"To Heap Distress upon Distress?"* Comparative Reflections on Interest Rate Ceilings

Iain Ramsay

University of Kent, Canterbury, UK**

* Jeremy Bentham, Letter VI "Mischiefs of the anti-usurious Laws".

** Draft paper for symposium in honour of Michael Trebilcock, University of Toronto, October 1-2, 2009. Thanks to Toni Williams for comments.

My paper examines recent debates in the UK and France on the role of interest rate ceilings in consumer credit regulation. [1] In an influential article written in 1973 David Cayne and Michael Trebilcock discussed ceilings as a method of protecting low income consumers. They concluded: "Can [an interest rate] ceiling, in Professor Ziegel's terms, protect 'the unsophisticated and vulnerable borrower against exploitation and [encourage] the lender to adopt more prudent credit standards'? We think not."[2] In their view the "consumer problems of the poor are an inherent consequence of paucity of resources and can only be remedied by augmenting these resources, that is by making the poor not poor...we have too often in the past yielded to the temptation to look for scapegoats to whom to attribute the unpleasant consequences of poverty. The somewhat unromantic and visible figures of the ghetto merchant, slum landlord, peddlar and loan shark have proved easy, although irrelevant, targets".[3]

Many economists would agree with this verdict viewing interest rate ceilings as anachronisms within a "modern" economy with workable competition in credit markets. [4] One legal scholar describes usury laws as "crude and misguided devices", relics of the nineteenth century.[5] A hint of this approach appears in Richard Hynes and Eric Posner's survey of the law and economics of consumer credit where they comment that usury laws have been "repealed in every industrialized nation except the United States, Belgium and France".[6] But Hynes and Posner are wrong both on the number of "industrialised" countries with usury laws and the assumption that interest rate ceilings are fading away. Germany[7] and Japan both have ceilings and Japan has recently reduced its existing ceiling.[8] Other countries with ceilings include Italy, Netherlands, Switzerland, Austria, and South Africa. Brigit Helms and Xavier Reille list about forty developing and transitional economies that have introduced some form of interest rate ceiling.[9] Canadian provinces have introduced a public utility model of regulation for regulating the price of payday loans and Quebec prohibits payday loans through its effective interest rate ceiling of 35%.[10] Islamic finance 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 probably argue to be the futility of ceilings. A more pertinent thought is Posner's comment in 1995 about the "fantastical survival of

[1] This is a part of a larger study on UK and French approaches to regulation of consumer credit markets.
[2] DJ Cayne and MJ Trebilcock "Market Considerations in the Formulation of Consumer Protection Policy" (1973) 23 Univ of Toronto LJ 396 at 415.
[3] Id. at 430.
[4] A relic of "precommercial morality" Benjamin Nelson, The Idea of Usury (2d ed 1969). An economist could write in a historical survey of usury in 2003 that "the idea that government should regulate interest rates directly through usury laws seems foreign" H. Rockoff, "Prodigals and Pojectors: An Economic History of Usury Laws in the United States from Colonial Times to 1900" NBER Working Paper (2003) at 12.
[5] J J White, "The Usury *Trompe L'Oeil* 51 So Carolina L Rev 445 at 466.
[6] R Hynes & E Posner, "The Law and Economics of Consumer Finance" (2002) 4 American Law and Economics Review 162 at 176.
[7] Their mistake about Germany is understandable since the usury ceiling has been established by the judiciary at "double the average" market rate. For a brief account of the German law of usury see B. Markesinis et al (2006), *The German Law of Contract*, Oxford: Hart Publishing, (2006) at 250-253.
[8] See S Kozuka and L Nottage "The Myth of the Cautious Consumer: Law, Culture, Economics and Politics in the Rise and Partial Fall of Unsecured Lending in Japan" in J Niemi, I Ramsay and W Whitford (eds) *Consumer Credit, Debt & Bankruptcy: Comparative and International Perspectives* (Oxford, Hart 2009).
[9] B Helms and X Reille (2004) "Interest Rate Ceilings and Microfinance: The Story so Far" CGAP Occasional Paper 9 CGAP/World Bank and see CGAP (2006) World Bank, *Access for All: Building Inclusive Financial Systems* (Washington: World Bank) at 82-85.
[10] Quebec will not licence lenders charging interest rate levels above 35%.

usury laws despite almost incessant controversies over hundreds of years and in many different countries". [11] Political pressure for ceilings increases with wealth inequality and during economic downturns. [12] Both criteria currently exist in the UK and US. In developing countries the provision of microfinance as a method of "making the poor not poor" has been queried by those who criticise the "fairness" of prices charged by micro financiers[13].

Cayne and Trebilcock wrote in the early 1970s, a period of much interest in rate ceilings[14]. The National Commission on Consumer Finance in the US (1972) thought that disclosures and competitive markets were a better protection for consumers than interest rate ceilings. The Crowther Committee in the UK (1970) recommended a continuation of the rule that charging more than 48% was *prima facie* harsh and unconscionable, but the Conservative government abolished interest rate ceilings in the 1974 Consumer Credit Act. These changes coincided with the dominance of neoliberal policies since the 1970s which have facilitated not only an enormous general growth of consumer and mortgage credit in countries such as the UK and the US, but also the growth of sub-prime and alternative credit markets in these countries where individuals pay substantially higher costs for credit. This period has also been accompanied by growth in inequality in the developed world[15] with consumer credit compensating many for relatively flat disposable incomes.

