

Britain's Personal Debt Crisis

How we got here and what to do about it

Damon Gibbons

Digital reissue, 2026, with a new preface. First published by Searching Finance, 2014.

This reissue has been re-set from the print edition. Original page numbers are shown in grey square brackets, e.g. [5], at the point where each printed page begins.

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First published in 2014 by Searching Finance.

This digital reissue, with a new preface, published in 2026 by the Centre for Responsible Credit, a registered charity in England and Wales (no. 1199945) and a company limited by guarantee (no. 12488846).

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Suggested citation: Gibbons, D. (2026). *Britain's Personal Debt Crisis: How we got here and what to do about it*. Digital reissue with a new preface (first published 2014). Centre for Responsible Credit.
<https://doi.org/10.5281/zenodo.23017686>

DOI 10.5281/zenodo.23017686

The information in this publication was obtained from sources believed to be reliable at the time of writing, but is not guaranteed. The 2014 text reflects the position when it was first published, and has not been updated except as set out in 'A note on this reissue'. Nothing in this publication constitutes financial, legal or other professional advice.

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For Rowan, Alice, and Esme

Preface to the 2026 digital reissue

THIS BOOK WAS FIRST PUBLISHED in 2014. It has been out of print for some years, it was never issued in electronic form, and second-hand copies of a paperback that originally sold for £9.99 now change hands for many times that price. This digital reissue makes it freely available to researchers, students, advice workers, campaigners, and anyone else with an interest in how Britain came to depend so heavily on household debt. The text is reproduced as it was published, apart from the correction of a small number of factual errors, which are listed in a note at the end of this preface. The original page numbers are shown in grey square brackets at the point where each printed page began, so that readers can continue to cite the 2014 edition. A new index has been compiled for this reissue. I have also provided a bibliography, which was absent from the original.

Why return to a book written more than a decade ago? This is not due to nostalgia. It is because the central argument of the book has acquired new relevance following the recent change in Britain's leadership.

Forty years of wrong turns

The book opened by asking what sort of crisis Britain was in twelve years ago. It argued that the financial crisis of 2007/08, which subsequently drove the austerity economics of the Coalition Government, was, at root, a personal debt crisis: the product of increased household indebtedness and financial vulnerability. It then traced that crisis back through four decades of economic and political choices. The abolition of ceilings on bank lending under the Competition and Credit Control policy of 1971, the deregulation of the City in the 'Big Bang' of 1986, the sale of council homes under Right to Buy, and the steady substitution of consumer credit for rising wages and adequate social security were not separate episodes. Together they amounted to a model of growth in which households borrowed to sustain living standards that the wider economy no longer delivered. Chapter 7 put the point directly: 'Over a period of 40 years, the expansion of financial services and of credit in particular, has contributed to a considerable decline in Britain's economic position in the world, as well as to the near-decimation of the welfare state'.

In September 2026, the new Prime Minister, Andy Burnham, used his first Commons speech in the role to make a similar diagnosis. 'From the 1980s,' he told the House, 'this country took a series of wrong turns. Political power was centralised, economic power privatised and the country deindustrialised. Austerity followed'. 'For 40 years,' he went on, 'too many places have been drifting', under 'a failed economic model' that 'allows wealth to be extracted and siphoned out'.ⁱ It is rare for a Prime Minister to describe the preceding four decades of national economic

ⁱHansard, HC Deb, 1st September 2026, 'Direction of Government', col. 27.

policy as a series of wrong turns, and especially so when his own Party governed Britain for fifteen of those.

Yet one element is missing from the account. How did living standards hold up, for as long as they did, while industry declined, wages stagnated, and the welfare state was cut back? The answer this book gives is financialisation: the growing role of financial markets, financial institutions, and debt in the everyday life of households. Credit filled the gap. It allowed consumption to be sustained without rising incomes, turned housing from a home into a leveraged asset, and shifted the costs of economic insecurity from the state and employers onto individual borrowers. That shift was not neutral. It transferred income from those who borrow to those who lend, and it did so most aggressively at the bottom of the income distribution, where the price of credit is highest. The personal debt crisis was not a side effect of the model. It was the mechanism by which the model was held together.

Research published since 2014 has put this argument on firmer empirical ground. Mian, Sufi and Verner, analysing data from thirty countries between 1960 and 2012, tested two competing explanations for rising household borrowing. The first, the 'credit demand' hypothesis, holds that households borrow rationally in anticipation of higher future incomes. The second, the 'credit supply' hypothesis, holds that borrowing rises because lenders expand the availability of credit, leading households to borrow more than their incomes can sustain. The evidence firmly supported the second: expansions in household debt were followed by slower growth, as households cut back on consumption to service what they owed.ⁱⁱ Lombardi, Mohanty and Shim reached similar conclusions using data from fifty-four economies between 1990 and 2015. Household debt boosted consumption and growth in the short run, mostly within a year. In the long run, however, each percentage point increase in the ratio of household debt to GDP lowered growth by around 0.1 percentage points, and the damage intensified at higher levels of debt and in countries where creditors enjoyed strong legal protection.ⁱⁱⁱ Credit-fuelled growth borrows from the future. The bill arrives as stagnation.

If the new Government is serious about reversing the mistakes of the past 40 years, it will need to address this mechanism directly. There are some signs of common ground. The book called for the abolition of Right to Buy, for house building on a far greater scale than at any time in the previous four decades, and for greater security for tenants in the private rented sector. The Renters' Rights Act 2025 was passed under the Starmer administration, and the new Prime Minister has made council housebuilding a centrepiece of his programme. He has also described reform of Right to Buy as part of the solution to what he calls Britain's 'housing trap'.^{iv} Yet the Government's early decisions on housing finance and financial regulation, discussed below,

ⁱⁱMian, A., Sufi, A. and Verner, E. (2017). 'Household debt and business cycles worldwide'. *Quarterly Journal of Economics*, 132(4), 1755–1817.

ⁱⁱⁱLombardi, M., Mohanty, M. and Shim, I. (2017). *The real effects of household debt in the short and long run*. BIS Working Papers No. 607. Basel: Bank for International Settlements.

^{iv}Centre for Cities (2026). 'Briefing Burnham: housing and planning', 6th July 2026.

suggest that it has not yet recognised the role that credit has played in the model it seeks to replace. What has happened in the intervening years, and what remains to be done?

What has changed since 2014

Some of the reforms argued for in this book have been achieved. The most significant concern the cost of credit. The book was written as the campaign for a cap on the cost of payday loans reached its conclusion, and in January 2015 the Financial Conduct Authority (FCA) introduced one. The FCA's own review found that, two years on, the cap was saving 760,000 borrowers around £150 million a year.^v A comparable cap was applied to the rent-to-own market in 2019, following research and campaigning by the Centre for Responsible Credit. The FCA has also restricted the charges levied on people who go overdrawn, introduced rules intended to help those trapped in persistent credit card debt, and strengthened the requirement on lenders to assess affordability before advancing credit or raising credit limits. Several of the practices described in Chapter 5, including the routine 'rolling over' of payday loans, have been curtailed, and many of the lenders responsible for them have left the market, often following large numbers of successful complaints to the Financial Ombudsman Service. In July 2026, Buy Now Pay Later lending was finally brought within the scope of regulation, with lenders now required to check affordability and to support borrowers in difficulty.^{vi}

There has been progress for people already in debt, too. The Debt Relief Order, a simplified form of insolvency for people with low incomes and few assets, has been made considerably more accessible: people can now write off up to £50,000 of debt, and the application fee was abolished in 2024. A 'Breathing Space' scheme, launched in 2021, gives people protection from enforcement action and from the addition of further interest and charges for up to sixty days while they seek advice.

These reforms broadly followed the direction the book set out. None of them went as far as it argued was necessary. Caps on the cost of credit have not been extended across the entire market, and the persistent credit card debt remedies are an inadequate defence against the constant churning of debt, leaving households in a high-cost debt trap. Introduced in 2018 following the FCA's market study, these rules require card providers to prompt customers who have paid more in interest and charges than they have repaid in capital over eighteen months, and after thirty-six months to offer a way of repaying the balance within a reasonable period. Campaigners, including the Centre for Responsible Credit, warned at the time that the rules would not stop borrowers from repaying many times what they had borrowed and called for a cap

^vFinancial Conduct Authority (2017). *High-cost credit and review of the high-cost short-term credit price cap*. Feedback Statement FS17/2. London: FCA.

^{vi}Financial Conduct Authority (2026). 'New protections confirmed for Buy Now Pay Later borrowers', press release, 11th February 2026. The new rules took effect on 15th July 2026.

on the total cost of credit card borrowing.^{vii} Those concerns have been borne out. Some 2.5 million people remain in persistent credit card debt, a figure that has risen again since 2022, and eight in ten of them struggle to keep up with their bills and credit commitments.^{viii} The FCA's own evaluation of the rules, originally expected in 2025, has since been put back to 2026, with no publication date yet confirmed.^{ix} No programme to write down and restructure household debts has been established. Our insolvency framework remains fragmented, and debt advice services are inadequately resourced. The Child Trust Fund, abolished in 2011, has not been restored, and the 'national renewal savings scheme' proposed in Chapter 7 has no counterpart in policy. Most importantly, the regulatory gains of the past decade have treated the symptoms of credit dependency rather than its causes.

The housing trap tightens

Nowhere is this clearer than in housing. The book argued that Britain's broken housing market sat at the centre of the personal debt crisis, driving up mortgage borrowing, pricing a generation out of home ownership, and forcing low-income households into an insecure and expensive private rented sector. More than a decade on, the trap has tightened.

In 2025, the median home in England cost 7.6 times the median full-time salary. That was the most affordable the market had been for a decade, which says a great deal about the past ten years.^x Over two million homes have now been sold under Right to Buy since 1980. Since the scheme was 'reinvigorated' with larger discounts in 2012, just 55,275 replacement homes have been delivered.^{xi} The discounts were cut back to their pre-2012 levels in November 2024, and the Government has since confirmed a longer qualifying period, exemptions for newly built social homes, and legislation to give effect to the changes.^{xii} These are welcome steps, but they fall short of abolition, which has already taken place in Scotland and Wales. Meanwhile, the human cost of the shortage of social housing continues to mount. At the end of March 2026, a record 135,580 households in England were living in temporary accommodation, almost three times the number in 2011.^{xiii}

The book also warned that interest rates should not be raised until it was clear that doing so would not provoke a wave of mortgage repossessions. That warning was tested when Bank Rate rose from 0.1 per cent in December 2021 to 5.25 per cent in August 2023; it stood at 3.75 per cent

^{vii}Centre for Responsible Credit, Jubilee Debt Campaign, New Economics Foundation and Research for Action (2019). *Regulating the credit card market: why we need a cap on costs*. End the Debt Trap briefing, July 2019.

^{viii}Butler, A. (2026). *Credit cards, financial difficulty and persistent debt*. Policy briefing. London: StepChange Debt Charity.

^{ix}Financial Conduct Authority (2025). *Regulatory Initiatives Grid*, December 2025; Financial Conduct Authority (2026). *Regulatory Initiatives Grid*, May 2026.

^xOffice for National Statistics (2025). *Housing affordability in England and Wales: 2025*.

^{xi}Ministry of Housing, Communities and Local Government (2026). *Right to Buy sales and replacements, England: April 2025 to March 2026*. A total of 2,052,813 homes had been sold by March 2026.

^{xii}House of Commons Library (2026). *The Right to Buy scheme in England*. Research Briefing CBP-12193.

^{xiii}Ministry of Housing, Communities and Local Government (2026). *Statutory homelessness in England: January to March 2026*. The figure for June 2011 was 48,330 households.

in September 2026.^{xiv} Despite higher interest rates, large-scale repossessions have not returned. The number of mortgage accounts in arrears rose by almost 30 per cent between the autumn of 2022 and mid-2024, peaking while Bank Rate stood at 5.25 per cent, but even then, affected 1.5 per cent of accounts, compared with 2.6 per cent in 2009. New possessions, which follow arrears with a considerable lag, rose from fewer than 400 a quarter in early 2021 to almost 2,500 in the third quarter of 2025 before easing but remain far below the 13,000 a quarter recorded at the height of the financial crisis.^{xv} The main reason is that mortgage lending standards were tightened in the same year this book was published. The FCA's Mortgage Market Review rules took effect in April 2014, requiring lenders to verify borrowers' incomes and to assess whether they could afford their repayments if interest rates rose; the book regarded them as a watered-down version of the original proposals but, nevertheless, 'a step in the right direction' (p. 95). Two months later, the Bank of England's Financial Policy Committee limited the share of each lender's new mortgages that could be made at 4.5 times income or more to 15 per cent and required lenders to stress-test whether borrowers could cope with a substantial rise in rates.^{xvi} The FCA now reports that 99 per cent of the mortgages taken out since 2014 are not in arrears.^{xvii} The Mortgage Charter agreed by lenders in June 2023 provided further protection, allowing borrowers to switch temporarily to interest-only payments or extend their mortgage terms, and committing lenders not to repossess a home within twelve months of the first missed payment without the borrower's consent.^{xviii}

The headline figures conceal a less reassuring shift. In mid-2009, some 44,600 mortgage accounts were in arrears equivalent to 10 per cent or more of the outstanding balance, around one in nine of all accounts in arrears. By mid-2026 there were more, around 52,400, and they made up a third of the total.^{xix} Forbearance has kept people in their homes, but it has also left a growing group of borrowers in deep, long-term arrears with no clear route out. The book's call for rescue schemes for heavily indebted mortgage borrowers has lost none of its force.

Nor did the costs of higher rates disappear. They were displaced. Bank of England research by Bunn and Rostom indicates that, after 2007, spending cuts by highly indebted households may have reduced aggregate consumption by up to 2 per cent.^{xx} Evidence from the more recent tightening points the same way: households that could not restructure their mortgages or borrow

^{xiv}Bank of England (2026). *Monetary Policy Summary and minutes, September 2026*.

^{xv}Financial Conduct Authority (2026). *Mortgage lending statistics, September 2026*, MLAR detailed table 1.7 (residential loans to individuals, regulated and non-regulated). Figures refer to loan accounts with arrears of 1.5 per cent or more of the outstanding balance.

^{xvi}Financial Services Authority (2012). *Mortgage Market Review: final rules*. Policy Statement PS12/16. Bank of England (2014). *Financial Stability Report*, June 2014.

^{xvii}Financial Conduct Authority (2025). 'FCA sets out plans to help build mortgage market of the future', press release, 15th December 2025.

^{xviii}HM Treasury (2023). *Mortgage Charter*, June 2023.

^{xix}Financial Conduct Authority (2026). *Mortgage lending statistics, September 2026*, MLAR detailed table 1.7.

^{xx}Bunn, P. and Rostom, M. (2015). *Household debt and spending in the United Kingdom*. Bank of England Staff Working Paper No. 554.

against rising house prices made significant cuts to their spending as their payments rose.^{xxi} Mortgage debt is not only a private burden. It carries shocks from the housing market into the wider economy.

Tighter lending standards were the approach this book advocated. It argued that the preferred way to build a more responsible housing market was 'the imposition of well enforced responsible lending requirements which prevent loans from being given to those that cannot afford them and which, if set tightly enough, will ration the amount of mortgage credit that is made available. If combined with ambitious house building programmes, this will allow the cost of homes to fall over the longer term' (p. 93). Only the first half of that proposal was implemented. The house building programme never materialised. Without it, tighter lending rules protected those who could borrow while doing little to bring homes within reach of those who could not. Now even the first half is being unpicked. The Financial Policy Committee withdrew its interest rate stress test in 2022. In March 2025, the FCA reminded lenders of the flexibility in its own stress-testing rules, allowing many borrowers to borrow around £30,000 more, and in July 2025 the Financial Policy Committee removed the 15 per cent limit on high loan-to-income lending for individual lenders, while the previous Chancellor made permanent a government-backed guarantee scheme for low-deposit mortgages.^{xxii}

Old habits are proving hard to break. The Help to Buy equity loan scheme, which the book argued should be abolished because it inflated house prices without addressing the shortage of homes, closed to new applicants in 2022. That was welcome. But in September 2026, on the eve of his first party conference as leader, the Prime Minister announced its successor. Under 'Your First Home', first-time buyers will be able to purchase a new-build home with a deposit of just 2.5 per cent, supported by a government equity loan worth 20 per cent of the price and interest-free for an initial period.^{xxiii} The aim, to help those who cannot call on the 'bank of mum and dad', is a worthy one. The mechanism is not. Buyers will enter the market with 97.5 per cent of the purchase price borrowed, highly exposed to any fall in prices or rise in interest rates. Research on the original scheme found that in London, where the supply of new homes was most constrained, it pushed up prices without increasing construction, so that much of the subsidy was captured by developers rather than buyers.^{xxiv} The Government's own evaluation concluded that, while Help to Buy was effective in supporting people into home ownership in some areas, it 'did not remove affordability barriers for first-time buyers in areas that were already relatively

^{xxi}Bracke, P., Everitt, M., Fazio, M. and Varadi, A. (2024). *When refinancing meets monetary tightening: heterogeneous impacts on spending and debt via mortgage modifications*. Bank of England Staff Working Paper No. 1,105.

^{xxii}Bank of England (2022). *Withdrawal of the FPC's affordability test Recommendation*. Financial Conduct Authority (2025), 'FCA sets out plans to help build mortgage market of the future'. Bank of England (2025). *Financial Stability Report*, July 2025. HM Treasury (2025). 'Reeves to cut financial red tape to boost homeownership', press release, 15th July 2025.

^{xxiii}Pike, J., Wheeler, R. and Keenan, C. (2026). 'Burnham announces scheme to help first-time buyers onto housing ladder', *BBC News*, 26th September 2026.

