%</td>
<td>€16</td>
</tr>
<tr>
<td>Specialised Credit companies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cofidis</td>
<td>Libravou €500-5000</td>
<td>Libravou 20%, Flexibilis 13%, Projelia 10%</td>
<td>No fee</td>
</tr>
<tr>
<td></td>
<td>Flexibilis €6000-10000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Projelia €11000-20000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cetelem</td>
<td>Réserve Instant €500-3000</td>
<td>14-19%</td>
<td>No fee</td>
</tr>
<tr>
<td></td>
<td>Réserve Live €500-10,000</td>
<td>20-20.59%</td>
<td>€19</td>
</tr>
<tr>
<td></td>
<td>Les 3 Suisses</td>
<td>From €40 to 2200</td>
<td>20.45-20.55%</td>
</tr>
<tr>
<td>----------</td>
<td>---------------</td>
<td>------------------</td>
<td>--------------</td>
</tr>
<tr>
<td></td>
<td>Galeries Lafayette</td>
<td>To €21,500</td>
<td>14-20%</td>
</tr>
</tbody>
</table>

Source: (Athling Management 2008)

4.1. Contemporary Debates on Usury in France

Official documents identify the contemporary rationales for interest rate ceilings in France as: (1) protection for consumers where the market is not working competitively, (2) protection against financial exclusion by preventing over indebtedness in high cost credit to precarious debtors, (3) one lever for achieving responsible lending. (Lépine and Laloue 2009). The recent Senate report (2009) states the issues to be those of establishing an interest rate sufficiently high to permit borrowers with little security to obtain access to credit but sufficiently low so that lenders do not lend to the most fragile borrowers whose precarious position would be made worse by a larger amount of interest to repay (Sénat).

Several French reports published before the current financial crisis questioned whether the usury ceiling in France resulted in French consumers being ‘under-indebted’ and mortgage finance less available to ‘non-standard’ consumers (Babeau 2006; Bourdin 2006). They argued that the low level of consumer credit may have had a detrimental effect on the growth of the French economy which compared unfavourably with its Anglo-Saxon neighbour. The Bourdin report in 2006 argued that public policy since the 1980s had been too focused on over-indebtedness and protection from debt. This resulted in an over-cautious approach to credit granting with the consequence that some individuals did not get access to credit. Other reports claim that young people (under 25) have difficulties accessing credit, and that it is difficult for micro-finance to develop within the ceilings. The introduction of the ‘hypothèque rechargeable’ in 2006 permitted greater use of home equity loans. These pre credit crunch developments fitted with the French government’s interest in borrowing ideas from the ‘Anglo-Saxon’ model of capitalism. The Lefebvre report on mortgage credit in 2008 continues to suggest the limiting role of the current ceilings in mortgage credit, (particularly when interest rates are low). However, the Report indicates that the principle of ceilings is sound and protects against the slide into the type of sub-prime mortgage lending to marginal risks that occurred in the UK and the US (Lefebvre 2008).

The current implementation of the 2008 EU Consumer Credit Directive, against the background of the world financial crisis, has stimulated further discussion

59 See Pastré Report, supra note 83 at 79.
60 Lépine & Laloue Report, supra at 8 referring to the submission by ADIE (Association pour le développement de l’initiative économique).
in France on the role of consumer credit. Financial institutions, and some economists, relying partly on the UK Policis study, continue to argue that ceilings cause excessive exclusion from the credit market for significant numbers of individuals. Consumer groups have criticised revolving credit – crédit renouvelable – regarded as an Anglo-Saxon import, with interest rates close to the usury rate. Consumer groups claim that it is a ‘financial trap,’ tempting consumers to become over-indebted and pointing to the fact that 80% of over-indebtedness dossiers have a revolving credit. The PS (Socialist Party) proposed a ban on revolving credit. The different rate ceilings for personal loans and revolving credit are claimed to provide incentives for retailers and specialist financiers to channel lower income and near-prime consumers to the higher rates of revolving credit. Individuals purchasing goods on credit are steered to using a card with a revolving credit rather than being offered a loan for a fixed price and pre-agreed amortisation schedule.

A governmental investigation of ceilings in early 2009 concluded that there were no reliable data on the extent of credit exclusion (Lépine and Laloue 2009). However, analysis by the Bank of France of demand curves for credit from financial institutions suggested that loans over €1524 were rationed as was revolving credit, primarily supplied by specialised credit institutions to working class consumers. The Bank also speculated that the clustering of revolving credit terms around the ceiling indicated a lack of competition. The Senate report (Dominati report) proposed uniform rates dependent only on the size of the loan. This was adopted in the most recent version of the law with the establishment of an expert committee chaired by the Bank of France to monitor and report annually on the development of industry practices on interest rates. These would be established at a rate between the currently two distinct levels for personal loans and revolving credit. The Report recognises that this will result in some reduction in access to credit but is also intended to stimulate competition.