The current financial crisis and credit crunch pose fundamental questions about the financial services system, the role of consumer credit within that system, and the appropriateness and effectiveness of existing forms of regulation. We do not yet know the future shape of regulation. [16] More importantly we do not have a sharp idea of "what works" in credit regulation. Although social science research and behavioural economics have undermined confidence in existing forms of

[11] E Posner "Contract Law in the Welfare State: A Defence of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract" (1995) Journal of Legal Studies 283 at 318. J Persky comments that "Since the Middle Ages each epoch has participated in the debate over the conditions in which lending should be prohibited as usury" J Persky "Retrospectives: From Usury to Interest" (2007) 21 (1) Journal of Economic Perspectives 227. For a useful survey of contemporary approaches to ceilings and further literature see N Howell, T Wilson and J Davidson *Interest Rate Caps: Protection or Paternalism?* (Centre for Credit and Consumer Law, Griffith University) (2008).

[12] See E Glaeser & J Scheinkman, 'Neither a Borrower nor a Lender be: an Economic Analysis of Interest Restrictions and Usury Laws' (1998) 41 Journal of Law & Economics 1. Posner supra note 11. A transatlantic coalition of religious groups has begun an anti-usury campaign. See Maurice Glasman, "The Struggle Against Debt Servitude" The Guardian Tuesday 11 August 2009; Paul Schmelzer, "Anti-Usury Movement Hits the Streets, But House Bills Stuck in Committee" Minnesota Independent August 10, 2009; Jonathan Freedland, "Heard the One About a Rabbi, An Imam and A Priest, who Walk into A Bank?" The Guardian Wednesday July 22 2009.

[13] See e.g. T Williams, "Requiem for Microcredit? The Demise of a Romantic Ideal" (2004) 19 Banking and Finance Law Review 145. Dean Karlan has examined several aspects of microfinance programmes. See the various papers at http://karlan.yale.edu/p/index.php?sort=type&detail=published . See also M Hudon, Social Justice with Credits to the Poor: A Neo-Contractarian Approach CEB Working Paper No 07/003 (2007).

[14] Christopher Peterson refers to the large number of law review articles of this period considering interest rate ceilings. See C Peterson "Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits" (2008) 92 Minn. L.Rev. 1110 at footnote 10.

[15] For documentation in relation to the US and the UK see A Offer, *The Challenge of Affluence* (Oxford, OUP) at 271 et seq.: S O'Connell, Credit and Community: Working Class Debt in the UK since 1880 (Oxford:OUP) (2008) at 186-187: P Mason, *Meltdown: The End of Greed* (London Verso) 2009 at 128.

[16] See Iain Ramsay & Toni Williams, "The Crash That Launched a Thousand Fixes: Consumer Credit Regulation after the Credit Crunch" (forthcoming 2010).

regulation they do not promise a clear set of policy guidelines.[17] Behavioural economics suggests that much competition in credit markets is organised around exploitation of behavioural biases which often has a detrimental effect on lower income consumers. Many potential solutions have been proposed such as simplified "vanilla" mortgages, traffic light standards for products, *ex ante* assessment of the safety of consumer credit products, and upskilling consumers through financial literacy. Despite the promise of this regulatory innovation the problem of providing access to credit at affordable rates for low-income consumers remains although it has become transformed into the concepts of financial and social exclusion[18]. The challenge is to develop products which are appropriate to the needs of low income consumers.

My interest in credit rate ceilings was stimulated by several factors. First, in the UK the poor continue to pay more for credit, much of UK consumer credit is based on regressive cross-subsidisation, and, notwithstanding task forces and initiatives on financial inclusion, there appears to be no simple policy solution to the credit needs of low income consumers .[19] The credit crunch, like previous recessions may result in a flight to quality by credit providers reducing the availability of credit to lower income groups.[20] Historical scholarship on working class debt in the UK indicates that "cheap credit remains elusive for the depressingly large number of families who still have to manage on a limited budget...the great leap into the consumer society has not produced a simple solution for the economic problems of the poorest groups. For them easy terms remains elusive".[21] The historical record also seems to confirm Cayne and Trebilcock's analysis, with periodic high profile "crack downs" on "loan sharks". O'Connell describes the "crackdowns" of the 1960s in Glasgow when the police claimed to have driven "hoodlum moneylenders" from the street, only for illegal lending to reappear a few years later. There is currently a crackdown on illegal moneylending: the media reported in August 2009 the successful prosecution of a loan shark who made £88,000 in interest from an initial loan of £500.[22] Initiatives exist to extend credit unions and other non-profit lenders in areas of illegal moneylending but the success of these policies remains unclear.

Second, there has been a lively debate about the role of interest rate ceilings within the EU. The EU is committed to achieving an integrated capital and credit market. Many initiatives have been directed towards the construction of a competitive internal market.[23] The 2008 EU Consumer

[17] See discussion of recent behavioural economics contributions in Tony Duggan's paper for the symposium.