^{xxiv}Carozzi, F., Hilber, C. A. L. and Yu, X. (2024). 'On the economic impacts of mortgage credit expansion policies: evidence from Help to Buy'. *Journal of Urban Economics*, 139.

expensive'.^{xxv} Taken together with the loosening of lending standards, these measures reveal the limits of the Government's critique. It has condemned several of the effects of the past 40 years, but not the mechanism that produced them. Expanding mortgage credit so that people can buy homes they could not otherwise afford is the remedy that has been applied, in one form or another, since the 1980s. Growth is once again being made to depend on it: as interest rates have come down, the boost to consumption has come mainly from households borrowing against higher house prices rather than from lower repayments.^{xxvi} Unless this is matched by house building on the scale the Government has promised, it will once again push up prices and leave a new generation of first-time buyers more heavily indebted. The Housing Secretary has already conceded that there is only a 'slim chance' of meeting the Government's target of 1.5 million new homes in England by the next election.^{xxvii}

New pressures, old mechanisms

Alongside unfinished business, the past decade has brought new pressures. The Covid-19 pandemic and the cost-of-living crisis that followed it placed severe strain on household finances. By 2023, nearly one in four UK households was over-indebted, describing their bills and credit commitments as a heavy burden or reporting that they had fallen behind with payments.^{xxviii} Arrears on council tax, energy bills, and rent have grown, and the social security system has itself become a major creditor. In May 2026, some 3.3 million households claiming Universal Credit, nearly half of the total, were having deductions taken from their payments, most commonly to repay advances that had been needed to cover the five-week wait for a first payment.^{xxix} A benefit system that lends to people because it will not pay them promptly, and then recovers the debt from incomes already assessed as the minimum needed to live on, reproduces the very dynamic this book criticised in the commercial credit market.

New forms of credit have also emerged. Buy Now Pay Later and employer salary advance schemes have grown rapidly, largely outside the reach of consumer credit regulation until very recently. At the same time, the credit industry has made increasing use of data analytics, artificial intelligence, and machine learning in assessing whom to lend to and on what terms. These developments have been accompanied by a renewed emphasis on 'financial inclusion'. Following the regulation of Buy Now Pay Later in July 2026, some have argued that affordability checks risk leaving people who 'use BNPL responsibly', in the sense that they keep up their repayments, 'unfairly excluded' from credit.^{xxx} This misunderstands what responsible lending

^{xxv}Pike, Wheeler and Keenan (2026), *BBC News*, 26th September 2026.

^{xxvi}Foulis, A., Hazell, J., Mian, A. and Tracey, B. (2026). *How do interest rates affect consumption? Household debt and the role of asset prices*. Bank of England Staff Working Paper No. 1,173.

^{xxvii}Pike, Wheeler and Keenan (2026), *BBC News*, 26th September 2026.

^{xxviii}Gibbons, D. (2024). *The Need for Debt Advice and the Challenges Ahead: analysis of the MaPS Debt Need Survey 2023*. Centre for Responsible Credit.

^{xxix}Department for Work and Pensions (2026). *Universal Credit deductions statistics: June 2025 to May 2026*.

^{xxx}Fair4All Finance (2026). 'FCA regulations begin on Buy Now Pay Later', 16th July 2026.

rules are for. Many households keep up their credit repayments not because they can afford them, but because missed payments damage their credit scores and future access to credit. This disciplinary effect, built into modern credit reporting, leads borrowers to cut back on food, heating, and other essentials to protect their credit files.^{xxxix} Others keep paying their lenders by falling behind with rent, energy bills, and council tax instead, shifting the risks and costs of unaffordable lending onto landlords, utility companies, and local authorities. Meanwhile, a record 7.4 million low-income households went without at least one essential item in the six months to June 2026, and some 4.5 million were behind on at least one household bill or credit repayment.^{xxxix} At a time when millions cannot afford the basics, a drive to extend credit in the name of inclusion makes little sense. What these households lack is adequate income, not access to further debt. The Centre for Responsible Credit will publish detailed evidence on these issues later this year.^{xxxix}

The same instinct is evident in the Government's approach to financial regulation. I was in the audience at Mansion House in November 2024 when the previous Chancellor, Rachel Reeves, argued that the reforms introduced after the financial crisis had 'resulted in a system which sought to eliminate risk-taking', and that this had 'gone too far'.^{xxxix} Her 'Leeds Reforms' of July 2025 followed, including a commitment to return the Financial Ombudsman Service to its 'original purpose as a simple, impartial dispute resolution service'.^{xxxix} That is a significant retreat, given the part the Ombudsman's decisions played in driving the most predatory lenders from the market. Her successor, John Healey, has signalled continuity. Financial services, he told the *Financial Times* in September 2026, are not seen widely enough as 'the foundation and engine of greater investment and therefore potential growth in this country', and the country must move beyond the 'post-financial crash obsession with regulating for risk'.^{xxxix} It would be hard to find a clearer statement of the model this book describes. There is a real danger that the protections won over the past decade will be weakened in the name of growth and access to credit, just as households are least able to take on more debt.

I have examined these developments at length in my latest book *Trust and Power in Consumer Credit Relationships: Rethinking Creditworthiness in the Data-Driven Age*.^{xxxix} That book asks whether the credit industry can be trusted not to exploit the current economic situation and

^{xxxix}Gibbons, D. and Pena, A. R. (2026). *Good Score, Empty Cupboard: The credit score trap forcing households to cut spending on essentials*. Centre for Responsible Credit.

^{xxxix}Belfield, C. and Percival, N. (2026). *Record numbers cannot afford the essentials: JRF's cost of living tracker, summer 2026*. York: Joseph Rowntree Foundation, 22nd July 2026.

^{xxxix}Gibbons, D. (forthcoming, 2026). *In the Balance: Consumer Protection and Credit Exclusion in the Affordability Crisis*. Centre for Responsible Credit.

^{xxxix}Rachel Reeves, Mansion House speech, 14th November 2024.

^{xxxix}HM Treasury (2025). 'Leeds Reforms to rewire financial system, boost investment and create skilled jobs across UK', press release, 15th July 2025.

^{xxxix}Fleming, S. and Parker, G. (2026). 'John Healey puts Britain on notice for tough Budget in "more dangerous world"', *Financial Times*, 4th September 2026.

^{xxxix}Gibbons, D. (2026). *Trust and Power in Consumer Credit Relationships: Rethinking Creditworthiness in the Data-Driven Age*. Cham: Palgrave Macmillan.

argues that the post-crisis reforms improved some rules without altering the balance of power within credit relationships. It can be read as a sequel to this one. Where this book explains how Britain became dependent on household debt, the later one examines the power relationships that keep borrowers there.

Unfinished business

The diagnosis set out in 2014 has stood the test of time. The personal debt crisis was never a single moment that would pass once the financial system had been stabilised. It is an ongoing process, driven by inadequate incomes, the retrenchment of the welfare state, and a housing market that turns a basic need into a lifetime of debt. The regulatory reforms of the past decade have made the credit market less predatory at the margins. They have not made households less dependent on it.

A Government that wants to break with the past 40 years should therefore recognise household debt as one of the defining features of the model it seeks to replace, and act accordingly. At a minimum, that means:

- Restoring the 2014 responsible lending requirements for mortgage lending;
- Completing the reform of Right to Buy by abolishing it in England, and funding a programme of social housebuilding large enough to bring housing costs down relative to incomes;
- Establishing a debt resolution programme for over-indebted households, including an overhaul of insolvency procedures to include the protection of a debtor's main home;
- Extending caps on the cost of credit across the consumer credit market, and resisting pressure to weaken affordability requirements in the name of financial inclusion;
- Addressing the disciplinary effect of credit reporting and scoring systems; and
- Rebuilding social security so that credit is no longer the safety net of last resort for households facing an income shock.

None of these measures is new. Most of them were argued for in these pages more than a decade ago. That they remain necessary is a measure of how little the underlying model has changed. The question now is whether a government that has named the mistakes of the past 40 years will also be willing to confront the debt on which they rested.

Damon Gibbons, Leicester, September 2026

A note on this reissue

This reissue reproduces the text of the 2014 edition, first published by Searching Finance. Aside from addressing typographical errors, the following corrections have been made:

- Page 7: the nationalisation of Northern Rock is correctly dated to February 2008 (previously given as September 2008);
- Pages 27–28: the quotation from Charles Goodhart has been corrected against the original, and the accompanying footnotes now give the full reference (previously cited as Goodhart, 2007);
- Page 31: John Fforde's proposed policy of interest rate control is no longer presented as a quotation from his note to the Governor, and the accompanying footnote now cites a surviving reproduction of the note;
- Page 37: the quotation from Charles Goodhart's 1973 paper has been corrected against the original, and the paper is now identified;
- Page 77: the footnote on the 2010 changes to the Local Housing Allowance now cites the Government's evaluation of the reforms, as the source originally cited is no longer available, and gives the estimated savings as around £1 billion, in line with the Government's own estimate;
- Page 78: the quotation from the OECD's 2006 *Economic Outlook* is now correctly attributed to the opening of the report's special chapter on household debt, rather than to the opening of the report itself;
- Page 113: the Australian Law Reform Commission's inquiry into privacy law is correctly dated as having reported in 2008, and the accompanying footnote now cites the report in full;
- Page 173: the Business, Innovation and Skills Select Committee inquiry is now dated late 2011 and early 2012 (it was announced in October 2011 and reported in March 2012), and on page 175 it is described as the inquiry of 2011–12;
- Page 211: the Government funding provided for debt advice between 2004 and 2011 is given as £143 million, consistent with page 200.

Web addresses in the footnotes to the 2014 text are given as they appeared in the 2014 edition, and some may no longer be available.

The index has been compiled afresh from the 2014 index, with additional entries. Its page numbers refer to this reissue.

Acknowledgements

[iv] THE IDEAS AND ARGUMENTS presented in this book have been drawn from many sources and formulated over a long time. I have particularly benefitted from discussions with colleagues in the European Coalition for Responsible Credit ('ECRC'), established some nine years ago. I am especially grateful to Udo Reifner, Iain Ramsay, and Toni Williams for their insights and encouragement. It is also largely thanks to the endeavours of Sebastien Clerc-Renaud at the iff (Institut für Finanzdienstleistungen) in Hamburg that I have been able to keep in touch with regulatory developments and consumer campaigns across the world. Beyond Europe, my great thanks go to John Taylor and Maryellen Lewis at the US National Community Reinvestment Coalition; Saul Schwartz in Canada, and to Saya Oyama and Kiyohito Wada in Japan. They have all influenced my thinking, although they cannot be held in any way responsible for it.

I also owe a large number of debts here in the UK. Far too many to list here, but special thanks go to Dave Simmonds and colleagues at the Centre for Economic and Social Inclusion who have provided support for my work over many years. They have made a major contribution to projects conducted by the Centre for Responsible Credit, the results from which, in one form or another, have found their way into this book. Niall Cooper and Alan Thornton have been tremendous comrades throughout the 'Debt on our Doorstep' campaign and beyond. Progress on making banks disclose patterns [v] of lending in our local communities would simply not have been possible without the determination, energy, and considerable lobbying skills of Jennifer Tankard. Angela Clements has contributed her expertise in banking and knowledge of the challenges facing the credit union movement, together with an unstoppable faith in our ability to achieve change. Kathleen Carter and Greg Brown, taking the fight to the high-cost lenders in their local communities, provided inspiration when it was most required.

Finally, I would like to thank my publisher, Ashwin Rattan, for his (almost) eternal patience and, together with his team at Searching Finance, for bringing this book into being.

Chapter 1: What sort of crisis are we in?

[3] WE ARE LIVING IN A PERIOD OF GREAT UNREST. What is commonly regarded as starting as a 'credit crunch' in 2007 became a full-blown financial crisis the following year causing the 'deepest global downturn in recent history'.¹ Across Europe, rising business insolvencies and unemployment led to falling tax revenues, and to yawning national budget deficits. The austerity measures taken in response to these deficits are now exacerbating income and wealth inequalities and increasing social tensions, as evidenced by waves of demonstrations, violent protests and rioting. As the battle for resources has become increasingly bitter, a series of social, economic, and political crises have emerged – both within nations and, in the cases of Greece, Spain, Portugal, Italy, Ireland and Cyprus in particular, between the people of those nations and the 'troika' of the International Monetary Fund (IMF), the European Central Bank, and the European Commission.

Identifying the underlying causes of the crisis

[4] IT IS INEVITABLY TEMPTING to focus on the most immediate events as we experience them. But in so doing, we are failing to address the underlying causes of our crisis. In 2007 the money markets seized up, and policy makers diagnosed a 'credit crunch'. The 'cures' included pumping cheap money into the banks and, to stop widespread panic leading to the mass withdrawal of savings and the collapse of financial institutions, the extension of state guarantees for depositors. These measures were genuinely expected to solve the crisis in a short space of time. In September of that year, when problems became apparent at Northern Rock, the initial joint statement made by the Treasury, Bank of England and Financial Services Authority (FSA) was that:

*"The FSA judges that Northern Rock is solvent, exceeds its regulatory capital requirement and has a good quality loan book. The decision to provide a liquidity support facility to Northern Rock reflects the difficulties that it has had in accessing longer term funding and the mortgage securitisation market, on which Northern Rock is particularly reliant. In its role as lender of last resort, the Bank of England stands ready to make available facilities in comparable circumstances, where institutions face short-term liquidity difficulties."*²

THIS DIAGNOSIS OVERLOOKED THE FACT that Northern Rock, and many other UK lenders, had adopted a number of highly irresponsible lending practices and that households were becoming increasingly incapable of coping with the debt burdens placed upon them. I had cautioned about the vulnerability of households prior to problems emerging at Northern Rock. In an interview

¹International Monetary Fund, 2010: <http://www.imf.org/external/pubs/ft/weo/2010/update/01/>

²Bank of England News Release, 14th September 2007 'Liquidity Support Facility for Northern Rock Plc', <http://www.bankofengland.co.uk/publications/Pages/news/2007/090.aspx>

given to the BBC in December 2006, I warned that British households were on the edge of a debt 'tipping point' that could lead to recession.³

[5] Northern Rock's business model included many features similar to those present in the US sub-prime market, including mortgages at more than 100 per cent the level of the house price and the use of the 'originate to distribute' model whereby loans were packaged up as securities for sale in the investment markets to quickly release more funds for lending onto other mortgage borrowers. Northern Rock was therefore particularly quick to experience problems when the investment markets seized up as a result of panic at the level of defaults taking place in the US sub-prime mortgage market. But the underlying issue in the US was that borrowers could not afford to repay their loans, and so it was to prove in the UK also.

Irresponsible lending was not restricted to Northern Rock. It was widespread in the UK in the period leading up to 2007. The level of credit commitments that households had taken on had left them increasingly vulnerable to relatively small economic shocks. As I wrote just one month after the Bank of England provided its initial assistance to Northern Rock:⁴

"Britons now account for one third of all debt in Western Europe. Although the majority of our debt is secured on property (£1.05 trillion), net secured lending has outstripped the growth in house prices over the past 12 months (11% compared to 9.6%) and the increase in the overall level of indebtedness means that households are increasingly sensitive to interest rate rises ... Over 30,000 mortgage repossession actions have been started in each quarter since the end of 2005 – a total of 229,821 households in less than two years. Approximately 25,000 people are now entering insolvency in each quarter with the total number of insolvencies for the year forecast to equate to the entire population of Exeter. These indicators reveal a growth in financial problems at a time when general economic performance in respect of employment levels and average income [6] growth remains relatively strong. We attribute this phenomenon to irresponsible lending."

THIS FUNDAMENTAL POINT WAS MISSED by policy makers, who remained extraordinarily complacent about the position of British households in the run-up to the crisis. In 2004 the Government had set up a cross-departmental working group to monitor levels of over-indebtedness, but its report in 2007, published just months before the crisis hit, showed few signs of recognising the extent of the problems. Instead, Government preferred to highlight that:⁵

"... a strong labour market, continuing strong economic growth and relatively low inflation and interest rates still indicate an economy that continues to perform strongly."

³See 'New Year could see debt 'tipping point'', BBC News, 29th December 2006, <http://news.bbc.co.uk/1/hi/business/6168793.stm>

⁴'Responsible Credit: Proposals for Action', 2007, *Debt on our Doorstep*.

⁵*Tackling over-indebtedness, Annual Report 2007*. Department for Business, Enterprise and Regulatory Reform, p.9

WHAT IS MORE, from August 2006 onwards, the Bank of England proceeded to increase the financial pressure on many households by increasing base rates. In August 2006, base rates were raised from 4.5 per cent to 4.75 per cent. They were raised further to 5 per cent in November that year, and increased again in January 2007, to 5.25 per cent. In May, the bank further increased them to 5.5 per cent, and in July they rose another quarter of a percent to 5.75 per cent. The cumulative impact of these increases was to add around £84 per month to the cost of servicing a £100,000 mortgage. Those with the highest borrowing to income ratios felt this hit the hardest, and between 2006 and 2007 the number of mortgages three or more months in arrears increased by over 10 per cent. The impact would, no doubt, have been even worse had the Bank of England not belatedly put its policy into reverse in July 2007 by reducing the rate to 5.5 per cent and again to 5 per cent in December that year.

By then it WAS TOO LATE to stop the slide. The Government's attempt to prop up Northern Rock failed as the extent of the rot in the US sub-prime market and global financial system became [7] ever more apparent. Credit market conditions continued to deteriorate over the course of the following year, and the Government urged the banks to be honest about the extent of their difficulties. It was still apparently of the view that, once these were known, it would be possible to restore the markets to something approaching normality within a short space of time. In April 2008, the *Daily Telegraph* reported that the then Prime Minister, Gordon Brown, had become involved in an "acrimonious row" with banking chiefs over responsibility for the credit crisis, with Brown arguing that it was essential to:

"... reduce the uncertainty that is holding the banks back from lending to each other. If the world's largest banks could come together quickly and agree as a group to come clean about the potential bad debts they face, we could reduce the uncertainty and risk they face and restore confidence back into the markets."