These contemporary French documents are of interest for several reasons. First, the discussion illustrates the complexities in establishing, monitoring and assessing the effects of usury ceilings. France has experimented with a broad contextual standard (until 1966), a single objective ceiling (1966 to 1989) and ceilings tied to distinct categories of loans (1989-). The modern forms of ceiling represent the influence of both consumer and producer groups. The distinct category of revolving credit, linked to market rates, permitted the increased ratcheting of rates to expand the market to higher risks through the use of risk based pricing. There is therefore in existence a de facto prime and sub-prime market for personal borrowing. Second, the French ceilings are intended to exclude some consumers from obtaining credit. They will be protected from high risk credit. There is however the absence of reliable data on the dimensions of financial exclusion and market distortion caused by ceilings or the links between revolving credit and over-indebtedness. The presence of revolving credit in 80% of over-indebtedness dossiers says little about the correlation or causal links between this form of credit and insolvency. The absence of evidence is however taken as a reason for not straying too far from the status quo, for example, through the abolition of ceilings.

63 Lépine & Laloue Report, supra at 4.
4.1.1. The Impact of Ceilings in France

Ceilings in France have an effect on pricing. More credit cards have annual fees than in the UK and there is a very high penetration of payment protection insurance which adds the equivalent of about 7% interest for specialized credit suppliers and 3.5% for banks.\(^{64}\) This may render pricing less transparent but the existence of fees might dampen slightly demand for cards, an objective suggested by Bar Gill in his discussion of US credit cards (Bar-Gill 2004). Some cards require co-signers. Consumers in the lowest income decile are underrepresented among card holders.\(^{65}\) It is not clear what sources of credit this group uses. The Babeau report notes the existence of the municipal pawn shop which caters to the ‘sub-sub’ prime consumer. Two thirds of users of these shops are women and the great majority are ‘étrangers,’ representing equally Europeans and Africans. The loans requested range from €100 to €2000.

I noted earlier the restrictive effect of usury on the availability of mortgage finance. Consolidation loans as a form of credit repair exist in France—the so called ‘rachats de credit’—but the ceilings on loans secured on real estate (and other restrictions on mortgage loans?) prevent the existence of the ‘tertiary’ second mortgage market in the UK which charges high rates of interest.

Consumer groups support ceilings and the perception by politicians and elites that general public opinion also supports ceilings substitutes for the limited empirical evidence on the effects of ceilings. The Athling report concludes that ‘unlike the Anglo-Saxon countries and Scandinavian countries, fixing a maximum interest rate ceiling is not perceived by the public as a constraint on banking offers, but rather as a means of protecting consumers.’\(^{66}\) The Senate rapporteur, Philippe Dominati while expressing his personal view in the report that France, like other developed countries, should abolish ceilings concludes that it would be premature in the light of public opinion. The Babeau Report argued that the abolition of interest-rate ceilings in France would ‘not conform to our cultural traditions’ and that ‘the Anglo Saxon world is, particularly in its attitudes as regards credit, very different from continental Europe.’ Notwithstanding these economic voices there is little likelihood of France abolishing ceilings and the question focuses rather on modifying them to nudge business away from steering consumers to revolving credit. But ‘public opinion’ is a vague term and the question may be raised as to who represents those who are currently excluded from the credit system. This group may be indirectly represented by lenders but although lenders may support an easing of ceilings there is probably little support among lenders for abolition which would permit greater competition, possibly from foreign institutions such as the English sub-prime industry of home loans, and payday loans.

\(^{64}\) See Athling Report, supra at 36.
\(^{65}\) Ibid. at 88.
\(^{66}\) Ibid. at 40 [translated by author]. See also the following comment, ‘While some societies such as the US encourage broad access to credit...consumer associations in France on the other hand call for stricter preventative measures against overindebtedness.’ EC, Internal Market and Services Directorate General, Study on Equity Release Schemes in the EU-Part II Country Reports by Institut für Finanzdienstleitungen (DG Internal Market, 2009) at 68, online: European Commission – Internal Market <http://ec.europa.eu/internal_market/finservices-retail/docs/credit/equity_release_part2_en.pdf>.
5. Discussion

Analysis of interest rate ceilings is only one aspect of the different approaches to regulation of consumer credit in France and the UK. It must be placed in the context of supply side regulation and other forms of regulation of credit markets in the two countries before any firm conclusion might be made about their role. This is the subject of further research.

This paper was initially interested in whether ceilings reflected “legal origins”, a cultural preference or political interest groups.

First, the existence of interest rate ceilings in France does not appear to reflect a French civil law tradition: they were not enshrined in the Civil Code but exist as part of a modern consumer code. Nor can we argue that they represent a contrast to an ‘Anglo-Saxon’ tradition of regulation, unless one limits ‘Anglo-Saxon’ to England; the United States has a long history of ceilings. Their modern version in France represents an aspiration to protect consumers from market risks, as opposed to the United Kingdom’s concern about consumer choice. There seems to have been little questioning until recently of the potential exclusionary effects or limiting effects on consumer choice. One could argue that there is an element of path dependency. Ceilings existed pre-1966 and therefore seemed to be an obvious method of regulation of consumer credit. Micklitz argues that French consumer policy grew out of a tradition of price control and protection against unsafe products (Micklitz 2008). In contrast, the key moments in the UK was the Crowther Committee, dominated by an economist and also influenced by the US idea that a broad doctrine of unconscionability was the most effective method of addressing problems with high cost credit (see archive material).