[18] Financial exclusion is defined in a recent EU study as "a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong" EC Directorate General for Employment, Social Affairs and Equal Opportunities, *Financial Services Provision and Prevention of Financial Exclusion* VC /2006/0183 (Brussels: EC) (2008). Social Exclusion represents " linked problems such as "unemployment, poor skills, low incomes, poor housing, high crime environments, bad health, poverty and family breakdown". Financial Services Authority, In or Out? Financial Exclusion: A Literature and Research Review (London: FSA, 2000).

[19] The OFT found regressive cross-subsidisation concerning bank overdrafts. See Office of Fair Trading, *Personal current accounts in the UK - an OFT market study* (2008) and this also exists with credit cards.

[20] There has already been a substantial increase in applications to the UK government social fund which provides crisis and budgeting loans, primarily to those on welfare benefits. The applications for crisis loans increased from 1.5 million in 2006/07 to 2.8 million in 2008/09.

[21] S. O'Connell, supra note 15 at 291.

[22] "Borrowers urged to avoid backstreet lenders as 'ruthless' loan shark jailed" The Guardian 5 Aug 2009 (describing the jailing of John 'Johnny Boy' Kiely who ran a large loan sharking operation).

[23] For a fuller discussion see I Ramsay, "Regulation of Consumer Credit" in G Howells, I Ramsay and T Wilhelmsson (eds) *International Handbook of Consumer Law* (in press 2010 Edward Elgar).

Credit Directive[24] which proposes a standardised European APR and pre-contractual disclosures is primarily designed to stimulate transnational competition. However the EU has also instituted projects on the social costs of debt and financial exclusion.[25] Clear differences exist between countries within the EU in their use of, and belief in, interest rate ceilings as a protection for consumers. A recent EU report commented :

> the debate around legislation setting interest rate ceilings tends to be emotive. On the one hand there is a strong moral argument for protecting consumers against excessive charges; on the other it can be argued that they distort markets and can contribute to financial exclusion. Both points of view have validity but are almost impossible to reconcile.[26]

The report concluded that the issues "should be left to member states to decide".[27] The debate within the EU does not reflect merely a political clash between business and consumer interests. There is a significant divide within consumer groups in the EU. The mainstream UK groups oppose ceilings while those in France and Germany generally favour ceilings. Both groups in good faith believe that they are acting in the best interests of lower income consumers. They agree that the poor pay more for credit but differ on the most effective means of responding to this problem. For the English, the spectre of the loan shark for those excluded by ceilings haunts all discussion. For the French the absence of ceilings will hasten over-indebtedness and consequent financial exclusion. Both therefore focus on financial exclusion but take quite different views of the effects of ceilings. These differences may reflect deeper ideologies about the market and consumers, with more concern in France to protect consumers from the market rather than a presumption in favour of consumer choice or access. UK policy is more likely to evaluate policy in its impact on consumer choice.[28]

Finally, the politics of interest rate ceilings are often constructed as those of economic expertise versus populism. A South African report bluntly concludes that "the laws establishing them [ceilings] ...are often proposed by politicians and not by agencies or other groups with expertise in finance".[29] In Japan, recent debates on reductions in interest rate ceilings were "dominated by anecdotes about borrowers taking out too many loans". Economic analysis was "largely ignored".[30] Posner argues that usury ceilings have persisted because of "popular politicking" for usury laws in an economic downturn. Ceilings may certainly be a populist measure responding to atrocity stories of outrageous APRs on short term loans of 400 per cent . The

---

[24] Directive 2008/48/EC on Credit Agreements for Consumers (2008) O.J. L133/66.

[25] For an outline of the programme and papers see http://www.fininc.eu/index,en.html

[26] EC Directorate General for Employment Social Affairs and Equal Opportunities *Towards a Common Operational European Definition of Over-Indebtedness* (Brussels, EC, 2008)

[27] ibid.

[28] For further reflections on the different ideologies of consumer protection see G Trumbull (2006) Consumer Capitalism (Ithaca: Cornell) at 25 and J Whitman, 'Consumerism versus Producerism: An Essay in Comparative Law' (2007) 117 Yale Law Journal 340. The World Bank Doing Business Project concluded that the French civilian tradition is less hospitable to facilitating credit (a conclusion denied by French scholars!) See World Bank, *Doing Business in 2004 Understanding Regulation* and subsequent reports. See "les droits de tradition civiliste en question, 'A propos de Reports *Doing Business* de la Banque Mondiale'" Association H. Capitant vol 1 2006

[29] See Finmark Trust, "The National Credit Act and its Regulations in the Context of Access to Finance in South Africa" at 27.