THE BANKS, FOR REASONS WE NOW KNOW, were reluctant to play ball, and by the time they 'came clean' about their problems, we were engulfed in what has been identified as a 'second phase', or a 'financial' crisis. This started to play out in the UK with the nationalisation of Northern Rock in February 2008 and was then followed by an attempt to recapitalise the entire sector, involving the injection of huge amounts of money as bail-out funds into the banks.⁶

Again, this failed to solve the underlying problem. This came as no surprise. In a statement made jointly with Professor Udo Reifner, Chairman of the European Coalition for Responsible Credit, in September 2007, we warned that the problems at Northern Rock, "considered by many commentators to be an after-shock of the US sub-prime lending disaster," were in fact "a precursor of [8] wider problems that will be witnessed in the UK over the next 12 months" and that "assistance to the banking industry ... should not be given on a no-strings basis ..." but should be

⁶In the UK this phase included the Treasury injecting £45 billion into Royal Bank of Scotland and £17 billion into Lloyds Banking Group – formed from the merger of Lloyds TSB and HBOS, as well as, on 8th October 2008, the Bank of England unveiling a special liquidity scheme to provide £200 billion of cheap funds for banks.

combined with requirements for banks to “meet the needs of the whole population for financial services at fair prices with strengthened regulation.”⁷

In fact, quite the opposite was happening. Although the Bank of England started to cut base rates aggressively (from 5.75 per cent in July 2007 to 3 per cent by November 2008), this was having little impact on the mortgage payments that those households in most financial difficulty were paying. Mortgage lenders were not passing on these cuts to the borrowers in most trouble. In a paper written in November 2008,⁸ I noted that mortgage rates had become ‘decoupled’ from Bank of England base rates – cuts in the Bank of England base rate had not been passed on to borrowers in full since December 2007, and the gap between the two was increasing as the crisis deepened. The Government was pumping money into the banks, but precious little of this was finding its way towards hard-up households.

Mortgages had become increasingly unaffordable in the run-up to the crisis. Between 2002 and 2006, households with mortgages increased their expenditure on housing costs as a proportion of their disposable income by an average of 6 per cent (from 23 per cent to 29 per cent). The number of households paying out in excess of 30 per cent of their disposable income on housing costs also increased significantly over this period (2.8 million households in 2002/03 to over 4 million households in 2006/07).⁹ As the crisis hit, there [9] was an alarming rise in mortgage arrears and repossessions, concentrated particularly on households with large loan-to-income ratios (notably those that had taken out loans from 2005 onwards), many of which had little or no equity left in their properties as a result of falling house prices. Over 79,000 mortgage possession actions were taken out by lenders in the first half of 2008 alone – a 17 per cent increase on the same period in the year previous.

Writing at the time, I noted that:

“... it is now essential to reduce the cost of mortgages if a huge growth in repossessions is to be avoided. The traditional method to achieve this would be through cuts to central bank base rates ... [but if lenders aren’t passing these on] ... even aggressive cuts to the base rate may not prove adequate to significantly bring down the cost of borrowing for many households. At that point, central banks may need to take more direct control over the setting of mortgage rates if repossessions are to be prevented from accelerating further.”

THE GOVERNMENT AND THE BANK OF ENGLAND were not prepared to go that far. To its credit, Government did require mortgage lenders to demonstrate that they had considered all other options prior to seeking court orders for repossession. This played a part in preventing

⁷See ‘Irresponsible lending hits home: why Northern Rock is only the start’, 18th September 2007, European Coalition for Responsible Credit, <http://www.responsible-credit.net/index.php?id=1980&viewid=40249>

⁸D. Gibbons (2008). ‘Responding to the mortgage crisis: a review of recent policy announcements’. Centre for Economic and Social Inclusion

⁹Data retrieved from <http://www.communities.gov.uk/documents/housing/xls/141533.xls> on 1/11/08

repossessions from accelerating to the levels witnessed in 1990 and 1991. However, the failure to address the underlying problem of mortgage affordability for large numbers of households continued to bear down on the performance of the economy as a whole and played a major part in causing the initial recession. As Chapter 3 describes in more detail, it has also left many mortgage borrowers vulnerable to repossession moving forwards.

As well as failing to pass on reductions in the base rates to mortgage borrowers in financial difficulties, the lenders have been hiking up rates in the consumer credit market. Many borrowers (and those holding high levels of credit card debt in particular) are unable to switch to a better deal and are being exploited by lenders. As Martin Lewis puts it on his Money Saving Expert website:¹⁰

[10] "... boosting interest rates is a win-win for lenders, as it encourages those who can [do so] to ... switch elsewhere. Those who can't need to pay a huge amount more, helping offset the lenders' bad debts and boosting their profits. So paradoxically, in the name of responsible lending we're seeing lenders put rates up for those they consider a bad risk. That isn't responsible, it's greedy and dangerous. It makes people less, not more likely to be able to afford to repay – proving the old adage that banks are institutions that'll lend you an umbrella when the sun's shining but want it back when it rains."

THE NUMBER OF BUSINESSES GOING BUST,¹¹ redundancies, and unemployment¹² all rose sharply in the initial recession, which in turn reduced the tax base and placed public spending under pressure as welfare claims rose. Thus followed the 'national debt crisis', to which the 'solutions' are savage austerity programmes, either imposed voluntarily by national governments, as in the case of the UK, or imposed externally (as in the case of Greece, Spain, Portugal, Italy, Ireland, and Cyprus) by the international 'troika'.

But none of the underlying causes have been addressed. The reality is that what we are living through is not a 'credit crunch', nor is it 'just' a 'financial crisis', or for that matter a 'national debt' crisis. What we are continuing to experience are the impacts of a personal debt crisis, and we will need to be much more radical if we are to resolve it.

Why acknowledging this is a personal debt crisis matters

[11] IN MAY 2012, THE EUROPEAN COMMISSION¹³ provided a staggering assessment of the state of the UK economy. The review, which was conducted to provide an alert to the UK government about

¹⁰<http://www.moneysavingexpert.com/reclaim/credit-card-interest-rate-increases>

¹¹Between 2007 and 2009, the number of company insolvencies in England and Wales increased by over 50 per cent from 12,500 to more than 19,000.

¹²See, for example, Campos et al (2011): Impact of the Recession. *Regional Trends* 43, Office for National Statistics.

¹³European Commission Staff Working Document: *In Depth Review for the United Kingdom*, 30/5/2012 available at http://ec.europa.eu/europe2020/pdf/nd/ldr2012_uk_en.pdf

‘economic imbalances’, indicated that household and business debt levels have been out of control for some time.

As at the end of 2010, the Commission noted, households and businesses, excluding the financial sector itself, owed over twice as much (212 per cent) as our entire annual economic output.¹⁴ The level of household and business debt increased by over 80 per cent in the period between 1995 and 2012, and for households alone, our collective debts increased by nearly one-third in the period from 2000 to 2009, where they peaked at 104 per cent of Gross Domestic Product (GDP). By comparison, total government borrowing was 80 per cent of GDP in the same year. To spell it out: household debt is a bigger problem than government debt.

Despite this fact, hardly anything is now being done to help people to reduce their debt burden. On the contrary, households are being hit by a combination of job insecurity, under-employment (more involuntary part-time working) and unemployment, stagnant wages, higher food, fuel, and transport costs, and the largest programme of welfare and public spending cuts in living memory. This combination is particularly bad news for people on low to middle incomes – basically, what we might call ‘ordinary people’: or, in more political terms, the working class.

The question arises as to why more isn’t being done to help these households. Indeed, why have we poured billions into the banks – to bolster their liquidity and provide them with the opportunity [12] to reschedule their liabilities – and yet ignored the needs of households for these very same types of assistance? Is it a failure of intelligence – to accurately characterise the crisis for what it really is and make the required responses – or rather, as may now reasonably be asked, a reflection of deliberate political choices to preserve the privileges of the financial sector and its representatives, and to make the people pay for a crisis that was not of their making?

What is Government saying now?

IN A RECENT policy document, the UK Treasury opines that the mess we are in is the product of three factors. Firstly, there was a failure of banks to manage their businesses ‘prudently’ and to understand the risks of what they were doing. Secondly, regulators failed to effectively ‘challenge’ the banks and prevent them from collectively taking risks which posed a danger to the financial system as a whole. And finally, the global interconnectedness of the financial system, and the size and complexity of a number of banks and financial institutions is such that these became either ‘too big’ or ‘too important’ to fail – putting them beyond the reach of national regulators.

The Treasury has therefore taken a number of steps designed to improve how banks are run; ensure they have sufficient capital reserves and liquid assets to reduce the risk of future state-backed bail-outs; separate out essential retail banking services, such as current and savings accounts and payment systems, from ‘casino’ investment banking operations; provide for better

¹⁴Using Gross Domestic Product as the measure.

regulation of financial products and greater consumer protection; and give the Bank of England a clear responsibility to ensure financial stability.

The big problem is that the Treasury's actions are solely designed to avoid a future financial crisis rather than deal with the ongoing personal debt crisis, and so the actions being taken forwards in the UK are incomplete and will not work. To be absolutely clear about this, a personal debt crisis is not the same as a financial crisis.

[13] Defining what we are experiencing as a financial crisis focuses solutions on the financial sector – on saving the banks in return for some reforms to the way they operate in the future. But the personal debt crisis refers to both the supply and the demand side and specifically looks to answer the question as to why it is that households have increased their use of credit to levels which are patently unsustainable, as well as how the financial and political system allowed, and indeed in many respects encouraged, that to happen. It speaks to helping households now and looking at how their needs can be met without forcing them to take on huge levels of debt in the future.

It is important to realise that the personal debt crisis is not a single moment in time. As this book seeks to explain, the personal debt crisis is an ongoing product of economic and political decisions over a period of 40 years; of deep change within the structure of our labour market; of failed housing policies; and of the erosion of the welfare state, which is now being accelerated with the latest round of austerity. Whilst there may temporarily be a swing back towards tighter credit regulation and greater 'responsibility' in mainstream lending practice, the long-term trend remains one of continued credit booms and busts – each one of greater intensity than the last. The austerity policies that are currently being pursued are likely to make people more, not less, reliant on credit and financial services in the future. We are, even now, and in the name of reforming the banking system and dealing with the national debt, creating the conditions for future, bigger, global economic crises.

The measures being taken now are particularly bad news for low-income households. As I put it in a press statement issued by the European Coalition for Responsible Credit in September 2007:¹⁵

"Ultimately, [mainstream] lenders will become more restrictive ... on the face of it a good thing, but in reality, it will drive low-income households [14] into further difficulties and leave them in the hands of predatory and extortionate lenders."

SIX YEARS ON, a fierce debate now rages about how to regulate payday and other high-cost lenders that have grown exponentially and caused misery to millions since this prediction was made. Whilst we should celebrate the recent announcement from Government that it will introduce a cap on the cost of credit that payday lenders can charge, we also need to understand why the

¹⁵'Irresponsible lending hits home: why Northern Rock is only the start', 18/09/2007, available from <http://www.responsible-credit.net/media.php?t=media&f=file&id=2732>

campaign for limits on credit charges – which has taken up a great part of my life for the past 15 years – has been so vociferously opposed by the financial services industry. The fact is that it is not just payday lenders, but the entirety of the financial services system which operates regressive pricing policies – charging those who are least able to afford it the most. The victory on payday lending urgently needs to be built upon to create a more progressive financial services system if we are to address one of the main causes of growing wealth inequalities in Britain today.

The expansion of credit over the past 40 years has also been one of the main drivers of Britain's economic problems. Our balance of payments crisis now deepens by the day. But it has been long in the making. Reliance on household consumption as a means of generating economic growth, and on financial services as a source of exports, has made a major contribution to the deterioration of our manufacturing and industrial base. As financial services exports have collapsed since 2008, the value of sterling has depreciated by over a quarter. This has driven up the cost of living as the price of imports, particularly food and fuel, has risen. This is creating inflationary pressures that Government is attempting to contain by making savage public spending cuts. The alternative of base rate increases, as attempted in the late 1980s, would, if implemented now, result in a mortgage repossession crisis on a scale never previously witnessed. We must rebalance our economic base, but to achieve this will take long-term investment; and the refocusing of credit away from the housing and consumer credit markets and towards ^[15]industry. Ironically, as we further erode the welfare state, this will drive us toward even greater crises in the future. To give just one example, successive cuts in the level of state pension have pushed people into private provision and required them to seek out higher returns – to 'make money work harder' – resulting in pressure on investors to take higher risks, which runs contrary to the stated objective of creating a stable financial system.

The personal debt crisis is also a cultural crisis. It has arisen from, and in turn fed, the development of a highly individualist, consumer culture. We no longer seem to take collective responsibility for the creation of a 'fair society', based on progressive taxation and democratic accountability for the allocation of resources to secure education for our young people, decent jobs at fair rates of pay, and dignity in retirement for our pensioners. Instead, we must all now take individual responsibility and use financial services to secure these outcomes for ourselves. Concepts of self-reliance and responsibility have also been morphed by the credit industry into messages of 'have now, pay later'; encouraging people to meet short-term 'wants' at the expense of long-term 'needs'. It is almost beyond belief that, having supported the creation of this culture through mass advertising over a period of at least three decades, the lenders and a large part of the political class now have the temerity to castigate borrowers as being irresponsible for taking on too much debt. They now call for greater efforts to be made to improve levels of 'financial capability' as an alternative to tighter regulation of their practices – as clear a case as can be found of 'blame the victim' and one which ignores the key role of economic and social policy in creating the demand for credit in the first place.

The consequences of the personal debt crisis are not only the financial ruin of individual households, and the devastation of national economies, or, as a result of the way that the ongoing problems are being handled, increased social and political tensions. The expansion of credit has also been a significant contributor to environmental destruction. Consumer credit provides households [16] with the ability to purchase goods and services that they would not otherwise be able to afford (in the absence of increased earnings or a period of time to build up savings). It therefore accelerates the rate of production of many goods to meet credit-fuelled demand. As a consequence, the rate of use of the earth's resources in the production process, notably in the rapidly growing economies of Asia which have been the main manufacturers of consumer goods, has been far beyond the speed at which those resources can be replenished.

Addressing the personal debt crisis is therefore not just a matter of tweaking our existing approach to credit regulation. Instead, it requires us to take a long look at how we arrived at the current position – at the deep forces unleashed by policy decisions over the past 40 years – and to critically reassess the role of credit in society.

But isn't credit a good thing?

AT ITS HEART, THE CONCEPT IS SO SIMPLE, and the benefits from it so apparent, that it is hard to imagine how an expansion of credit could have led to the current unrest. Boiled down to its essentials, people borrow money to meet their current needs in the expectation that they will be able to make repayments to their lenders from future income. Credit therefore allows us to obtain goods and services now and to pay for these at a later point in time. It can be used to spread out the cost of large items over a time-frame which is more manageable. It appears particularly suitable as a means of paying for so-called 'big ticket' items, such as a car, or, for that matter, a place to live. The alternative to using credit is saving. However, few people who find a place they want to live in on a long-term basis would wish to save up for 20–30 years before being able to do so.

Credit can also be used to smooth out consumption patterns, covering the cost of expenditures when income is lower than expected (or desired), or when we are faced with unexpected bills. [17] The periods over which credit is used in this way can be both short and long. Overdrafts and credit cards can be used to meet unexpected costs one month and the debt entirely cleared the next. Alternatively, people may use considerable amounts of credit when incomes are lower at the start of their working lives, paying interest on this for a significant period, and finally paying down the debt when they are older and in receipt of higher earnings or when costs are reduced, for example when children leave home.

In this sense, credit is empowering. It allows us to gain access to goods and services in the here and now and to manage fluctuations in income and expenditure over the course of a week, a month, years, or even a lifetime. In recent years, credit has therefore become associated with freedom and opportunity – a helping hand towards personal upward mobility that allows those

who would not otherwise be able to do so to get a foot on the 'housing ladder', pay their way through university, start a business, or cope with the additional costs of starting a family.

In theory, this works for the economy as a whole as well as for individuals. Lots of households simultaneously using credit boosts the total level of demand for goods and services and, with credit also provided to businesses to enable supply to be expanded, can drive rapid economic growth. Credit expansion can be a powerful economic stimulant. And, if credit can help households smooth out their consumption over time, then perhaps it can help even out the business cycle, and perhaps 'abolish boom and bust'.

But this simple conceptualisation conveniently glosses over a number of fundamental problems with credit. Firstly, no-one knows for certain what their future earnings will be, and we tend to be over-optimistic in this respect. Findings from a survey of over 12,000 young people aged between 12 and 19 years old conducted by Royal Bank of Scotland in 2011 make the point.¹⁶ More [18] than 60 per cent of young people were unable to imagine what their future salaries would be, and the remainder had very high expectations, indicating that at 35 years old they would have wages averaging over £61,000 – which would put them all in the top 5 per cent of earners in the country. The survey reports that boys and older pupils had particularly high-salary expectations and that many young people were also unrealistic about when they would be able to afford to make large purchases and leave home. Most expected to be able to afford to buy a car by age 21 (70 per cent), leave home by 25 (87 per cent) and buy their own home by 30 (82 per cent).