Second, the role of ideas and political interest groups may provide a guide to explanations for differences in forms of regulation between these countries.

The influence of neo-classical/liberal economic analysis and market failure analysis may be stronger in the UK. It is very influential in UK government departments such as DBIS and the OFT where economists rather than lawyers now play key policy roles. There seems little support for ceilings among this group. The UK has also been at the forefront of the search for “better regulation”, using market failure analysis, impact studies, evidence based policy and searching for alternative instruments to traditional command and control regulation. Price controls outside the regulated industry sector might be viewed as a “blunt”, possibly anachronistic, form of regulation (cf minimum wage). France, in contrast has been a rather late arrival to better regulation and techniques such as regulatory impact analysis(Radaelli C.M. 2004). The relative influence of these ideas on regulation might be affected by legal origins.

Neo-classical analysis also has an influence in France, but seems less embedded in relevant government departments (check). Although there is evidence of scepticism among some French economists about the efficacy of ceilings, this seems to have had modest influence on current debates. Neo-liberalism and the ideology of consumer
credit as a motor of growth is also influential in the UK where the promotion of UK financial services and its model of regulation was significant during the New Labour period. These ideas do also influence the contemporary French government, witness the attempt to develop home equity credit and the initial admiration of the Sarkozy government for the Anglo Saxon model of consumer credit, but this has been tempered by the contemporary world financial crisis.

Third, the politics of industry and consumer interest groups differs in the two countries. Protectionist motives might explain the limited criticisms by French financial firms of the existing usury laws. The existence of ceilings in France may constrain the possibility of new foreign entrants to the French credit market. The failure of Crazy George [now Brighthouse]—a large UK rent-to-own store with interest rates of 29.9%—to successfully enter the French sub-prime market is an example. “Express loans”—short term loans at high interest rates delivered by mobile phones in Scandinavia—would not be possible in France. The UK Home Credit business model would not be possible in France. Its relatively transparent pricing which includes all fees would contravene the usury ceilings. Ceilings have not however prevented the development in France of a sub-prime credit market based on revolving credit.

Further support for this argument might be located in the response of the French banks to recent proposals to extend public credit reporting through the introduction of a fichier positif. The banks opposed the introduction of a fichier positif while a minority of consumer groups supported the concept. Banks usually favour an increase in available information on consumers as a method of increasing markets and more accurately assessing risks. The French banks have however developed their own proprietal credit scoring systems and probably do not welcome the introduction of a positive credit bureau which might provide valuable information to new foreign entrants to the credit market. In contrast in the UK, large firms such as Provident lobbied hard against the introduction of ceilings, given the effects that they would have on their business.

A central distinction is the role of consumer groups, with French consumer groups in general supporting ceilings (a micro credit group argues that ceilings prevent the development of micro credit) and the largest UK groups opposing ceilings at crucial moments, such as the passage of the 2006 Consumer Credit Act amendments. Groups such as Citizens Advice in the UK have consistently opposed ceilings (Citizens Advice 2000). Consumer choice and access to credit, along with the spectre of the illegal loan shark in a regime with ceilings are key arguments. Hilton argues that much of consumer activism in the UK in the 1960s and early 1970s was primarily about consumer choice. (Hilton 2003). In contrast Labour and family groups played an important role in the development of the usury laws in France and the former were distrustful of credit as a threat to working class buying power.

The history of ceilings in the UK indicates also that a resistance to ceilings is not solely a recent phenomenon and one could hypothesise that the economic liberalism of Bentham, Mill and others does provide a background to general thinking in the UK. The ideological influence of the Crowther Committee (1971) was one important liberator of consumer credit in the UK, at the beginning of the ascent of neo-liberalism.


The article analyses the rise in household indebtedness from the point of view of its causes and long-run macroeconomic implications. The analysis is focussed on the US case. Differently from life-cycle interpretations of the phenomenon, and from interpretations in terms of erratic deviations of current income flows from their long-run trend, the rising household debt is viewed as the outcome of persistent changes in income distribution and growing income inequalities. Through household debt, low wages appear to have been brought to coexist with relatively high levels of aggregate demand, thus providing the solution to the contradiction between the necessity of high and rising consumption levels, for the growth of the system’s actual output, and a framework of antagonistic conditions of distribution which keeps within limits the real income of the vast majority of society. The question of the long-run sustainability of this substitution of loans for wages is finally discussed.


Policis (2004). The Effect of Interest Rate Controls in Other Countries, Department of Trade and Industry.


Public Accounts Committee (2010). Department of Business Innovation and Skills: Helping Over-Indebted Consumers. HC. London, TSO.


Sénat Rapport No 447 portant sur le projet de loi portant réforme du credit à la consommation (Rapport Dominati).