[30] See discussion in Kozuka & Nottage supra note 0 at 218-221.

economist will coolly explain that this percentage rate is a misleading statistic for a short term loan, that the fixed costs associated with such loans inevitably result in an annualized high rate and that establishing ceilings could result in exclusion for certain borrowers. Competition, better information and a progressive tax and welfare system might be proposed by the economist. This economic explanation does not necessarily convince critics and an appeal to a broad principle such as Rawls's difference principle "that ceilings will not make the poor better off in the long run" is unlikely to settle the argument. There is often a continuing sense of unfairness that the poor should pay more, particularly in societies of high inequality. Undoubtedly "populism" may conceal more sophisticated interest group accounts for the creation, maintenance and destruction of usury laws. [31]

This dichotomy of expertise versus populism is a familiar theme in risk regulation where policymakers are concerned that "responding to lay people's perceptions of risk tends towards overregulation, while policies based entirely on scientific evidence will be seen as an inadequate response".[32] The UK during the past decade has instituted many measures to ensure "evidence based policy" . Expertise seems to have trumped populism in recent debates over interest rate ceilings in the UK. The UK government and the Competition Commission, a body based on expertise, both rejected interest rate ceilings in the face of "the strongest campaign against moneylending charges since the 1920s".[33]

I do not propose to settle the interest rate controversy in this paper but rather play the role of a "sympathetic spectator" in understanding the positions and assumptions about credit made by proponents and opponents of ceilings. Comparative analysis, in this case the contrast between recent policy development in the UK and France, provides an opportunity for examining the arguments and assumptions in each country, as a preliminary to evaluating whether the use of ceilings simply reflects an "economic mistake", a cultural preference, or the influence of political interest groups. Interest rate ceilings are of particular interest for the comparativist. Much comparative law has focused on supposedly value neutral areas of law such as private law. Interest rate ceilings are partly about economic regulation a relatively technocratic process but the history of rate ceilings suggests however that they also reflect non-economic, cultural and religious values.

It is useful to remember that interest rate ceilings may take many forms and be premised on a variety of rationales. There may be a single ceiling or different ceilings for different types of loans. Ceilings may be linked to market prices, 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. They 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.

[31] Niall Ferguson in *The Ascent Of Money* argues that there is a "recurring hostility to financiers" partly because "debtors have tended to outnumber creditors". RH Tawney points to the closure of the Antwerp money markets in the late 16th century as an important catalyst for the relaxation of the English usury laws by a Crown in need of cash. RH Tawney *Introduction to Thomas Wilson: A Discourse on Usury* (London: G Bell 1925). Glaeser & Scheinkman supra note 12 outline the variety of interest group and public choice explanations of regulation.

[32] Better Regulation Commission, *Risk Responsibility Regulation Whose Risk is it Anyway?* (2006) at 3.

[33] See O'Connell supra note 16 at 194.

There are several rationales for ceilings. They may be justified as a response to behavioural mistakes where individuals are perceived to underestimate the risks of high cost credit . Second, by providing a bright line rule substantially above the market rate they may respond to the high costs of proving fraud or exploitation in credit markets. Third, they may be intended to respond to problems in competition in a market which leads to supra normal prices. Fourth, they may be intended to address externalities to high cost credit such as state costs of support for individuals who become over-indebted. Posner argues that this was a rationale underlying usury in the UK and US. However the UK had no real usury ceilings during the period of the flowering of the welfare state. Fourth they may be intended to be redistributive by ensuring a "fair" price in transactions.

The economic criticisms of interest rate ceilings are well known . They are argued to be both over and underinclusive . They are a "blunt 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. They may be circumvented through the charging of "fees" or insurance. They may have undesirable substitution effects where individuals are forced into less convenient, more costly and less transparent forms of credit. They may result in exclusion where suppliers withdraw from the market. Consumer choices are limited. Ceilings result in hurting most low income consumers who are the intended beneficiaries of the ceilings. For these reasons other policy instruments such as more competition, better information, more warnings, debiasing interventions or even product term regulation 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.

The variety of types of ceilings and their distinct rationales suggest caution in making broad statements about their effects , recognising that studies of the effects of one type of ceiling might not be applicable to other types. Many issues concerning the effects of ceilings are empirical. The extent of circumvention, market substitution and exclusion depends on the level of ceilings and the elasticity of supply and demand. The purpose of a ceiling is also relevant to assessing its role. If a ceiling is not intended to be primarily a redistributive mechanism then to criticise its limits on this ground misses the point. Canadian criminal interest rate legislation for example was premised as a proxy for fraud rather than primarily a redistributive tool , reducing the costs of policing loan sharking in Montreal. Context is important in understanding the effects of interest rate ceilings.

I **England and Usury: The triumph of expertise over populism ?**

Adam Smith thought that price ceilings would ensure that funds did not go to "prodigals and projectors" but English opinion since Bentham has generally opposed ceilings. John Stuart Mill thought that the usury law reflected religious prejudice and has "been condemned by all enlightened persons since the triumphant onslaught made upon it by Bentham in his *Letters on Usury*[34] The general usury laws were abolished in 1854 although controls remained on the price of pawns described as-- "the poor man's bank". By the 1870s there was concern about high cost moneylending and the use of bills of sale. The 1898 Select Committee on Moneylenders considered but rejected the idea of ceilings, based partly on analysis of US experience of 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

[34] JS Mill Principles of Political Economy cited in Rockoff op cit.