Whilst we over-estimate our earnings potential, we also tend to under-estimate the likelihood and impact of changes in our lives: whether this is having our hours of work reduced or becoming ill or unemployed. Our children are beautiful: but as every parent knows, they can also be expensive. A relationship may not work out, leading to separation or divorce and the loss of a supporting income or the need to spend more on childcare. There is a myriad of possibilities, and neither the lender nor the borrower can know precisely how much a person can realistically undertake to repay in the long term without any of these difficulties. It is these changes of circumstance which have been traditionally most likely to give rise to debt problems. For example, the debt advice charity StepChange (formerly the Consumer Credit Counselling Service), which was contacted by nearly 370,000 people in 2011, reports that unemployment or under-employment (for example, having to take part-time work) is the cause of debt problems in over half of all cases; that women are almost twice as likely as men to contact the service following a separation or divorce; and that unsecured debt levels are around one-fifth higher for households with dependent children than without.¹⁷

We can, of course, take out insurance to protect against the impacts of some of these life events. Much of that insurance was previously provided by the state, for example in respect of decent [19]

¹⁶*MoneySense Panel Report, 2011*, Royal Bank of Scotland, available at <http://www.rbs.com/content/dam/rbs/Documents/Sustainability/MoneySense-panel-report-2011.pdf>

¹⁷Consumer Credit Counselling Service, *Statistical Yearbook 2011*

benefit levels. It was then effectively privatised, and the lenders moved in. But the product they developed, Payment Protection Insurance (PPI), has proved to be a disaster. The problem with PPI was that it insured the lender against default, and so encouraged more risk taking on their part, not less. After all, if the payments are covered by an insurance policy, then does it really matter who you lend money to? What is more, this product was often foisted on prospective borrowers as an apparent condition of approving a credit application. Borrowers were largely unable to shop around for better-priced insurance and were frequently mis-sold expensive PPI that they did not really want to take out. In some circumstances, PPI was also sold to people even though their personal circumstances were such that they would be excluded from receiving any benefits from it, for example where they had a pre-existing medical condition. This astounding lack of care for the customer has landed UK banks and credit card companies with a mounting bill estimated to be in the region of £13 billion.¹⁸

However, it is important to recognise that campaigning to provide people with redress for PPI and other mis-selling scandals is not enough. We must also look to address the underlying causes – in this case, the privatisation of state-based insurance schemes and the transfer of responsibility that this implies. Instead of pooling our resources and looking after each other in hard times, we have created a system which relies on each of us, individually, to look after ourselves. Financial services have expanded in importance as a result of this fundamental shift.

Third, how much should we pay for our credit? Credit repayments have to be made out of current income and so reduce the amount that we have to spend on other things or to put aside as savings. This causes problems for lower-income households in particular, which struggle to meet the costs of day-to-day living and to fund the purchase of essential items. Where consumer credit is used for these purposes, it often comes at a high cost and the [20] repayments can reduce the ability of households to pay for other essentials, leading to arrears on other household bills, cold homes, and, increasingly, hungry mouths. Credit affordability is therefore not just about the total amount of indebtedness relative to income, but also about the level of repayments and the impact of these on other areas of the budget and on living standards more generally.

Fourth, why we use credit is important. Obtaining credit and investing this in education and skills potentially opens the door to increased earnings. Spending it on the latest electronic gadget does not. The former use of credit is 'productive', the second is not. There are grey areas. Buying a car can improve access to jobs where public transport is unavailable; buying a suit could make the difference at that all-important job interview. But using credit to fund a 'shopping binge' on the latest fashions, live the 'high life' or gamble away on the horses – whilst fun for a while – is likely to cause problems.

Both the 'what' we do with credit, and the 'why' we make those choices are important. Whether to buy homes, access higher education, or to develop vocational skills to improve our

¹⁸<http://www.bbc.co.uk/news/business-20177515>

employment prospects, the reasons why people are using credit to the extent that they are is not due to ignorance or borrower irresponsibility, but because there is a lack of other options available to them to secure these types of desirable life outcomes.

Nowhere is this more apparent than in our housing market. People who want to start families tend to want to do so in a place of their choice and on a long-term basis. In the UK at least, this generally now requires a mortgage. Housing policy decisions have limited the ability of people to obtain long-term tenancies, and social housing is so over-subscribed that only those with the greatest needs are now housed through that route – and where this happens, the individuals often have a limited amount of choice as to where they end up living.

But it is not just housing policy decisions that have driven people to use financial services. Low state pensions; the removal of student [21] grants; more flexible employment patterns, low levels of welfare benefit payments – all of these have an impact. Over the course of the past 40 years, the state has reduced its responsibilities, and financial services have grown in importance as the tool with which people are expected to manage their own risks and obtain access to key markets.¹⁹

This shift from collective responsibility, organised through a welfare state, to the individual has major implications. Public services are mainly funded through tax revenues, which can (although they are not always) be designed in progressive ways to offset income and wealth inequalities. Who gets access to public services is also subject to democratic debate and accountability. Reducing public provision and replacing this with the increased use of credit and other financial services is likely to be regressive, as poorer consumers are charged the most for services or may be denied access altogether. As a consequence, the process inevitably increases wealth inequality.

It is not just about us as individuals. The drive to increased credit use has implications for us all, whether or not we ourselves are borrowers. Yes, lots of households simultaneously using lots of credit gives a short-term boost to overall consumer spending and can drive economic growth. But in the longer term, the interest repayments create a drag or 'debt overhang' on the economy, depressing consumption. And what about the resources used to make all of those new consumer goods bought during the credit boom – the raw materials and energy? Bringing forward consumption power through the expansion of credit has consequences for the natural environment. The regulation of credit is therefore not just a matter of regulating the terms on which lenders and borrowers contract with each other, with the focus on transparency of contract terms, and 'light touch regulation'. As we now witness all around us, contracts between lenders and borrowers affect more than those who lend and borrow, and there is a wider public interest in credit [22] regulation which needs to be asserted over the freedom of the market.

¹⁹See, for example, Gray & Hamilton, 2006, p.21

Structure of this book

THIS BOOK IS ABOUT THE PERSONAL DEBT CRISIS: its origins and effects, and, critically, what we have to do about it. It is about how we managed to get it wrong and create a global crisis. It provides evidence about how dazzled we became by credit and details the consequences of what happens when we forget the underlying principles that need to govern its use. Importantly, this book is also about how to get it right. It is not an 'anti-credit' book – it is a pro-credit book. It is about how to create a credit system that really meets the needs of households and businesses and supports sustainable economic growth. It is about how to build a credit system that works for people and the planet.

The remainder of the book is structured as follows.

CHAPTER 2 charts the rise of credit by looking at how successive governments between 1970 and 1990 failed to adequately control the expansion of credit, and in some cases deliberately encouraged this as a means of boosting economic growth. The chapter considers the long-term impacts of these policies, indicating how the processes of credit boom and bust, combined with the economic priorities of controlling inflation and low levels of personal taxation, led to greater wealth inequality.

CHAPTERS 3 AND 4 then take a detailed look at more recent developments in the mortgage and consumer credit markets respectively, with particular emphasis on how the growth of these have driven an increase in wealth inequality and contributed to Britain's economic decline. They argue for much greater responsibility in lending as a means of controlling credit expansion and set out a number of possible measures to achieve this.

CHAPTER 5 then focuses on the particular problems faced by low-income households. The chapter provides details of the campaign ^[23] for caps on the cost of credit and better regulation of the high-cost credit sector, and for the re-engagement of banks and development of affordable financial services in low-income areas. These are campaigns that I have been heavily involved in over a period of 15 years.

CHAPTER 6 looks at the impacts of debt on individuals, communities and wider society. It reviews the UK's strategy for dealing with debt problems, which have exploded from 2006 onwards, and argues that our fragmented insolvency and debt advice 'system' is inadequate to resolve the problems we now face.

Finally, **CHAPTER 7** brings together the main conclusions from previous chapters and appeals for effective measures to be taken to tackle the personal debt crisis and create a responsible credit system.

Chapter 2: The rise of credit

[25] THE CRISIS WE ARE NOW EXPERIENCING has been long in the making and is the product of a failure to find effective ways to control the expansion of credit over a period of more than 40 years. This chapter focuses on the deep forces that have underpinned the rise in credit use over this period.

It begins by providing a brief context of the state of banking supervision and consumer credit regulation in the 1960s and proceeds to detail the experiment of the Conservative Government led by Ted Heath to boost economic growth by relaxing credit controls from 1970 to 1973. This created a housing and consumption boom but was swiftly followed by a balance of payments crisis and recession. A new form of control on bank lending was then introduced towards the end of 1973, although this was subsequently evaded by the banks.

The chapter then looks at the genesis of the Consumer Credit Act 1974, which repealed a host of separate laws, some of which provided Government with direct control over key terms and conditions in credit agreements. These were removed and replaced by a single regulatory regime focused on 'truth in lending', and established the Office of Fair Trading as the licensing body.

By the time Labour came to power in 1974, there were few effective credit controls in place, although it appeared to trust in the measures that had been introduced in late 1973 and attempted [26] to use these as part of its wider strategy to try to combat inflation. However, by 1976 inflation was running at over 26 per cent. Policies of wage restraint and public spending cuts dominated the political agenda, and a balance of payments and sterling crisis saw the Government turn to the IMF for a bail-out. Although inflation was falling by the time of the General Election in May 1979, rising unemployment and widespread industrial strife created the conditions for a Conservative victory.

The chapter ends by highlighting how the policy choices of the Thatcher Government from 1979 through to 1990 resulted in the rapid expansion of both mortgage and consumer credit lending. Despite a stated commitment to 'strict monetary discipline', these choices included the promotion of home ownership and the Big Bang reforms of the City in 1986. Monetary targets were all but abandoned as the Government increasingly targeted the exchange rate and relied on public spending cuts to hold down inflation. As North Sea oil revenues fell, the Government deregulated the City, and financial services became a more important contributor to our trade balance, strengthening the hand of the financial sector. Credit expanded rapidly to underpin the boom of the late 1980s but ended once more in a major recession and led to record numbers of mortgage repossessions and credit defaults. The scale of default was later to become a major driver behind the 'segregation' of credit markets, with lower-income households pushed out of the credit 'mainstream' and into newly developed 'sub-prime' or high-cost markets. This process, which remains unchecked, is a major contributory factor in the personal debt crisis we face today.

Banking supervision and consumer credit regulation in the 1960s

THE RETAIL FINANCIAL SERVICES SECTOR OF TODAY is barely recognisable to that of the 1960s. To begin with, the sector is much more [27] concentrated and significant in terms of its potential impact on the economy. In 1960 there were 16 major clearing banks holding assets equivalent to approximately 30 per cent of GDP. Today, the banking sector has a balance sheet worth more than 500 per cent of GDP, and three of the biggest banks each individually hold assets worth more than our entire annual economic output. The 'big four' (RBS, HSBC, Lloyds Banking Group, and Barclays), together with Santander and the Nationwide Building Society, account for more than 80 per cent of the entire stock of customer lending which takes place in the UK.²⁰

As well as the 16 clearing banks, which primarily focused on providing current and savings accounts and business lending, there were over 700 building societies in 1960, mutually owned by their members. These provided an important source of mortgage lending to households and held combined assets of £2.6 billion. Today, there are just 50 building societies left standing, but their combined assets are worth around £375 billion.²¹

The regulation of banking and credit provision was also very different. The Bank of England had extremely limited involvement in the supervision of the clearing banks and a lack of oversight of the financial system as a whole. As Charles Goodhart,²² a former adviser to the Bank of England, has noted:²³

"... what was remarkable was how sparse were the formal links between the Bank, the commercial banks, and the rest of the financial system. ... There was a limited provision of monetary data (mostly provided on a voluntary basis by the clearing banks ...), but the Bank did no off- or on-site bank inspections, though it did discuss their annual results with (most of) the banks ([28] with the clearing banks not deigning to talk with anyone other than the Governors)."

ALTHOUGH THE BANKING SECTOR was largely unsupervised, the government took a much more direct 'command and control' approach to the control of inflation, with the clearing banks set direct lending limits by the Treasury. Not content with setting these overall limits, the Treasury was also in the habit of asking the banks to prioritise lending to specific sectors of the economy. The end result was that the Bank of England became a 'go-between' of the Treasury and the major banks:

"For its part the government relied on the Bank to introduce, monitor and maintain (if not quite enforce) its commands; while the banks and other intermediaries knew that they had to get the Bank on their side if any special pleadings that they wished to make"

²⁰Davies et al (2010, Q4) Evolution of the UK Banking System, *Bank of England Quarterly Bulletin*, pp. 322

²¹Figures from the Building Societies Association, obtained from <http://www.bsa.org.uk/keystats/index.htm> on 25th May 2013.

²²Charles Goodhart was special adviser to the Bank of England from 1969 to 1985 and subsequently became a member of the Bank of England's Monetary Policy Committee between 1997 and 2000.

²³Goodhart, C. A. E. (2004). 'The Bank of England, 1970–2000'. In R. Michie and P. Williamson (eds), *The British Government and the City of London in the Twentieth Century*. Cambridge: Cambridge University Press, p. 341.

*would be taken seriously by the government. This role provided considerable informal leadership of the City for the Bank, and a process of similarly informal gathering of information, e.g. via City lunches”.*²⁴

HOWEVER, THE POLICY of placing direct lending limits on the clearing banks was to have the unintended effect of stimulating the development of a large number of ‘fringe banks’ which were created and structured in ways to avoid Treasury control. These were often highly leveraged, holding relatively little in the way of capital relative to the value of lending being undertaken. Further to this, although their payments needed to go through a clearing bank, there was no direct relationship between these lenders and the Bank of England, which did not supervise their activities.

Non-bank and consumer credit lending

ALTHOUGH THE BANK OF ENGLAND exercised little supervisory control over the clearing banks and none whatever over the [29] growing fringe bank sector at this time, there was specific legislation in place regarding the operation of building societies. This significantly constrained their operations, allowing them to offer only mortgages and savings accounts. There were also specific laws relating to hire purchase companies and for a range of other types of consumer credit lenders, including pawnbrokers and moneylenders.

For example, Government had direct control over key terms in hire purchase and rental contracts and used these as a means of dampening consumer spending to further its wider economic objectives, particularly to reduce levels of demand for imported cars and other consumer goods. A statement made to the House of Commons on the 1st November 1968 by the then President of the Board of Trade, Anthony Crosland, illustrates the point:²⁵

“The Government has been reviewing the level of domestic demand. There are now signs of a continuing buoyancy of consumer spending which, if it were to continue unchecked, would pose a threat to our balance of payments objectives ... In the light of this situation, the Government have decided that some further restraint on consumption is needed. I have accordingly made Orders, coming into operation at midnight, which will increase the restrictions on hire purchase and rental contracts.”

THE ORDERS REFERRED TO BY CROSLAND included raising the minimum deposits required from borrowers and reducing the maximum length of hire purchase agreements used for the purchase of cars, consumer durables and furniture – effectively making it more difficult for people to obtain credit for these purposes and raising the level of their monthly repayments if they did.

There was also a specific law relating to moneylenders, who targeted low-income households. This attempted to restrict the level of interest that could be charged. The Moneylenders Act of

²⁴*Ibid.*, p. 342.

²⁵<http://hansard.millbanksystems.com/commons/1968/nov/01/hire-purchase-and-rental-contracts>

1927 stipulated that a court would find a loan with an interest rate above [30] 48 per cent to be ‘unconscionable’ – with the effect that the loan would not be recoverable from the borrower – unless proven otherwise. Enforcement of this law was, however, difficult, both because the formula set out in the Act to calculate the interest rate was complex²⁶ and because it relied on low-income borrowers to take unscrupulous lenders to court: something they were unlikely to do if they thought they would need to obtain credit from the same lender again. Nevertheless, a small number of successful prosecutions were brought under this Act.²⁷

However, by the end of that decade, the approach of legislating separately for different types of credit product and for different types of lender was causing confusion. The laws were many and, depending on the specific type of agreement or institution, sometimes overlapped. Parliament was also finding it difficult to keep pace with the rate at which new products were appearing on the market. As a consequence, in 1968 Harold Wilson’s Labour Government commissioned a comprehensive review of consumer credit legislation. The review was led by Lord Geoffrey Crowther, a former editor of *The Economist*, and the report was published in 1971, by which time the Government had changed and the Conservatives, led by Ted Heath, were in power.

The report of the Crowther Committee marks a watershed in the way that consumer credit was viewed, arguing not only that the “existing legal tangle” was badly in need of reform but that the consumer credit industry needed to be ‘liberated’ from ‘antiquated provisions’ and ‘official restrictions’ so that it could ‘make an increasing contribution to the efficiency of the national economy and to the standard of living of the public’. In this sense, the report [31] was perfectly in line with the thinking of the Heath Government which was looking for a way to boost economic growth.

The Heath ‘experiment’ and the ‘dash for growth’

BY THE END OF THE 1960S, frustration with Britain’s ‘stop-go’ economic performance resulted in a change of attitude toward both the controls on bank lending and the system of consumer credit regulation.

In December 1970, there were discussions within the Bank of England concerning the possible overturning of credit controls. In a ‘top secret’ note²⁸ sent by the Bank’s Executive Director for Home Finance (John Fforde) to the Governor, Leslie O’Brien, Fforde advocated for the replacement of limits with a policy of interest rate control, through which the Bank of England

²⁶For full details see Bizley, M.T.L. (1966). ‘The rate of interest under the Moneylenders Act 1927’. *Journal of the Institute of Actuaries*. Vol. 92: pp. 340–346

²⁷For example, eleven successful prosecutions were reported for the period 1960–1964. Commons Hansard, Written Answers, 7th December, 1965

²⁸The note was subsequently published by the Bank of England and is reproduced in Goodhart, C. A. E. (2014). *Competition and Credit Control*. LSE Financial Markets Group Special Paper 229, Appendix A.

would seek to manipulate the price, and therefore the demand, for credit through changes to Bank of England base rates.

The main arguments put forward to support the proposed change in policy were that individual banks would be provided with greater freedom to lend and that credit allocation would be more efficient. The efficiency argument was based on the belief that lenders and borrowers, not government, were best placed to decide whether opportunities existed to generate a return in excess of the interest being charged. When government intervened and set limits on the amount of available credit, it was constraining the ability of banks to conduct what would otherwise have been profitable business and inevitably meant that some of these opportunities were being missed.

Further to this fundamental belief in the rationality of lenders and borrowers, the abolition of lending controls was also advocated [32] as a means to free the banking sector from its role as a 'slave' to the Government's economic priorities:

"... prolongation of the present system [of credit controls] is inconsistent with the Bank's fundamental, and correct, view that the shape of the banking industry, and its capability for change, should not be notably subordinated to the requirements of monetary policy. Banking, as a legitimate commercial activity, often inconveniences the Government of the day. There is accordingly a persistent temptation to convert the banks into mere slaves of official policy. We have always said, and rightly, that this is a temptation that must be resisted."

FFORDE'S NOTE INDICATED that Treasury officials were initially reluctant to adopt his proposal:

"It is apparent that Treasury officials are in no great hurry to join us in any attack upon the system of control that we now have."

HOWEVER, THE MOOD CHANGED as unemployment increased throughout 1971. In September of that year, with the number of people out of work heading towards a million, the six-year-old system of controls on bank lending was abolished in a bold experiment to boost the economy.

In fact, the new Bank of England policy went much further than simply abolishing the system of ceilings on bank lending. Termed the 'Competition and Credit Control' policy, this also allowed banks which took deposits (savings and investments from households and businesses) to participate in the wholesale financial markets and reduced the level of liquid assets that they were required to hold. Before 1971 the clearing banks had been required to hold liquid assets equivalent to 28 per cent of their total deposits. However, following the introduction of the Competition and Credit Control policy, this was relaxed and extended to all banks (including the fringe banks), which were now required to hold reserve assets equivalent to just 12.5 per cent of their liabilities. Measures were also taken to allow banks to make mortgages (previously the preserve of building societies), and to relax restrictions on hire purchase borrowing. Consumer

credit spending was further boosted in 1972 when four [33] banks (NatWest, Midland, Lloyds and RBS) jointly created a company to provide the Access credit card.

The rapid expansion of credit that followed was combined with fiscal measures contained in the 1972 budget, including increases in the level of income tax personal allowances and public spending. Together, these provided a major boost to the money supply²⁹ and to economic growth. GDP grew by 5.5 per cent between the second quarter of 1972 and the same period one year later. Unemployment fell by around 200,000.

However, the boom was to be followed swiftly by economic and banking crisis. Too much of the credit expansion had been used to stoke the housing market. The number of mortgages grew by 8 per cent between 1970 and 1971 and a further 5 per cent the following year, and the average house price in England doubled from £5,000 to £10,000 between 1970 and 1973.

Too much of the consumer spending facilitated by credit expansion also went on buying imported goods, creating a balance of payments crisis in 1973 when the UK posted a trading deficit of £1.6 billion. By the middle of that year, with inflation spiralling out of control, the 'dash for growth' was over. Between June and November the Bank of England increased interest rates from 7.5 per cent to 13 per cent, and the Government announced a programme of public spending cuts.

The increase in interest rates burst the property bubble, causing house prices to fall, but the Bank of England was then required to organise a 'lifeboat' operation to bail out a number of fringe banks that now found their collateral was worth less than the value of their loans. The major clearing banks were asked to pool funds to provide additional loans to 26 of these lenders, which were assumed to need help with liquidity. In total, around £1.3 billion of loans were provided, although many of the firms were subsequently [34] found to be insolvent and were later acquired by the larger banks as a result.

In November 1973, the banks were asked to restrict levels of lending to households, and by the end of December, with the economy now in recession, the Government announced a new system of formal lending controls and put in place a number of other restrictions on consumer credit – including a requirement that banks and other finance houses were not to provide this on more favourable terms than was available for hire purchase agreements.

These domestic measures may have been sufficient to stabilise the economy in normal circumstances, but the Yom Kippur war of October 1973 led to an export embargo by Arab oil-producing nations which lasted until March the following year, sparking an energy crisis and a quadrupling in the oil price. Inflation and unemployment both rose, and Heath responded by pursuing a policy of wage restraint, leading the Government into a series of industrial disputes, including with the miners, which ultimately forced a General Election in February 1974.

²⁹Using the M3 measure. In 1970 this grew by 9.6 per cent; in 1971 by 13 per cent; and in 1972 by 25.8 per cent. *Commons Hansard, Written Answers*, 15th November 1973.

The Consumer Credit Act 1974

DESPITE THE 'DASH FOR GROWTH' having constituted an unmitigated economic disaster, the Heath Government managed to press ahead with reforms to the regulation of consumer credit prior to the General Election of 1974. In November 1973, it introduced a Consumer Credit Bill to Parliament which substantially followed the recommendations of the earlier Crowther Committee.

The Bill proposed to abolish seven previous laws in their entirety and replace these with a single overarching framework for the regulation of all forms of consumer credit. This would include a single licensing regime, overseen by the Director General for Fair Trading, and focus on enforcing 'truth in lending' requirements, including greater transparency of terms and conditions and the use of a consistent measure of interest – the Annual Percentage Rate ^[35] (APR) – which was designed to allow consumers to compare the price of credit across different types of agreement.

In the main, the Bill proved uncontentious. The Crowther Committee had been established by a Labour government, but its recommendations were being taken forward by the Conservatives. However, the Bill departed from Crowther's recommendations in at least one important respect. The Crowther Report had included an acknowledgement that the price of credit charged to people on lower incomes was often excessive:

"The less educated and poorer members of the community, through ignorance of the credit market and of the protection provided by existing legislation, are frequently in the position of paying higher interest rates than are justified by their relative creditworthiness."

IN ADDITION, CROWTHER RECOGNISED that some levels of interest could be 'socially harmful' as the knock-on effects included a deepening of poverty. He therefore advocated that a cap on credit costs be included in the reforms. However, no such power was included in the Bill. Instead, the courts were to be enabled to reopen credit agreements if they found these to be 'extortionate' and the interest rate 'grossly exorbitant'. These terms were not defined.

Whilst the Labour front bench opposed the decision not to cap credit charges,³⁰ the Government's spokesperson, Michael Heseltine, maintained that the proposal in the Bill would provide the courts with greater flexibility and would aid consumers:

"Our concern about the general question of fixing rates of interest which are a hard and fast barrier is that, in order to deal with extreme cases, we have to pitch the rate of interest relatively high. In the Moneylenders Acts ^[36] it was pitched at 48 per cent, which in virtually every circumstance is a very high rate of interest. But if 45 per cent is charged it is arguable that that is getting more reasonable, simply by working back from the high

³⁰During the Bill's second reading, the Labour spokesperson, Alan Williams, expressed his 'deep misgivings' about the Government's decision to "depart from the Crowther recommendation that there should be a ceiling" and argued that "... the Government should take this bull by the horns and declare what they regard as an extortionate rate of interest. It should not be left to the courts to determine".

ceiling introduced in the legislation. It therefore seemed to us better not to fix a firm ceiling which would tend to draw people up to it but to have a set of guidelines which the courts would be able to interpret in order to deal more flexibly with all the systems and problems that will arise.”

THE BILL PROCEEDED through its Committee Stages without amendment on this point, although its passage through Parliament was then interrupted by the General Election. The election results were inconclusive, with Labour winning the most seats, but not enough to secure an overall majority. Nevertheless, following a failed attempt by Heath to form a coalition with the Liberals, Harold Wilson returned to No. 10 at the head of a minority Labour Government.

The Consumer Credit Bill was subsequently reintroduced in the House of Lords. Although the Labour position prior to the election had been to include a cap on the cost of credit, the failure to obtain an overall majority meant that it could not push this through, despite some of its backbench Labour MPs pressing on the issue,³¹ and the Bill received Royal Assent in July 1974.

Back in control? The design of the ‘corset’

BY THE MID-1970S the ability of Government to control the level of credit expansion was extremely limited. Not only had the introduction of the new consumer credit regime meant the loss of direct powers to manipulate the terms of hire purchase agreements, but the bank lending control, introduced at the end of 1973, had [37] been designed in the full knowledge that it was likely to prove ineffective.

During the meltdown that ensued following Heath’s ‘dash for growth’, the Bank of England sought advice on the precise form that bank lending controls should take, and this was provided in an options paper by Charles Goodhart [‘Alternative Methods of Credit Control’, 19th November 1973, reproduced in Goodhart, 2014, Appendix C]. Traditionally, retail banks operate by taking deposits from savers and other investors and then lending this money on. This is a process known as intermediation – with banks operating as the ‘middle-man’ between those that can afford to save and those that would like to borrow. In his paper for the Bank, Goodhart expressed the view that systems of control should seek to impact the extent to which the banking system can perform this intermediary function, for example by limiting the proportion of total deposits that a bank can put out on loan.

However, Goodhart also had major reservations about the practicalities of doing this, considering that any system of controls would be difficult to apply beyond the main clearing banks, unless a statutory system was put in place to bring the ‘fringe banks’ under the Bank of England’s supervision. Even then, he cautioned that a system of explicit ceilings or quotas on

³¹For example, on 20th May 1974, Neil Kinnock asked whether caps should be placed on the rates that finance companies could charge.

lending levels would be inflexible, and, given the distorting impacts on credit allocation, not necessarily desirable.

According to Goodhart, the design of controls was therefore a ‘cosmetic job’ – one that would provide ‘more attractive looking monetary statistics’ rather than have any impact on the real economy:

“The apparent main object of this exercise is presentational, to reduce the observed rate of growth of the monetary aggregates, without necessarily or even desirably having any effect on the real economy.”

AS A CONSEQUENCE, Goodhart advised the Bank to support a scheme that provided the ‘best face lift’, proposing that the clearing banks be required to place a greater proportion of their available funds in non-interest-bearing deposits with the Bank of England. Whilst noting that this ‘new gimmick’ may prevent banks from [38] doing some business that they could profitably afford to take on, he considered it was the ‘least offensive’ option in this respect and would also make it easier to return to a ‘free system’ at a later point.

Goodhart’s recommendations formed the basis of the new system of lending controls introduced in December 1973. This was formally titled the Supplementary Special Deposit Scheme but became commonly referred to as ‘the corset’.

Despite Goodhart’s view that the introduction of the corset was primarily a cosmetic exercise, the Labour Government³² apparently considered it to be an effective means to control the growth of credit and an attractive alternative to further interest rate rises. During his budget speech of 12th November 1974, the Labour Chancellor, Denis Healey, reported that the Bank of England had written to all banks and finance houses urging them to limit lending for ‘personal consumption’ and setting out how the corset would be applied to ensure that credit would ‘provide adequately for the needs of industry without allowing the money supply to grow at a rate which would add to inflationary pressures’.

Certainly, the corset does appear to have had some initial impact, although it was used only intermittently by Labour due to wider economic concerns. During its first application, domestic credit expansion fell from £7.5 billion in 1974 to £4.2 billion in 1975.³³

Economic crisis and the International Monetary Fund

HOWEVER, THE BRITISH ECONOMY remained in recession whilst also subject to high levels of inflation, with the annual rate increasing from 19.1 per cent in 1974 to 24.9 per cent in 1975. In its attempts to address the crisis, Government removed the corset on bank lending but also

³²Following a second General Election held in October 1974, Labour had gained a narrow overall majority.

³³Commons Hansard, Written Answers, 5th August 1976

pursued a policy of pay restraint and set out [39] proposals to cut public spending, which had grown to around 60 per cent of GDP by early 1976.

The Government's plans to cut public spending led to a split within the Labour Party, and in March 1976, the Government was defeated on the issue in the Commons. Wilson subsequently resigned as Prime Minister, ostensibly on the grounds that he had never intended to continue in the role beyond his 60th birthday, and James Callaghan became Prime Minister on 5th April 1976.

Britain also continued to post dreadful trading results throughout the period 1974 to 1976, and speculation ensued concerning a possible devaluation of sterling, with the Government ultimately forced to negotiate a loan facility of \$3.9 billion from the IMF in September 1976. The IMF negotiators demanded that Britain's level of domestic credit expansion, which had risen to nearly £8 billion in the year,³⁴ be reduced alongside a 20 per cent cut in public spending.

In the event, Britain did not need to draw down the entirety of the \$3.9 billion IMF loan, but the crisis led to a renewed focus on the level of credit expansion. Reporting on the economic situation to the House of Commons on 21st December 1976, the Chancellor, Denis Healey, said:³⁵

"For at least the immediate future, it will be necessary to continue to constrain the total of private sector bank lending, using the Supplementary Special Deposits scheme which I recently reactivated."

IN ADDITION TO USING THE CORSET, Healey also considered that a combination of public spending cuts and a shift towards greater exports, aided by the reduced value of sterling and directions provided to the banks to give priority to investment in industry, would start to address the crisis. Indeed, the strategy showed signs of success. By 1978 inflation was down to 8.7 per cent, and new revenues from the recently developed North Sea oil fields were [40] starting to transform Britain's balance of trade, which reported a surplus that year.

Two major problems remained. The first was the breakdown of industrial relations as Government attempted to impose a cap on wage increases for public sector workers of just 5 per cent. With inflation running at nearly 9 per cent, this represented an attack on living standards and resulted in widespread industrial action in the winter of 1978. The second problem was the unemployment rate, which had increased from 2.6 per cent in 1973 to 5.6 per cent in 1978, allowing the Conservative Party, now under the leadership of Margaret Thatcher, to campaign in the following year's General Election with the slogan 'Labour Isn't Working'.

³⁴Commons Hansard, Written Answers, 28th July 1977

³⁵<http://hansard.millbanksystems.com/commons/1976/dec/21/economic-situation>

The Thatcher Government: credit and freedom

“No one who has lived in this country during the last five years can fail to be aware of how the balance of our society has been increasingly tilted in favour of the state at the expense of individual freedom.” (Margaret Thatcher’s Foreword to the Conservative Party General Election Manifesto, 1979)

THE EMPHASIS PLACED ON INDIVIDUAL FREEDOM in the Conservative Party’s General Election Manifesto of 1979 was to find practical expression in its subsequent policy decisions to cut back on public spending, reduce income tax, sell off nationalised industries, and promote home ownership by reducing interest rates and by providing a right for council tenants to buy their homes.

Sat alongside these commitments, the manifesto also noted the need to ‘master inflation’ by exercising ‘proper monetary discipline’. The problem of controlling inflation when there were in reality few ways of restricting banks from expanding the amount of lending was immediately pointed out to the Government in correspondence from the Bank of England to the new Chancellor of the Exchequer, Geoffrey Howe.

Writing on the day immediately after the election, the Governor ^[41] of the Bank, Gordon Richardson, pointed out that there had been a recent ‘upsurge in bank lending, which in the three months to mid-March has been running at double the rate of the preceding three months’.³⁶

This was despite the fact that the corset was then in place. Ultimately, Goodhart had been proved to be correct, as by this time the banks had clearly learnt how to evade its impact.

The corset sought to inhibit the amount of money that banks could take as deposits and then lend out again. The amount that could be lent was therefore based on an assessment of the amount of deposits appearing on bank balance sheets. To lend outside the limits set by the corset, the banks simply started to find ways of creating credit without this being reported to the Bank of England. One of the processes used to achieve this became known as ‘bill leak’, whereby the banks would guarantee ‘commercial bills’ (effectively promises to repay) issued by companies seeking credit, and broker the sale of these onto investors. In these cases, the bank would take a commission for the brokering and guaranteeing of the commercial bill, but the amount of credit being advanced would flow directly from the investors to the company seeking credit, and so not appear on returns to the Bank of England. Bills held outside the banking system increased from £232 million at the end of June 1978 to £2.6 billion two years later.³⁷

In his letter of 4th May 1979, Richardson therefore cautioned Howe against the further use of the corset and advised the Government that it would need to maintain interest rates at high levels,

³⁶The letters were declassified in 2010 and are available from <http://www.margaretthatcher.org/document/113156>

³⁷See Cobham, D. (1991) Monetary Policy, in Artis, M. & Cobham, D. *Labour’s Economic Policies, 1974–1979*. Manchester University Press

at least in the short term. Indeed, by the end of 1979 the Bank of England base rate had risen from 12 per cent to 17 per cent.

Despite being clearly aware of the inflationary pressure that could be generated by an expansion of credit, the Government proceeded [42] by abandoning any pretence that direct controls over lending were effective, opting instead to use changes in the Bank of England base rate to control its pricing and so influence demand. The corset was formally abandoned in 1980.

In fact, an earlier decision made in October 1979 to abolish a system of exchange control, aimed at restricting the movement of capital in and out of the country, made the abandonment of the corset inevitable. Having committed to this course of action, there was no way that banks could be prevented from circumventing direct controls on lending volumes because of their ability to trade, without penalty, through offshore banks or their subsidiaries.

In effect, the new Government was back to pursuing a similar strategy to the Competition and Credit Control policy put in place by the Heath administration, and the rapid expansion of credit that followed, combined with a reliance on interest rate increases, would again eventually lead to a housing boom followed by recession and record levels of mortgage repossessions and household debt problems.

A nation of homeowners

THE THATCHER GOVERNMENT went further than any of its predecessors to encourage credit expansion. In pursuit of its ambition to expand home ownership, the Government once again allowed banks to enter the mortgage market. To promote competition, it also later took the step of relaxing the rules on building societies, for example by allowing them access to the wholesale financial markets, and to diversify into consumer credit lending.

Further impetus was provided to the mortgage market by the Housing Act of 1980, which made good on the Conservative Party's commitment to introduce a Right to Buy scheme for council tenants. By 1984, the number of mortgages had increased by over 17 per cent. Despite the Right to Buy scheme opening up a new source of supply of houses for purchase, levels of demand for home [43] ownership (fuelled by the greater availability of mortgage credit) outstripped this, and the average cost of a house leapt by 55 per cent from £17,793 in the first quarter of 1979 to £29,675 in the same period in 1984.