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[35] . 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 price ceiling and upheld higher charges unless there was evidence of advantage taking.[36] The Crowther Report which was intended to modernise and liberate the credit market would have retained this provision but the UK government abolished ceilings in the 1974 Consumer Credit Act, substituting an extortionate credit bargain test which had little regulatory bite and was subject to criticism from the outset. 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, where consumers often paid high interest rates and were unable to obtain the tax deductions wealthier consumers could use in relation to loans and overdrafts.

The New Labour government had promised in its 1997 manifesto to "tackle loan sharks" and continues to use the logo of a shark on press releases about its credit protection for consumers. Several groups proposed interest rate ceilings as a mechanism to address the growing problem of overindebtedness.[37] 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. This was resisted by the government citing to a government commissioned study which indicated higher levels of exclusion and illegal lending in France and Germany.[38] The 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 Policis study argued that the absence of a sub prime market in France similar to the UK meant that French consumers often used mainstream credit products not appropriate to their needs. Credit card companies served lower income consumers in France but did so by levying high charges for missed payments possibly adopting a "sweatbox" model of lending.[39] The study claimed that home lending, a UK form of high cost low income lending, was more suited to the payment rhythm and needs of low income consumers.

All major political parties supported the government position[40]. The mainstream consumer groups also wrote a letter to the relevant House of Lords Committee during the passage of the Bill, urging them not to recommend the introduction of ceilings. While some groups continue to press for ceilings the contemporary English position is intriguing given this general consensus among interest groups. The Competition Commission in an investigation of low cost credit (see below) also

[35] See Report from the Select Committee on MoneyLending (1898) at vi.
[36] See e.g. *Parkfield Trust v. Dent* [1931] 2KB 579: *Parkfield Trust v Portland* [1937] 81 Solicitors Journal 687.
[37] Most notably Debt on Our Doorstep (DOOD) a coalition of Church and credit union groups.
[38] See DTI /Policis *The Effects of Interest Rate Controls in other Countries* (2004). The study relied primarily on interviews with low income consumers in the UK, France and Germany. The study's methodology and findings were critiqued by Debt on our Doorstep. See www.debt-on-our-doorstep.com

[39] See R Mann, "Bankruptcy Reform and the "Sweat Box" of Credit Card Debt" (2007) University of Illinois L Rev 375.
[40] See Hansard HC 9th June 2005 cols 1405-06 (Parliamentary Undersecretary for Trade and Industry, Gerry Sutcliffe); col 1415 (Shadow Minister for Trade and Industry, Charles Hendry); col 1434 (Norman Lamb, speaking for the Liberal Democrats).

rejected interest rate ceilings as a mechanism for protecting low income borrowers . The UK policy's evidential basis was essentially one study of the effects of ceilings in France and Germany. It is therefore unfortunate that the report of the study contains little detail on methodology, crucial tables provide no indication of the number of cases in the tables and it is not possible to review the data which are proprietorial.[41] The relevant Department did not attempt a regulatory impact analysis of an interest rate ceiling policy.

1.1 Low income credit markets in the UK: Home Credit

A central UK institution in the provision of low income credit is Home Credit . This is a form of credit in the UK 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.[42] 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 £1.3billion 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. [43] The major UK provider Provident Financial 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 [44]. 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 are common. APRs generally exceed 100% and loans over six months often exceeded 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. [45] Six large lenders accounted for 90 percent of the market with one large lender [the Provident]accounting for 60 per cent of the market.[46] This lender now also offers payday loans at 245% interest on the Internet. The bad debt levels of large lenders compare favourably with losses incurred by some mainstream or sub-prime credit providers . Fifty per cent of customers interviewed had been customers for over 5 years and 30 percent over 10 years. Forty per cent of home credit loans are refinancings, resulting in higher costs than a separate second loan.

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.[47]

---

[41] See further discussion on assessing public policy studies in J Westbrook, "Empirical Research in Consumer Bankruptcy" (2001-02) 80 Texas L Rev 2122 at 2157-2160.
[42] See generally Competition Commission, Home Credit Inquiry : Final Report (2007).
[43] About 2.9 million individuals applied for crisis loans in 2008/09.
[44] O'Connell supra note 16 at 186-187.
[45] Competition Commission, Home Credit Market Investigation (London: Competition Commission) (2006) at 7.
[46] Provident has home credit operations in UK, Poland and elsewhere in Central Europe, and Mexico.
[47] The details of this procedure are regulated under s11 of the UK Enterprise Act 2002.

The OFT referred the supply of home credit for investigation by the Competition Commission which undertook a comprehensive examination of this market. 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. The Commission found APRs to be a poor measure of the price of a loan and the total cost of credit a more appropriate comparator among loans. However they also concluded that the APR would be useful in comparing a home credit loan with other forms of credit. 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[48]: data sharing of consumer repayment patterns; greater transparency in price through a dedicated website permitting borrowers to compare the costs of lenders in their area, and better contractual information. Lenders are required to refer to the price comparison site in periodic statements to consumers.[49]

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. [50] 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. [51]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". [emphasis mine][52] This was therefore a relatively cautious conclusion with little empirical evidence to substantiate it. Much was based on responses it received from interest groups to its proposed remedy notice.

The Competition Commission had 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.

[48] 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 s134(6).
[49] Home Credit Market Investigation Order 2007
[50] See Competition Commission 3-10-3-11.
[51] See Competition Commission at 9-28.
[52] Id at para 9-139.

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 "habitués". 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 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.[53] 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[54]. The assumption would be 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." [55] 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 "the communities in which illegal lenders operate are often both close-knit and self-contained, in some cases effectively ghettoised"[56]. Individuals not living within these communities who use home credit might be less likely to turn to illegal lending.

The 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

[53] 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. [53] A Littwin, "Comparing Credit Cards: An Empirical Examination of Borrowing Preferences Among Low-Income Consumers" (2008) Texas L Rev 000.

[54] 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. DTI/ PFRC/Policis *Illegal Lending in the UK* (2006) 76.

[55] See Competition Commission para 4-11-12.

[56] Supra note 56.

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. The study of illegal lending notes:

Users 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. User 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[57]

These data suggest that the nature of illegal lending may be quite different in Germany and France. In addition we would want to know what sources of credit individuals in France and Germany used with a similar profile to the UK users of illegal credit . The problems of cross cultural comparisons seem starkly raised. Without further data on the economic and cultural context of the individuals being compared caution might be suggested before drawing broad conclusions about the effects of interest rate ceilings.

The 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.[58] The problems for this group were housing costs and the rising costs of utilities. The policy implications are that measures ensuring predictable housing and utility costs and stable employment may reduce debt problems for low-income consumers. Rowlingson's study of home credit also concluded that "poverty is the underlying reason why some people lack access to suitable, low-cost credit. The improved provision of social lending schemes will be a help. But, to some extent, these schemes will just be papering over the cracks of the much more fundamental problem of poverty".[59] The policies of governments in the UK have partly created social exclusion in a country where the Gini coefficient has increased from 0.25 in 1979 to its current level of 0.36 (cf US 46.3 in 2007).[60]

The English experience 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. It is also possible that notwithstanding the apparent dominance of expertise over populism—and the Competition Commission investigation is a careful study—Benthamite ideas place a high burden on proof on those proposing interest rate ceilings.

The spectre of the loan shark haunts UK discussions. It is assumed to be better to have individuals borrowing from high cost imperfectly regulated low income lenders than to be outside

---

[57] Supra note 55 at 24.

[58] See S Bridges and C Disney, "Use of credit and arrears on debt among low-income families in the United Kingdom (2004) 25 Fiscal Studies 1.

[59] K Rowlingson, *Moneylenders and their Customers* (London: Policy Studies Institute) (1994) at 166.

[60] Compare the comments of the Crowther Report in 1971: "There may be cases where, in view of the poor financial standing of the borrower, interest of 100 percent would not yield an excessive profit to the lender; but if the borrower falls into a risk category as low as this, then we feel he ought not to be eligible for loans from the private sector. We recognise that such a borrower has to live; he has to have money from somewhere. But we feel that this is a problem which...must be solved through social welfare services rather than by the granting of loans at enormous interest rates". Report of the Committee on Consumer Credit (Crowther Committee) Cmnd 4596/1971 para 6.6.6.

the tent. The policy assumption is that home lenders and payday lenders as well as a flourishing "tertiary" sub prime lending market (a) serve a basic need for credit and (b) the costs of this high cost credit in terms of overindebtedness and default are outweighed by the benefits of access to meet short term needs . More competition and better information in low income markets, more credit unions and other non-profit providers, reform of the social fund and a crackdown on illegal lending are viewed as the way ahead.

2. France at the crossroads? Recent debates on interest rate ceilings

France has a lower rate of consumer and housing debt than the UK and Germany. In 2004 outstanding consumer credit per capita was €2,200 euro in France and €4,400 euro in the UK and in 2007 the average outstanding revolving credit per household was €1105 in France and €3570 in the UK.[61] The home ownership rate in France is 57% compared with 72% in the UK. Two distinct differences between the UK and France are the absence of positive credit reporting in France and the existence of interest rate ceilings.

France has had interest rate ceilings for many years. They were substantially reformed in 1989 as a method of preventing "active overindebtedness" . The assumption was that individuals needed to be protected from voluntarily overcommitting themselves on excessively risky credit. French ceilings are established by legislation at one third above the average market rate for different types of loans.[62] The categories of loans are established by administrative regulation and the Bank of France collects data on average rates each quarter to determine the ceilings. 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 is currently 7.8%. The French usury rates are therefore "floating" rates related to different markets.

The contemporary rationales for interest rate ceilings in France are: (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 .[63] Rationale (1) may be based on the further assumption that individuals may misestimate the risks of high cost credit. In the recent Senate report (2009) the policy issues are articulated as 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.[64]

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

[61] See *Pour un Développement Responsable du Crédit Renouvelable en France* Rapport réalisé par Athling Management pour le Comité Consultatif du Secteur Financier (2008).
[62] Article L.313-3 Code de la Consommation. The current provision dates from 1989 when the rate was changed from one quarter to one third above the average rate and there was a reclassification of the categories of loans. The 1989 article modified the 1966 usury law which in turn modified the 1935 decree which established usury at 50% above the average rate for loans with similar risks.
[63] See Inspection Générale des Finances and Inspection Générale des Affaires Sociales, Rapport sur les modalités de fixation du taux d'usure (2009).
[64] See Sénat No 447 Rapport Dominati (2009) at 34.

less available to “non-standard” consumers. [65] 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 with a high level of credit[66]. 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. The introduction of the “hypothèque rechargeable” in 2007 which permitted greater use of home equity loans was promoted as providing credit to groups which might not traditionally obtain credit. [67] These pre credit crunch developments fitted with the Sarkozy regime’s interest in borrowing ideas from the “Anglo-Saxon” model of capitalism.