The rise in house prices, breaking of the building society monopoly on mortgage lending, and the introduction of the Right to Buy scheme combined to bring a new variety of mortgage lender into the market. Under the scheme, council tenants were entitled to significant discounts on the market value of their homes – in some cases up to 50 per cent, depending on the length of time that the tenant had been in residence. In the eyes of mortgage lenders, these discounts, combined with a market in which house prices were rising, made the loans virtually risk-free. In the event that the borrower defaulted, the lender could repossess and sell the property which

would more than cover the outstanding balance on the mortgage. But why stop there? If there was so much equity available in these properties, then why not develop a business model to steal it? That is exactly what some lenders did, by designing mortgage products that quickly inflated the level of the debt once the borrower defaulted. This was done by writing contracts that increased the interest rate once a payment was missed and by levying additional fees and charges. In this way, as much of the equity as possible was realised and paid to the lender once a home was repossessed and sold.

Typical of the lenders operating in this way were Citi Mortgage Corporation and National HomeLoans, which launched their operations in the UK in 1985. These lenders targeted their marketing to council tenants, offering mortgages with no need for a deposit, at high loan-to-income ratios, and even lending to people with existing rent arrears. In effect, these lenders turned Right to Buy into an asset stripping exercise – when borrowers defaulted the home was repossessed and the lender pocketed the discount on its market value, whilst the household was left homeless and in many cases had to apply to the local council for rehousing. As the Right to Buy [44] rules prevented local authorities from using the receipts from the sale of properties to build new homes, councils were faced with the problem of having had their stock of houses depleted whilst the number of people seeking help was increasing.

Unemployment: a ‘price worth paying’?

WHILST THE EARLY THATCHER GOVERNMENT maintained a narrative of opening up opportunities for hard-working families to get ahead, and to start businesses and own their own homes, the period through to 1986 was dominated for many by rapidly rising unemployment, public spending cuts, and industrial conflict – the latter reaching its peak with the year-long miners’ strike of 1984 to 1985.

Within a day of coming to power in May 1979, Margaret Thatcher had been presented with a policy paper written by Kenneth Berrill, head of the Cabinet Office’s Central Policy Review team – a unit originally established by Edward Heath in 1971 to provide long-term strategic thinking and co-ordinate policy across Government departments.³⁸ Berrill had previously been the chief economic adviser to the Treasury during the meltdown that followed Heath’s ‘dash for growth’ in 1973, and was later to become Chairman of the Securities and Investment Board – the precursor to the FSA – where he was given the role of creating the regulatory structure for the City following the ‘Big Bang’ reforms of 1986.³⁹

Back in 1979, Berrill’s paper for Margaret Thatcher focused on the ‘problems, constraints and opportunities’ for the economy, highlighting the major issues as inflation, industrial performance and unemployment – ‘in that order’. Noting that the Government’s strategy was to ‘revive

³⁸The paper was declassified in 2009 and is available on the Margaret Thatcher Foundation website.

³⁹<http://www.telegraph.co.uk/news/obituaries/finance-obituaries/5339634/Sir-Kenneth-Berrill.html>

personal initiative' by reducing public spending (by an estimated £10 billion in 1979/80) and personal taxation, [45] and by bearing down on inflation through 'strict monetary discipline', Berrill observed that:

"During the first year or two, while inflation is wrung out, the disciplines may be painful in terms of growth and unemployment."

HE WAS NOT WRONG. The economy entered recession in 1981 and the unemployment rate (5.2 per cent in 1979) all but doubled to 10.2 per cent. In March 1981 opinion polls indicated widespread dissatisfaction with the Government, with only 16 per cent in support.⁴⁰ The rise in unemployment had been particularly dramatic amongst black youth.⁴¹ Rioting broke out in Brixton in April, and this was repeated later in the year in Handsworth, Chapeltown and Toxteth.

In this respect, Berrill's paper had been remarkably prescient. Noting that Britain's level of unemployment in 1979 was 'very high' by post-war standards, but that this was 'accepted with surprising equanimity', he warned that:

"If unemployment were to increase sharply, the present equable acceptance might break down, especially in the Inner Cities, with large numbers of young coloureds unable to find jobs."

DESPITE THE RIOTS, and increasing industrial unrest, particularly in the public sector and nationalised industries, the Government continued to prioritise the control of inflation over unemployment and relentlessly pursued its strategy of cuts as the means to bring down the public sector borrowing requirement and deliver reductions in interest rates.

The number of people out of work increased to over 3 million by 1982, resulting in rising mortgage repossessions and homelessness. In 1979 there were just 2,900 mortgage repossessions, but by [46] 1986, this had increased to 24,100. Over the same period, the number of homeless people turning to local authorities for help surged dramatically. In 1979, local councils accepted that they had statutory duties to rehouse 55,000 people. This figure rose year on year to stand at just over 100,000 in 1986. In total, more than half a million people qualified for help due to homelessness over the period.

Controlling inflation (1979–1986)

WHILST UNEMPLOYMENT WAS RISING, the Government was successful in bringing inflation under control. In December 1979 inflation was running at over 17 per cent, but by 1981 this had reduced to 12 per cent and by 1984 was just 4.6 per cent.

⁴⁰<http://www.ipsos-mori.com/researchpublications/researcharchive/3158/Margaret-Thatcher-19252013.aspx>

⁴¹Overall unemployment in Brixton stood at 13 per cent, but was 25.4 per cent amongst ethnic minorities, and amongst black youths was estimated at 55 per cent: http://news.bbc.co.uk/1/hi/programmes/bbc_parliament/3631579.stm

This was primarily achieved by reducing the amount of state borrowing by increasing VAT and by making cuts to government spending. The Government also realised income from the privatisation of state-run businesses⁴² and a tax on North Sea oil revenues. In addition, employment and social security rules were rewritten, weakening the bargaining position of labour, and these combined with mass unemployment to create a downward pressure on wages for already lower paid groups.

Reductions in public expenditure were particularly apparent in housing and education.⁴³ Housing expenditure was reduced by approximately three-fifths between 1979 and 1984, largely due to council house sales and rising council rents – another factor in making Right to Buy attractive to many tenants. Education spending fell by 12 per cent over the same period. State pension increases [47] were linked to prices rather than earnings. Short-term benefits for the sick, unemployed and disabled were cut by 5 per cent in real terms in 1980/81. However, due to high levels of unemployment, total expenditure on social security payments actually rose.

This resulted in a cycle of continuing and increased pressure for further savings. In 1985 the value of the State Earnings Related Pensions Scheme (SERPS) was reduced, and a radical overhaul of the Social Security system took place in 1986. This would include, amongst many cuts, the replacement of a system of right-based entitlements to grants to help meet essential needs with a new, discretionary, Social Fund system offering interest-free loans that would have to be repaid through deductions from future benefits.

Alongside these cuts, mass unemployment provided the foundation for the Government to push through a raft of reforms designed to weaken the bargaining power of trade unions in the Employment Acts of 1980 and 1982. These included the abolition of a statutory right for trade unions to be recognised in pay bargaining with employers, and measures designed to end ‘closed shop’ arrangements, which required all employees to join a union, as well as limitations on picketing and making it legal for employers to sack workers involved in strike action. Unions were also made liable for civil damages for secondary action, thereby preventing trade unions from organising strikes in support of each other. These measures were to prove critical in helping the Government win the battle with the National Union of Mineworkers concerning their plans for widespread pit closures following the year-long strike of 1984.

Changes to social security payments in 1982 also cut the level of benefits that the unemployed received relative to the level of their prior wages (the ‘benefit replacement ratio’). Prior to this date, unemployed workers were entitled to an earnings-related supplement to their benefit based on their national insurance contributions record, which was payable for nine months. The

⁴²In the period to 1986 these included Jaguar, British Aerospace, Cable and Wireless, Britoil, and British Gas.

⁴³For an assessment of both welfare state expenditure and qualitative changes in the nature of provision in the early years of the Thatcher Government see Ian Gough’s chapter, ‘Thatcherism and the welfare state’ in Hall, S. & Jacques, M. (1983) *The Politics of Thatcherism*. Lawrence & Wishart: London

abolition of this supplement made the prospect of unemployment a much greater threat to living standards than was previously the case.

[48] The impact of these changes created downward pressure on wage settlements in the early period of the Thatcher Government, although this was not distributed evenly across the workforce. Lower paid workers were most affected, contributing to a significant increase in wage inequality in the period.⁴⁴ Combined with a reduction in income tax for higher earners, from 83 per cent to 60 per cent in the first Conservative Budget and subsequently to 40 per cent in 1988, this contributed to rapidly widening income inequality during the Thatcher years.

Consumer credit expansion

ALTHOUGH THE GOVERNMENT had made a commitment to controlling inflation by reducing the money supply, this strategy was contradicted by a rapid increase in bank lending to households throughout the period 1979 to 1986. Alongside the increased availability of mortgage credit – necessary to drive forward the Government's ambitions to increase levels of home ownership – there was also a significant expansion of consumer credit. In 1979 the amount of outstanding consumer credit that had been advanced by banks was a little under £5 billion, but by 1986 this had increased nearly five-fold to £24.2 billion.⁴⁵ In just the four years that were to follow, it would explode further to over £43 billion.

This dramatic expansion coincided with a major shift in public attitudes towards the use of credit. This occurred mainly as a result of heavy advertising for credit cards. Although this market was still in its relative infancy at this point, outstanding balances increased from just £0.9 billion in 1979 to £5.2 billion by 1986. The Access credit card adverts are probably the most memorable of the period, featuring the cartoon talking pound sign called Money and his 'flexible friend', Access. In a series of these adverts, Money finds [49] himself in a number of predicaments, including not being able to pay his hotel for a large bar bill and other items run up during the course of his stay. 'I can't pay that!' he bemoans, when he discovers how his many small purchases have added up to a bill beyond his means. However, Access is always on hand to help out. 'Let me pay, Money, and we can settle up later', he says, leaving Money to gush 'Oh, he's ever so helpful. He's always there when you need him.'

In later adverts in the series, the flexibility of Access is contrasted to the limits of other characters including Fat Wallet, who is always empty of cash; Travellers Cheque, who needs a lot of time to get anything done, and Cheque Book, who is always running out. The adverts featured voiceovers from well-known television celebrities, including Prunella Scales and Chris Tarrant.

In a Barclaycard advert of the same period, the TV travel programme presenter Alan Whicker is sipping cocktails on a beach surrounded by women in bikinis to highlight how the card is

⁴⁴For further details see <http://cep.lse.ac.uk/pubs/download/cp260.pdf>

⁴⁵Source: Bank of England, lending to individuals data series

accepted in more holiday destinations than any other. What is striking about these adverts, aside from the casual sexism of the latter, is the absence of any information regarding terms and conditions, and the way that credit cards were encouraged to be used for luxury spending – indeed, how they were often portrayed as the means to obtain the trappings of a celebrity lifestyle.

The impact of widespread advertising of this nature is revealed by the very different responses to two similar surveys conducted some eight years apart – the first in 1979 and the second in 1987. In 1979 only 20 per cent of people taking the survey indicated that they thought credit was a ‘convenient way of paying for goods and services’, and just over a quarter said that they thought it was *never* a good idea to use credit. Eight years later, ‘convenience’ was selected as the most important reason to use credit by over half of those taking the survey. Reporting on the findings, the National Consumer Council noted:

“Credit is no longer viewed exclusively as an emergency measure, to be used for the necessities of life. For many people, it is becoming a way of [50] acquiring discretionary goods, to underwrite immediate consumption. This is important and might be taken to confirm a widespread feeling that people are no longer prepared to wait and save before they satisfy the wish to acquire luxury items.”

INDEED, STATISTICS relating to levels of household income and expenditure confirm this view. In each of the years between 1982 and 1987, the disposable income of households, after taking account of rising prices, increased by an average of just 2.1 per cent. By comparison, over the same period, levels of household spending rose by an average of 3.7 per cent.

Despite widespread advertising, and the fact that households were, overall, increasing their spending at a faster rate than their incomes were rising, consumers remained aware of the need for responsibility in both lending and borrowing decisions. For example, in the 1987 survey some 57 per cent of people agreed strongly with the statement that ‘there should be tighter controls on credit advertising’ and 64 per cent that ‘credit limits should be increased only at the customer’s request’. Finally, nearly three-quarters strongly said that ‘the amount of credit you get should be linked to the amount you earn’.

The thermometer isn’t working!

THE EXPANSION OF LENDING TO HOUSEHOLDS over the period to 1986 appears to have run counter to the Government’s strategy of maintaining tight control over the money supply in its efforts to control inflation. However, in light of the fact that growing North Sea oil revenues⁴⁶ had resulted in a strong pound and contributed to a slump in British manufacturing exports, household consumption was playing an increasingly important role in sustaining economic growth. The

⁴⁶By 1984, oil production amounted to 6.5 per cent of GDP.

strong pound also encouraged an increasing ^[51] number of Britons to holiday abroad, hence the focus of those Barclaycard adverts.

In fact, it was becoming increasingly apparent that the Government's preferred measure of the money supply was failing to act as an accurate predictor of inflationary pressures. As a result, a more balanced, interpretative approach was required which assessed economic conditions using a broad range of indicators.

The Government had set out its preferred measure of the money supply in its Medium Term Financial Strategy (MTFS) published in 1980, together with specific targets for this. The intention was to guide movements in the Bank of England base rates by reference to the extent to which the money supply was performing against its target. However, the measure seldom acted as expected, and there was never any clarity as to how far any adjustment would be needed in the base rate in the event that the target was missed. Indeed, just three months after publishing the MTFS, the Government reduced interest rates by 1 per cent even though the money supply was exceeding its target and it would reasonably have been expected to increase rates instead.

In reality, both the Government and the Bank of England took a more practical approach to the pursuit of policy than was implied by public statements about the need for 'strict monetary discipline'. Anthony Hotson, a member of staff within the Bank of England's Monetary Policy Group at the time, reported that the Governor, Gordon Richardson, was prone to using the analogy of looking out of a window at the garden:⁴⁷

"If you saw frost on the ground and in the trees, you knew that the temperature was low and if your garden thermometer suggested otherwise, you surmised it was broken. Likewise, if various indicators suggested the economy was contracting, you might suspect that your monetary indicator was faulty if it continued to grow over target."

GIVEN THE FAILURE of the monetarist 'thermometer', the Thatcher ^[52] Government eventually reverted to focusing on the exchange rate as a means of anchoring the UK to low inflation countries – notably Germany – and continued on its relentless drive to reduce the size of public spending.

However, in 1985 the pound fell dramatically as a result of a collapse in the oil price,⁴⁸ brought about by increased production in Saudi Arabia and neighbouring countries. This exposed the reliance of Britain's trade balance on North Sea oil revenues and had the effect of driving up the cost of imports and creating inflationary pressure. The fall in North Sea oil revenues from 1985 onwards was significant. From 1980 through to 1985, Britain's oil revenues increased year on

⁴⁷<http://www.lse.ac.uk/fmg/workingPapers/specialPapers/PDF/SP190.pdf>

⁴⁸Oil prices had peaked at over \$40 per barrel following the Iranian Revolution in 1979, but fell to below \$8 per barrel in 1986.

year, and peaked at around £30 billion in today's prices.⁴⁹ But from 1985 onwards these started to decline rapidly, dropping by a third in just two years.

Big Bang equals boom

WITH THE FOCUS ON MONEY SUPPLY TARGETS effectively abandoned, and the need to generate improvements in Britain's trade balance now a priority, the Thatcher government looked to the financial services industry. On coming to power, it had already taken some steps to regenerate London as an international financial centre, including by abolishing exchange controls which allowed banks to trade freely in international markets. In 1986 it went much further, breaking up the traditional cartel of City firms and inviting international capital into the heart of the UK's financial system. Writing in the *Daily Telegraph* some 25 years on from the Big Bang reforms, David Kynaston remarked how:

"... a legion of deep-pocketed commercial banks, often foreign, bought [53] up long-established broking and jobbing firms ..., while simultaneously ambitious American investment banks such as Goldman Sachs beefed up their London presence and would rapidly supplant the British merchant banks, traditionally the City's crème de la crème ... For those with a historical perspective, undoubtedly including Margaret Thatcher's Chancellor, Nigel Lawson,⁵⁰ the gleam in the eye was the hope of reprising the City's golden age, when London was the greatest financial centre the world had ever seen."

The Big Bang reforms were also combined with an, albeit ineffective, attempt to improve the regulation of investment banking activities and, in particular, the trading of securities. In this respect, the Government was seeking to reassure the world of standards of propriety as a means of building confidence in London as a world financial centre. To do this, it established a Securities and Investment Board (SIB) under the leadership of Kenneth Berrill. The SIB was responsible for preventing fraud and insider dealing and oversaw the work of a number of 'self-regulatory' bodies, including the Stock Exchange itself, which it authorised. However, the City objected to the detailed rule book that Berrill created, and throughout the initial period of establishing the SIB and drawing up its rules, Berrill came in for a large amount of criticism:⁵¹

"From the moment of his appointment in 1985, he faced hostility and resentment from the entrenched battalions of the City. They saw him as an outsider who did not understand how the City worked, even though for the previous four years he had been chairman of the prestigious stockbroking firm Vickers da Costa. His task was to bring order into the chaos of investment advice, where financial institutions had previously not been required to make it clear whether clients were being offered independent advice or simply being sold financial products. Far from not understanding [54] the

⁴⁹<http://www.newstatesman.com/politics/2013/04/thatcher-and-north-sea-oil-%E2%80%93-failure-invest-britain%E2%80%93future>

⁵⁰ Lawson replaced Geoffrey Howe as Chancellor following the 1983 General Election.

⁵¹<http://www.theguardian.com/politics/2009/jun/26/obituary-sir-kenneth-berrill>

workings of the City, as his critics claimed, he knew enough of its secrets to make them distinctly uncomfortable.”

IN THE END, Berrill served only one term as Chairman of the SIB, being replaced by a ‘city insider’, David Walker, who is currently the Chairman of Barclays Bank.⁵² In 2000, the ‘self-regulatory’ approach was abandoned following a series of scandals throughout the 1990s, including the unauthorised trading of Nick Leeson, which resulted in the collapse of Barings Bank. To maintain confidence in the UK financial system, the SIB was then replaced by the Financial Services Authority which was given statutory responsibility for the authorisation and supervision of firms.