The role of ceilings was raised again in recent discussions on the implementation of the 2008 EU Consumer Credit Directive. Financial institutions, based partly on the UK study, argued that ceilings were causing exclusion for significant numbers of individuals. [68] Microcredit providers argued that the low ceiling for loans above €1524 hampered their ability to provide loans. A governmental investigation concluded however that there were no reliable data on the extent of credit exclusion but that Bank of France data on demand curves for credit suggested rationing existed for loans above €1524 but no rationing for loans below €1524.[69]

The major focus of debate was not on the issue of abolition or retention of ceilings but rather on the effects of different levels of ceilings for loans and revolving credit. Consumer groups argued that lower income and near-prime consumers were steered to revolving credit for purchases of products and consequently paid higher costs than those generally higher income individuals able to obtain a personal loan. This was part of a general concern about the use of revolving credit. Consumer groups argued that the use of revolving credit created dangers for consumers since they would be tempted to become overcommitted (similar to the behavioural critiques of credit cards) on revolving loans without fixed amortisation schedules. Revolving credit could be a “financial trap” for those of modest means.[70] The increased specialisation of the revolving credit market targeted at lower income individuals ratcheted up the average rate as companies set rates close to the ceiling. The Bank of France claimed that the clustering of prices

[65] See A Babeau La Demande des ménages en matière de crédit a la consommation et les ajustements nécessaries pour y répondre (2006). Pastré Report, *Les enjeux économiques et sociaux de l’industrie bancaire* Rapport remis au Comité Consultatif du Système Financier, (2006); C Taffin & B Vorms Élargir l’accèss au crédit au logement des emprunteurs atypiques (2007). For a useful comparative analysis see G. Gloukoviezoff, De l’exclusion à l’inclusion bancaire des particuliers en France (Thèse de doctorat en sciences économique, Université Lumière Lyon 2) (2008) at 456-461.

[66] See Rapport d’information sur l’accèss des ménages au crédit en France par M. Joël Bourdin No 261 (2006)

[67] Id. at 51.

[68] A summary of the views of different groups can be found supra note 65 at pp7 et seq.

[69] The Banks claim that the effects of the usury ceilings are to exclude significant numbers of individuals was based partly on an extrapolation by Babeau based on the Policis study. The caisses de crédit municipal claim that usury limits pawns over €1524 and results in loans under this amount at the higher limit. The Report is not convinced that there is a big impact on the mortgage market.

[70] Rapport Dominati at 16. The Report of the Inspection Générale de Finances notes that the interest rates for revolving credit were high (around 20%), access seems easy and that this type of loan is present in 80% of cases of over-indebtedness dossiers.

towards the ceiling reflected a lack of competition and the Babeau report argued that there are supra normal profits being earned on revolving credit.

The objective of reform was to moderate the increased regressive segmentation of the loan market and ensure that individuals obtained credit appropriate to their needs. Uniform rates dependent only on the size of the loan with the trigger being €3000 and €6000 were proposed to reduce segmentation but without increasing exclusion. It was anticipated that this measure would result in a modest reduction in access to credit but also create competitive pressures on banks. The report rejected the addition of an additional "external" ceiling such as 10 points above LIBOR as well as the possibility of the administrative establishment of a fixed margin. The Rapport Dominati rejected this last option because it would be a return to administrative regulation of the market which would be susceptible to changing political influences. The 1989 reforms were intended to move usury law away from arbitrary political interventions by linking the rates to changes in market levels.

The French documents are of interest for several reasons. First, the discussion illustrates the complexities in establishing and monitoring usury ceilings . The report by the Inspection Générale des Finances discusses eight possible approaches. Second, the French ceilings are not conceptualised by the Report as price control or administrative regulation of the market but rather as based on the market. Third, there is a concern that there should not be the creation of a segmented sub-prime market similar to the UK. Finally, the Senate Rapporteur Philippe Dominati expresses a personal opinion that interest rate ceilings should be abolished but realizes that this would be premature in the light of public opinion. After outlining the proposed reforms he suggests that France is at a crossroads. If the reforms do not work—for example leading to greater exclusion—then they should be abolished as in the other large developed countries.

Ceilings in France probably 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 suppliers.[71] Banks use risk based pricing to make profitable returns from the use of revolving credit by working class consumers but the consumers in the lowest income decile are underrepresented among card holders.[72] 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 "etrangers", representing equally Europeans and Africans. The loans requested range from €100 to €2000. Consolidation loans as a form of credit repair exist in France—the so called rachats de credit—but the existence of ceilings on loans secured on real estate may prevent the existence of the so-called "tertiary" market in the UK which charges high rates of interest. There appear to be no studies in France of the illegal lending market in France.