In the interim, the Big Bang reforms ushered in a further period of credit expansion which both supported a boom in housing and consumer credit use by households and also increased the importance of the City to Britain’s balance of trade figures. This was particularly important given that our traditional industrial and [55] manufacturing sector – once a major source of full-time, male employment and apprenticeships – had been decimated in the previous period.

From October 1986 onwards, a huge expansion of mortgage lending began to take place. This was boosted by an incremental reduction in Bank of England base rates over the next 18 months, which combined with tax reductions to increase personal disposable income for those households that remained in employment, and particularly wealthier households. By May 1988, the cost of borrowing was reduced by roughly 4 per cent. House prices surged and lenders relaxed their lending criteria, allowing people – especially first-time buyers – to borrow increased amounts relative to their income.⁵³ The aspiration for home ownership was further boosted by the Housing Act of 1988, which abolished the system of ‘fair rents’ and reduced levels of security for private tenants, making private renting a more expensive and less attractive long-term proposition.

New endowment mortgage products also came onto the market at this time. Traditionally, mortgages require borrowers to make repayments that are sufficient to cover both the interest on the loan and clear the capital borrowed over the lifetime of the loan (typically, between 25 and 30 years). However, endowment mortgages split the traditional mortgage into its two component parts by providing an ‘interest-only’ loan to purchase the property, and an additional investment product to clear the capital on that loan at the end of the mortgage period. The investment

⁵²Sir David Walker began his career in 1961 at the Treasury, where, with a period on secondment to the IMF in Washington (1969–1973), he served until 1977. From 1977–1993, Sir David held several key positions at the Bank of England where, in 1981, he became one of four Executive Directors of the Bank. From 1988–1992 he was Chairman of the Securities & Investment Board. He was a non-executive member of the Court of the Bank of England from 1988–1993. He has held positions as Chairman of Reuters Venture Capital, Vice-Chairman of the Legal and General Group and was Chairman of the London Investment Bankers’ Association for four years until June 2004. Sir David joined Morgan Stanley in 1994, where he was Chairman and CEO, Morgan Stanley International, and subsequently Chairman. At the end of 2005, he retired as Chairman but remained a Senior Advisor until the end of August 2012. Since 2007 Sir David has completed two reports and made recommendations in respect of the private equity industry and corporate governance at financial institutions. He also co-led the independent review of the report that the FSA produced into the failure of Royal Bank of Scotland. He became Chairman of Barclays Bank in November 2012.

⁵³<http://www.bankofengland.co.uk/publications/Documents/workingpapers/wp314.pdf>

products were provided by insurance companies. These established a regular savings plan for borrowers, the proceeds from which were pooled and invested in stocks and shares. The grand expectation was that these investment funds would grow sufficiently to provide enough income to buy the house when the mortgage period came to an end, and perhaps even provide a bonus on top.

[56] In many ways, endowment mortgages neatly reflected the changed nature of the financial services industry after Big Bang, where retail operations (traditional bank accounts, mortgages and personal loans) combined with investment banking. They were also supported by Government, in the form of tax breaks. The rapid expansion of these products also highlighted the limits of self-regulation, as the products were frequently pushed by financial advisers who received high commissions on their sale but often failed to declare this to their customers. To encourage their take-up, mortgage borrowers were also provided with wildly over-optimistic estimates of how much they could expect to receive when their investments came to fruition, and the costs of leaving the product early were downplayed.

Investment fund managers received regular annual fees over the lifetime of the product. This compared to the relatively limited opportunities for making fees that they had when selling traditional mortgages, which would often only be remortgaged (and so present an opportunity for lenders to charge fees) once every three to five years. As the following chapter goes on to describe in more detail, we are only now facing up to the fact that many of the investment products sold at this time will not enable people to purchase their homes, and that many will be forced to sell their homes as they approach retirement to pay off their debts.

Back in the late 1980s, these longer-term considerations were of no consequence, neither to Government nor to those running the banks and insurance companies. Between 1986 and 1990 average UK house prices surged by 65 per cent, from around £36,000 to over £65,000. The boom initially started, and was greatest, in the housing markets of London and the South East of England. London's house prices leapt by just under a quarter in 1986 alone; by a further fifth the following year, and by just under this (17 per cent) in 1988. It then spread out to other regions. In 1989 London's house price boom was coming to an end. Prices rose by only 6 per [57] cent that year, but the average cost of houses in the North West and in Yorkshire and Humberside rose by 27 per cent.

The consumer credit market was also booming. However, Government remained complacent about its growth. Responding to questions in Parliament⁵⁴ in the summer of 1989, Lord Young, then the Secretary of State for Trade and Industry, remarked:

“... the amount outstanding on consumer credit is bound to rise as disposable incomes rise and the ability to repay loans increases. That has been the great change in this

⁵⁴Lords Hansard, 24th July 1989

decade. Personal sector financial assets are three times greater than financial liabilities. Indeed, they are actually growing faster.”⁵⁵

WHILST STRICTLY ACCURATE, this statement overlooked the fact that the measurement of ‘personal sector financial assets’ includes the value of pensions, which are not realisable until retirement age, and by being tied up with the future performance of the economy, were by no means certain.

By comparing the growth in household expenditure relative to income, we can obtain a much clearer picture of what was happening to households at this time. In 1986 the real disposable incomes of households grew by 3.4 per cent, but levels of household spending increased by 6 per cent. This gap could only have been bridged by either the use of existing savings or by taking on credit commitments, both of which reduce the ability of households to survive external shocks such as unemployment. Likewise, in 1987, real incomes rose by just 2.7 per cent, but spending by 5.2 per cent.

Even more remarkable was the fact that, under the Chancellorship of Nigel Lawson, aggregate household expenditure (i.e., the combined amount of all household spending in the UK) began to exceed the total amount of household disposable income in the third quarter of 1987, subsequently peaking at 102.5 per cent in the third quarter of 1988 and not returning to below 100 per cent ^[58] until a year later. This reveals a two-year period of over-spending, something which had not occurred since the late 1950s when personal loans were first developed by the banks and the use of hire purchase became commonplace for many people as a means of obtaining consumer goods that had previously been beyond their reach, including washing machines, televisions, and cars.

From boom to bust

BY 1989, THE LEVEL OF DEBT as a proportion of household income had become unsustainable, and the number of defaults began to increase.⁵⁶ These were driven by rising inflation, which squeezed household budgets and led to interest rate rises. The annual rate of inflation rose from 3.3 per cent in January 1988 to 7.9 per cent by the start of 1990, causing the Bank of England to raise interest rates to 15 per cent, where they stayed for a further 12 months.

The impacts were devastating. In 1989 there were just 15,800 mortgage repossessions, but the following year the figure nearly tripled to 43,900, and in 1991 the number of homes lost soared to a record high of 75,500.

Consumer credit defaults also increased dramatically. In 1989 around 2.3 million claims were made for the recovery of debts in the County Courts of England and Wales, but this increased to

⁵⁵<http://hansard.millbanksystems.com/lords/1989/jul/24/consumer-credit-promotion>

⁵⁶Over the 10-year period from 1979, the total liabilities of households had increased from just under £71 billion to £365 billion.

over 3 million in each of the years from 1990 to 1992. Likewise, the number of people being made bankrupt accelerated from just under 8,000 in 1988 to over 32,000 by the end of 1992.

With the consumer spending boom now at an end, Britain's economic growth collapsed, with GDP falling by 1.2 per cent in the third quarter of the year. This was to create a surge in unemployment, taking the number of people out of work towards 3 million by the end of 1993.

Who pays the bill for credit boom and bust?

[59] THE RETURN OF INFLATION in the late 1980s was used by Government to support the case for further public spending cuts. With the Government faced with a major upswing in credit expansion and a weak pound due to poor trade balances, more public spending cuts had effectively become its only remaining means of tackling inflation, which was being fuelled by the high cost of imported goods.

The other possible alternative was higher rates of taxation – taking money directly out of people's pockets. Depending on the level of increase, this may have worked to take the impetus out of the credit boom as well as help to address the budget deficit, but it would certainly have impacted on living standards. An increase in the rate of tax for higher earners would also have run counter to the Thatcher Government's stated belief that these were the 'wealth creators'. Government had therefore clearly ruled these out.⁵⁷

The result was that those on the lowest incomes were asked to pay the highest price. Following the election of 1987, Government turned its focus to local government as a means of finding further savings in public expenditure. This included the introduction of compulsory competitive tendering for the provision of council services, leading to privatisations and widespread wage cuts for lower paid workers, and in 1988 proposals to introduce a Community Charge or 'Poll Tax'.⁵⁸

The Poll Tax was referred to by Mrs Thatcher as the Conservative Party's 'flagship' policy proposal following the election. It was fundamentally unjust – requiring that everyone on the electoral register pay a flat rate tax to fund council services, regardless of their [60] income or level of wealth. Many of the poorest had previously been exempt or received significant rebates under the predecessor local rates system. The Poll Tax therefore represented a further attack on their living standards. They would really struggle to pay. In solidarity with these, many others pledged not to, leading to a mass non-payment campaign under the slogan 'Can't Pay, Won't Pay'. This was first organised in Scotland where the tax was introduced in 1989. From 1990 onwards, when the tax was introduced into England and Wales, the Scottish model of organising local anti-poll tax unions, which committed to the tactic of building mass non-payment and defending people

⁵⁷Certainly higher *income* taxes were ruled out, although Norman Lamont subsequently raised VAT by 2.5 per cent in 1991 under the Premiership of John Major. This increase had a disproportionate impact on people on lower incomes.

⁵⁸Other notable cuts of the time included the replacement of student grants with loans in 1990/91.

from enforcement actions, was expanded and co-ordinated by the All Britain Anti-Poll Tax Federation under the leadership of supporters from the Militant 'tendency' of the Labour Party. The campaign also drew support from left-wing Labour MPs, including Dave Nellist from Coventry, despite threats (subsequently carried out) of expulsion from the Labour Party for supporting people in breaking the law and for being a member of Militant. On 31st March 1990, the day before the tax was due to come into force in England and Wales, a mass demonstration of an estimated 200,000 people was organised by the All Britain Anti-Poll Tax Federation in central London, whilst up to 50,000 people marched simultaneously in Glasgow.

Although the London demonstration ended in violence, this did not erode the campaign's popularity. Support for the Government crumbled throughout 1990 as bills hit the doormats and the Conservatives performed dismally in the local council elections in May that year. By the end of the year, Margaret Thatcher had been ousted by a revolt of Conservative MPs and John Major had taken her place in Number 10. A swift review of the Poll Tax then took place, and in the following year Government presented proposals to replace it with a new council tax, which provided for those in more expensive properties to make a greater contribution to the cost of local services and which included a benefit scheme to protect those on low incomes.

[61] Defeating the Poll Tax was the first major victory for people on low incomes in 11 years, but it in no way addressed the fundamental problems facing the British economy and it did not redress the balance. In his book *Chavs*, Owen Jones details the overall impact on income and wealth inequality over the periods of the Thatcher and Major Governments:

*"By the end of the Tories' reign, in 1996, the richest ten per cent of families with three children were over £21,000 a year richer on average than when Thatcher came to power. The wealthiest decile's incomes shot up by 65 per cent for each married couple ... The real income of the poorest tenth collapsed by nearly a fifth after housing costs. The slice of the nation's wealth they owned nearly halved. There were five million people in poverty in 1979; by 1992 the number was closer to fourteen million."*⁵⁹

THE LIBERALISATION OF FINANCIAL SERVICES, rapid credit expansion and processes of both boom and bust to which this gave rise were the main driving forces behind this growth in inequality. When a government has made low inflation its key economic priority, then a credit boom effectively forces either a rise in taxes; cuts in public expenditure, or a combination of the two. More often than not, the policy choices that are made are to the disadvantage of working-class people. Likewise, every subsequent bust provides the opportunity for wealth to become further concentrated – as those with the fewest resources to ride out problems are eventually forced to sell their assets to those with deeper pockets at low cost.

⁵⁹As Jones proceeds to detail, this process was associated with the cultural and political demonisation of working-class people, who were blamed for their own poverty which was seen as resulting from individual character failings rather than from economic circumstances.

Further to these economic processes, social attitudes and policies also play key roles. In particular, Thatcherite notions of individual self-reliance became deeply embedded over the period, and credit use was seen as empowering and providing access to 'aspirational' lifestyles. This shift in attitudes was supported by specific social policy decisions. Policies were pursued to weaken the collective ^[62] bargaining position of labour; to expand home ownership, and to cut welfare provision. These created an ongoing demand for people to turn to financial services as the means of achieving basic outcomes that the state could no longer guarantee – access to education, a decent job, a secure home, and dignity in retirement.

In the space of just 20 years, the nature and scale of British banking and credit extension had been transformed, and with it British society. In 1970, the financial sector was a 'mere slave' to government economic policy, but by 1990 it had become the master. Subsequent governments, wedded to low inflation and low levels of personal taxation, would have to turn to it to release funds for investment in hospitals and schools. They would also leave it free to create a further credit boom, and another, even more damaging, recession. For successive governments, the sector was now too important a contributor to Britain's trade balance to be ignored. In just 20 more years, the banks would become 'too big to fail'.

Chapter 3: Britain's broken housing market

[63] I'VE NEVER MET NIGEL LAWSON, but I did experience the fall-out from his economic boom up close and personal. In 1990 I graduated from university and stumbled, almost by accident and (given the scale of unemployment, with relatively few other options), into a job as a debt adviser for a Citizens Advice Bureau (CAB) in Warwickshire. I swiftly found myself in at the deep end – attending the county court on a regular basis to represent people in repossession hearings, as well as negotiating with creditors to help people freeze the interest on their consumer credit debts and dealing with threats of disconnection for water, gas and electricity or bailiff action for the recovery of poll tax. At the age of 21, I started to witness the incredible pressure that debt problems can place on people. The experience of hearing how people twice my age considered themselves to be a failure to their children because of their home being repossessed has stayed with me all my life. Likewise, to see lone parents threatened with disconnection or imprisonment because of their inability to afford a gas bill or pay a fine incurred because they didn't have enough money to buy a TV licence was an affront to my sense of justice. Several years into the job, it would be a meeting with a group of lone parents struggling to put food on the table in the run-up to Christmas because of the charges made by high-cost [64] door-to-door moneylenders that would incite me sufficiently to start the Debt on our Doorstep campaign, calling for caps on the cost of credit and for banks to be called to account for their failure to meet the needs of low-income households.

Back in 1990 and 1991, it was the task of keeping people in their homes which exercised me most. As debt advisers, we were conscious of the need to do two things. Firstly, to draw up a realistic budget which ensured that people could pay their priority creditors: the mortgage lender or landlord; utilities providers, and, in respect of local taxes, the council. Secondly, and after taking account of basic household needs to feed and clothe themselves properly, to distribute any surplus monies to 'secondary' consumer credit lenders. This second task would also often include trying to negotiate the freezing of interest and applying in some cases to the county court for protection or bankruptcy.

The problem in the early 1990s, as now, was that many household incomes were insufficient to meet even their priority commitments, let alone make payments to their consumer credit lenders. Times were hard enough for those in work, with the required level of mortgage payments rising dramatically as a result of interest rate increases at the turn of the decade. And, once in arrears, it became virtually impossible for people to switch onto a better mortgage deal even though interest rates started to fall for some products over the following years. But the situation

was even worse if the debts had arisen because of unemployment. The state safety net, eroded over a period of 11 years, was simply inadequate.⁶⁰

The law that the courts were required to enforce in mortgage repossession proceedings was also pretty unhelpful.⁶¹ This stipulated that the courts could only provide assistance to people if they were [65] likely to be able to repay their mortgage arrears within a 'reasonable period' of time. Debt advisers up and down the country therefore spent much time arguing that district judges should take a liberal view of what this term meant. In this respect, we referred to a couple of old cases,⁶² decided by the higher courts, which had held that if the arrears could be cleared over the lifetime of the mortgage agreement (which could be another 20 years in some cases), that this would be 'reasonable'. We also argued that the courts should intervene in the mortgage contract where this contained a penalty clause that hiked up the rate of interest when a borrower was in arrears. Section 8 of the Administration of Justice Act of 1973, which had been passed by Parliament as Britain was going through the mortgage meltdown caused by Heath's 'dash for growth', appeared to give the courts the power to reduce the interest rate back to its original level, but in practice District Judges were extremely reluctant to interpret the section in this way.

What was astonishing, given the impacts of mortgage repossessions on families and the pressure that repossessions placed on local authorities in terms of their rehousing, was the attitude of mortgage lenders at this time. Without exception, the mortgage lenders pushed aggressively for repossession orders to be granted – for example, by arguing that the mortgage arrears had to be cleared within as short a period as three months.

Repossession hearings were daily battles concerning two very different conceptions of the role of the legal system. On the one side, the lender's solicitor stressed the sanctity of the contract which had been broken by the individual borrower. The penalties, as stipulated in the contract, needed to be enforced. On the other side, the debtor and their adviser argued that the court should take into account the wider economic situation and the social impacts of a surge in repossessions, including the fact that there was a growing queue of people seeking rehousing from local authorities – a problem contributed to by the sale of council houses under Right [66] to Buy. The outcome of any particular case depended on which County Court judge you got on the day. I remember, for example, one of the District Judges telling me that he would refuse to make any eviction orders in the month before Christmas. He stuck to that promise, despite howls of protest from the lenders that there was no legal basis for his decision (technically correct). In another case, I represented a man in the latter stages of an inoperable cancer. In what was a surreal hearing, we pointed out that his life insurance policy would pay off the mortgage within a short space of time. We were basically arguing that he would have the good grace to succumb to

⁶⁰For example, although the Social Security reforms of previous years provided some help for people with mortgage costs, benefit payments would only cover the interest element of the mortgage and only once people had been out of work for six months.