There are no rigorous studies in France of the relationship between ceilings and debt default. Write off rates and consumer insolvency levels are lower in France than the UK notwithstanding French concerns about their levels of over-indebtedness.

[71] See Cabinet Athling, supra note 64.
[72] Id at 88,

Many documents claim that France is strongly committed to the protection of the consumer, that it has some of the strongest protections in Europe for the credit consumer and that they are stronger than English protections. Setting aside rhetorical chauvinism the idea of "consumer protection" from the dangers of the market has been identified by some writers as characteristic of a French approach to consumer policy.[73] Certainly consumer groups support ceilings and the Dominati 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.[74]" The question is why does the public conceive of ceilings in this way? And what are the factors that shape public opinion?

The current French debates should be set in context. Neo-liberal ideas have been influential in the regulation of French financial services since the 1980s when the French financial system was substantially deregulated, part of the general rolling back of the dirigiste model.[75] There is thus a tension between neo-liberal ideas of consumer policy emphasising choice and access which seems to be held by many economic experts and a model of consumer protection from the market held by consumer groups. A recent report concludes a discussion of cultural attitudes to credit as follows: "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".[76]

Discussion

My comparative analysis is obviously partial and incomplete. A full analysis of not only interest ceilings but also other relevant credit regulations and their application would be necessary to draw conclusions about the costs and benefits of English and French approaches to credit regulation. However, my brief analysis suggests that neither France nor the UK has solved the problem of providing affordable and appropriate credit, particularly for small amounts, to low income individuals. The existence or absence of interest rate ceilings does not solve the problem. Cayne and Trebilcock were on this point correct. The following further points might be raised.

First, should we interpret the distinction between France and the UK as representing two distinct national cultural preferences? In France they prefer potential protection from the market with its costs and benefits. In the UK consumer choice and access are the primary values. At first sight this fits neatly with cultural arguments that the French "mistrust credit". Babeau argues that the abolition of interest rate ceilings in France would "not conform to our cultural traditions" and that "the Anglo Saxon world is in particular in its attitudes as regards credit, very different from continental Europe".[77] However this position collides with the economic argument that there is an irreducible cross cultural need/ demand for credit "irrespective of the regulatory or cultural context".

[73] See e.g. Trumbull supra.
[74] Rapport Athling supra note 64 at 40.
[75] See generally Jonah Levy, Economic Policy and Policy-Making in A Cole P Le Gales and J Levy (eds) Developments In French Politics 3 at ch11. M Bertrand, A Schoar and D Thesmar, Credit and Product Market Effects of Banking Deregulation: Evidence from the French Experience CESifo Dice Report 2005.
[76] IFF *Study on Equity Release Schemes in the EU-Part II Country Reports* at 68. DG Internal Market (2009)
[77] Babeau at 24.

Both economic universalism and cultural specificity may be overstated. Cultural arguments about national preferences on credit have been undercut by research findings that they often mask important institutional differences or represent the influence of particular interests. Thus Japan was once thought to be a country of savers with a low credit card use. However Japan has a high level of consumer debt and the absence of credit card borrowing may be as much explained by institutional as cultural factors.[78] In France, too much attention to a cultural explanation underplays the contemporary tension between neo- liberal consumer policies and consumer protection. We should be careful about drawing broad contrasts between Anglo-Saxon capitalism and continental European approaches in the area of consumer protection. Of greater interest is the contrast between neo-liberal ideas and consumer protection throughout Europe and elsewhere.

The existence or absence of ceilings shapes the structure and nature of the debate about ceilings. The French credit system has adapted to the existence of ceilings and abolition would result in a major change to the *status quo*. The UK remains opposed to ceilings, but perhaps as a response to the demand for ceilings, refracted through the media and parliamentary initiatives, the government accepted an amendment to the Consumer Credit Act 2006 which imposes the credit license condition that firms do not lend irresponsibly. This will permit regulators to review *ex ante* the business model of higher risk lenders. Thus the UK may be in fact more "interventionist" than France in its regulation of credit lenders . The issue of ceilings may now move to the level of the EU where the EU has commissioned research into the effects of interest rate ceilings. This will offer groups a new opportunity for influencing change within a setting where the new more neo-liberal member states may support abolition of interest rate ceilings.

Social science expertise has played an important role in the recent debates on ceilings in the UK and France. The appropriate role of social science in policy making and politics is a large topic. There is no doubt that without systematic empirical research consumer policy making may be "an exercise in accidental wisdom".[79] Certainly there should also be a presumption that the research data on which public policy is based should be open to public scrutiny. Both opponents and proponents of ceilings often make broad claims about their effects which seems curious in an era when many are sceptical about the broad instrumental effects of law. The empirical effects of ceilings need to be carefully analysed in the context of their particular objectives, relationship to other instruments, and in view of the particular type of ceiling being proposed.

[78] See Kozuka & Nottage at 200.

[79] See M Trebilcock, "The Pathology of Consumer Credit Breakdown" (1975) 22 McGill LJ 415 at 467.