⁶¹S.36, *Administration of Justice Act 1970*

⁶²For example, *Western Bank v Schindler*, 1976. 2 All ER at p.400

his cancer within a 'reasonable period'. That the lender sought to fight against this decision or had even required a hearing to debate this given the medical evidence that they had previously been sent, was utterly disgraceful.

Most acts of compassion in this period were undertaken in spite of the law and in the face of stiff opposition from the mortgage industry. Compassion probably has greater meaning when it is displayed in these types of circumstance. But such occasions were rare. There was, in fact, precious little consistency in the interpretation of what was a 'reasonable period', and most of the time it was not extended beyond 12 months. As a consequence, a number of appeals were lodged, and in 1995 the Court of Appeal clarified that a 'reasonable period' could indeed be taken to mean the remaining length of the mortgage contract.⁶³ Whilst this was a welcome ruling, it had taken five years from the height of the mortgage repossession crisis to get there. In 1990 and the four years that followed it, over half a million people faced court action to have their homes repossessed.⁶⁴ In the subsequent repossession proceedings, around half of these led to 'outright possession orders' where the borrower [67] is not provided with a second chance to pay down the arrears but faces imminent eviction; and half led to 'suspended orders' where debtors are provided with an opportunity to pay down the arrears and remain in their homes, but where many subsequently breached the terms of the court order and ended up evicted further down the line.⁶⁵

The immediate impact of the recession was to depress house prices and mortgage lending. But the housing market was not as badly affected as may have been expected. Although the average house price stagnated for the three years from 1992 through to 1995, it started to rise again the following year, increasing by 2 per cent, and by a further 10 per cent in the General Election year of 1997. The underlying forces behind the demand for mortgages had not changed. There was no reversal in Britain's increased reliance on home ownership, no improvement in housing rights for private tenants, and no major social house building programme. There was, in fact, no real questioning of the overarching mission of expanding home ownership by Government at the time. Indeed, the number of mortgages continued to rise, albeit at a slower pace than previously. In the five years to 1992, the number of mortgages outstanding in Britain rose by just over 20 per cent to 9.9 million. The growth rate was slower in the five years after 1992, but this was still a 'respectable' 8.2 per cent.

The sub-prime crisis

THIS IS NOT TO SAY that major changes in the mortgage market were not taking place. One of Britain's biggest problems is that the construction of new homes has lagged woefully behind the

⁶³*Cheltenham and Gloucester v Norgan*, CA 1995. <http://www.independent.co.uk/news/people/law-report-arrears-can-be-paid-over-full-mortgage-term-1525672.html>

⁶⁴590,000 mortgage possession claims were issued during the period.

⁶⁵Bizarrely, given the impacts of mortgage repossession on mental health and on the welfare of children, there are no official statistics concerning the numbers of people who successfully maintain the terms of court orders to repay mortgage arrears or how many fail to do so and are subsequently evicted.

[68] expansion of mortgage availability. In the 40 years between 1971 and 2011, the average annual growth rate in England's housing stock has been just 1 per cent. We have added a total of just over 6.7 million additional homes in that period. Although Right to Buy opened up council house properties as a new source of homes for purchase, this has not increased the pool of houses sufficiently to stop an expansion of mortgage credit from driving up prices. These have escalated rapidly. Between 1992 and 1997, the average cost of a home increased by 12.5 per cent. In the next five years (1997 to 2002), it rose by 45 per cent, and in the five years to 2007 by a further, astonishing, 83 per cent. Across the whole 15-year period, the cost of an average home trebled from £56,500 to £170,400.

We have reached the point where home ownership is simply not an option for many people. For example, the National Housing Federation reports that in the West Midlands the average house price is now some nine times the level of average regional wages.⁶⁶

How did these staggering price increases come about so quickly after a period of record mortgage repossessions in the early 1990s? Certainly, the failure to build more houses is a key factor, but there were also developments on the lending supply side which created this phenomenon.

These developments were to give rise to what we now refer to as 'sub-prime' mortgage lending. The recession of 1990 and 1991, and the associated increase in unemployment, mortgage arrears and consumer credit defaults, left many households with impaired credit ratings. In previous times, this may have made it harder for households to obtain credit, including mortgages, moving forwards. This is known as 'financial exclusion' – where people are shut out of credit markets because they are considered to be too high risk.

With regard to the mortgage market, a considerable number of households faced exclusion from 1990 onwards. In normal circumstances, this would have reduced the demand for mortgages and so [69] weakened house prices, and, indeed, that is what appears to have happened through to 1995, when lenders were also engaged in a 'flight to quality' – focusing their products on lower-risk borrowers. However, the intense competition in these markets significantly reduced profit margins.

Towards the end of the 1990s, the credit industry was looking at ways of increasing its returns and was starting to view the growing number of people with impaired credit ratings as an untapped market and opportunity to make money. After all, in credit markets, price is largely reflective of risk. If someone is a high risk, then the response is not necessarily to refuse them credit, but to lend to them at a higher price, increasing the cost of credit to cover the increased likelihood that borrowers will default. So long as enough people make their payments at the

⁶⁶<http://www.yestohomes.co.uk/the-problem#.UnZQBINLdkU>

higher rates to cover (indeed, more than cover) the losses from those who do not repay, then the lender still comes out ahead.

The concept was easy enough to grasp. But to implement it, lenders needed both the technology to segment the population into different risk groups, as well as access to sufficient funds to put out on loan. The banks set to these tasks with some urgency, especially in the US. New risk management models started to be constructed using complex mathematical algorithms to predict default levels based on prior repayment histories, and investment banks developed a securities market that would then spread the risk across the financial system and raise more funds from investors to put out on loan. The intention was never to reduce the level of risk that was being taken – the whole point was to take bigger risks to obtain bigger returns – but to limit the *exposure* to those loans for individual banks in case these went bad. High risk and high returns were good. It's just that no-one wanted to pick up the bill if it all went wrong.

As we now know, both the risk assessment models and the financial instruments that were used to manage exposure to risk were, in fact, useless. In a way, this didn't matter. They gave the impression of [70] science, and that was all that was required for people to start making money. Writing in 2010, Joseph Stiglitz, a former chief economist at the World Bank and winner of the Nobel Prize for Economics, highlights how lenders were financially incentivised to create products that couldn't possibly stand up for long:⁶⁷

“Mortgages with teaser rates (temporarily low rates that exploded after a few years) and balloon payments (a short-term mortgage taking advantage of currently low interest rates that had to be refinanced in five years) were particularly advantageous to the lenders. They entailed repeated refinancing. At each refinancing, with the borrower facing a new set of fees, the mortgage originator had a new source of profits.”

THROUGH THE PROCESS OF SECURITISATION, the banks sought to offload the responsibility for these products throughout the financial system. It was like pouring toxins into the oceans. Initially, no-one would notice the effects, but once the practice became commonplace it would lead to catastrophe.

The rapid acceleration of house prices should, in and of itself, have alerted the Bank of England and the FSA to the fact that there was an excess of capital flowing into mortgage lending, relative to the supply of houses. Evidence of problems building up in the UK market was also readily available in terms of the features of products being brought to the market. These clearly involved a significant relaxation in lending standards. Deposit requirements were low and in the case of some lenders (including Northern Rock) were to disappear altogether, with mortgages worth 100 per cent or more of the value of the house. More interest-only mortgage products were also being sold. In June 2007, 34 per cent of all new mortgages were interest-only compared to just 12 per

⁶⁷Stiglitz, J. (2010, p. 85). *Freefall: free markets and the sinking of the global economy*. Penguin Books. London

cent in July 2003, and in just under a quarter of cases there was no mechanism sold with the mortgage that would repay the capital at the end of the term.

In 2005, the FSA finally got around to looking in detail at [71] standards of lending in the UK's sub-prime mortgage market. It noted some concerns and wrote to lenders in the market asking them to put their house in order. They didn't. Two years later, following a further review, the FSA found:

"None of the lenders adequately covered all relevant responsible lending considerations in their policies. For example, some firms' lending policies contained unclear affordability or self-certification requirements. In many cases, lenders did not apply their own policies in practice. For example, some firms failed to check the plausibility of information, as required by their own lending policy. There were also failings by lenders to monitor the application of their policies, which resulted in the approval of potentially unaffordable mortgages."

THE FSA PROMISED A CRACKDOWN and started to take action against the worst offenders, but it was all too little and much too late. In the US, sub-prime loans were turning bad, and the system was about to go into meltdown.

Looking back at the development of the sub-prime mortgage crisis reveals that regulators in both the US and the UK failed to challenge the industry despite ample evidence of a systemic greed and irresponsibility. Traditionally, it was mortgage lenders who bore the risk of their own lending decisions. They lent to people and maintained responsibility for the outcomes of those mortgages. If someone defaulted, then it would incur a cost for the lender who made the mortgage loan. This provides an incentive for lenders to be reasonably cautious as they bear the consequences for the risks they are taking – particularly in competitive markets where prices cannot simply be hiked up to cover large-scale defaults. But securitisation changed all of that. Now, mortgages were bundled together and sold as investment products through global financial markets. Mortgage originators may have known that the products they were selling were risky, but they didn't care as the risks would be borne by someone else further down the line.⁶⁸ Stiglitz refers to the [72] process as a 'grand deception', arising because no player in the system took responsibility for the risks that they were creating:

"The securitization process involved a long chain. Mortgage originators created mortgages that were bundled together by investment banks, which then repackaged and converted them into new securities. The banks kept some of these securities in special investment vehicles off their balance sheets, but most were passed onto investors, including pension funds. To buy the securities, managers of pension funds had to be sure the securities they were buying were safe, and the credit rating agencies played a role by certifying their safety. Financial markets created an incentive structure

⁶⁸That there is a tendency for people to take higher risks when dissociated from the consequences of their actions is not a new discovery. See, for example, the work of Georg Simmel who wrote *The Philosophy of Money* in 1907.

which ensured that each of those in this chain played their role in the grand deception with enthusiasm.”

BUT WHY DIDN'T ANYONE TAKE RESPONSIBILITY? There are some, including Professor Robert Shiller at Yale University, who believe that everyone just got carried away on a wave of 'irrational exuberance'. Through the process of securitisation, mortgages were turned into investment products, which released more capital for lending. In fact, mortgages were being sold to put investment products onto the market. It was an 'originate to distribute model' – sell mortgages to sell the investment products that could be created from them, releasing more capital to sell mortgages to create more investment products, and so on again around the cycle.

There was no way in which the number of homes could increase at the same pace as capital was being released for mortgage lending, so house prices inevitably rose – and quickly. But this then seemed to make mortgage lending even more attractive. After all, if house prices continued to go up in this way, then there would always be equity in properties, even if they were repossessed. The lenders, it seemed, just couldn't lose. So, according to Shiller, people just lost their senses:⁶⁹

“The sub-prime crisis was essentially psychological in origin, as are all [73] bubbles. The crisis was not caused by the impact of a meteor or the explosion of a volcano. Rather it was caused by failure to anticipate quite obvious risks – by ‘irrational exuberance’ at the prospects for profits, if one bought into the concept of an ever-expanding bubble.”

FOR SHILLER, THE ATTEMPT to 'democratise' finance by providing low-income households with the opportunity to own their homes remains a noble one, but better products need to be designed to help them do this – for example, 'continuous workout mortgages' which adjust to fluctuations in their income, and 'livelihood insurance' to protect them in times of unemployment. These ideas are worth exploring in further detail, as would be the development of longer-term mortgages that offer flexibility in repayments to better reflect the pressures on households at different life stages (for example, when starting a family). However, the assumption remains that home ownership is an aim that is worth pursuing and that changes in the supply side could prevent another sub-prime crisis.

Is this necessarily the case? It is certainly true that people often say they want to buy their home. A YouGov survey conducted with 18 to 24-year-olds in 2009 found that 70 per cent of respondents aspired to home ownership. The question is why? When this question is asked, the answer is often that people want 'security'; to have a 'choice' about where they live, or to build up an asset of value and to pass something onto their children when they die.⁷⁰ In fact, this latter ambition is underpinned by a more basic concern that parents just want to know their children will be OK in life. But none of these *necessarily* requires people to own a house. It is just that home ownership

⁶⁹R.J. Shiller (2008, p. 24). *The subprime solution: how today's global financial crisis happened, and what to do about it*. Princeton University Press

⁷⁰See, for example, Wallace, A. (2010) *Public attitudes to housing*. Joseph Rowntree Foundation.

is offered as the main route to these things. We have not adequately explored other ways of meeting the fundamental needs that underpin its demand.

Further to this, the reality of mortgage borrowing can turn into [74] the precise opposite of what is being promised. Taking on large mortgages relative to income doesn't make borrowers 'secure', and when house prices fall, people can't sell and are unable to move – contradicting the ambitions often expressed by neo-liberal economists for more flexible labour markets.⁷¹ If borrowers fall into arrears, there is also very little flexibility, and the prices charged to them can increase significantly. For those that lose their homes, the shortfalls between the amounts realised following the sale and the level of the outstanding mortgage debt often then result in bankruptcy – removing all assets from them and forcing them out of credit markets for a period of at least six years.

Why did house prices continue to rise, following what should have been the sobering experience of the 1990s recession? Because no-one asked: 'why do people want mortgages; why do they want to own their homes?' and then thought about how to come up with alternative ways of addressing the deeper requirements that the answers to those questions uncover, especially as these relate to people on low to middle incomes.

What people want are the outcomes that they think financial services will bring – in this case, decent homes and protection from life's uncertainties. People want a combination of security, choice, flexibility, and value. These concepts often underpin the advertising of financial services but are not actually realised by many people that take out the products, which turn into the opposite of what has been promised. As ever, all that glitters is not gold.

On the supply side, the sub-prime mortgage market did not develop in the way it did just because people got carried away. Rather, the debacle appears to have arisen from a much more deliberate and calculated means of exploiting people on low to middle incomes, in which the near entirety of the financial sector was complicit, involving:

- The writing of contracts which lenders knew people on lower [75] incomes would not be able to comply with in the long term. In some cases, this involved the positive encouragement of borrowers to overstate earnings to qualify for mortgages (so-called 'liar loans');
- The sale of mortgages on the investment market in ways which deliberately hid the level of risk being taken because of the financial incentives provided by way of fees to investment banks and to credit ratings agencies to do so; and
- In the time-honoured fashion, and reminiscent of 'bill leak' in the 1970s, the pre-meditated attempt to evade the attention of regulators and supervisors by utilising off-balance-sheet

⁷¹<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb090203.pdf>

and other accounting mechanisms to hide the scale of lending that was taking place and the extent to which banks were over-leveraged.

THE BANKS KNEW there would be a problem: they just didn't think it would be as big as it turned out to be. In any event, they could always rely on governments to bail them out. As Stiglitz (p. 83) writes, once the separation between retail and investment banking had been abandoned:

"... the biggest banks had become bigger and bigger – too big to fail, and they knew it. They knew that if they got into trouble, the government would rescue them ... bankers [also] had perverse incentives that encouraged shortsighted behavior and excessive risk-taking. Not only did they know the bank would be rescued if it got into trouble, but they knew they would still be well-off even if the bank was allowed to fail. And they were right."

THE EXPANSION OF MORTGAGE CREDIT is, however, only one aspect of the problem. There has also been a failure to address the reasons for the underlying high demand for home ownership. In particular, there has been a failure to offer low to middle-income households a viable alternative to home ownership. That offer now requires careful design and implementation. At its heart must be the ambition to significantly expand access to affordable housing. As a consequence [76] of the extremely high cost of home ownership, recent years have witnessed an increase in private renting. However, a recent report from Oxford Economics for the National Housing Federation indicates that private rents are rising at around 6 per cent per year, and tenancies are expected to cost up to 32 per cent more by 2018.⁷² A mechanism will therefore need to be found to bear down on the cost of private rents and ensure that they provide greater security of tenure. One way of addressing this problem would be to provide private tenants with the right to obtain longer-term tenancies, with annual rent increases capped at the rate of inflation, once they have lived in a property and maintained the terms of the contract for a period of six months. Proposals to achieve just this type of tenancy have been developed by Shelter, which has set out the basic conditions for a 'stable rental contract' which would offer tenants security of up to five years with rent increases restricted to inflation over the period. However, the ability of landlords who have purchased their properties using buy-to-let mortgages to provide this level of stability may be compromised by the nature of those mortgages – which are often sold on a variable basis (tracking the Bank of England base rate) or on short-term two-year fixed rates. This means that landlords themselves are uncertain of the costs that they will need to meet over a five-year period. Further to this, it is apparent that many mortgage lenders actually require buy-to-let landlords to let their properties on assured shorthold tenancies which are set to run for only six or 12 months, and which enable the landlord to evict tenants without having to prove any breach of the tenancy agreement with only two months' notice.⁷³ If stable private rented contracts are to

⁷²<http://www.housing.org.uk/media/press-releases/housing-crisis-choking-economic-recovery-say-businesses>

⁷³See LSE London Briefing *Private renting: learning the lessons from other countries*. Autumn 2011

become a reality in the UK – as they are in many other European countries – then changes to the structure of many mortgages provided to landlords will also be needed.

[77] Unfortunately, the current Government lacks the conviction to either increase access to affordable housing or find ways of reducing rents in the private rented sector, preferring instead to promote home ownership and cut back on Housing Benefit⁷⁴ entitlements for tenants. In 2011, the Government released its housing strategy and set aside just £4.5 billion for investment in affordable housing for the period through to 2015.⁷⁵ By comparison, in 2013 the Government announced that it would provide ‘Help to Buy Schemes’ to promote home ownership by supporting people to raise deposits and provide guarantees to mortgage lenders. The schemes are designed to increase the amount of mortgage credit available by £130 billion over the next five years.

The vulnerability of UK households

AS THE FULL EXTENT of the sub-prime mortgage crisis hit, it was tempting for many to think that Britain was simply the victim of malfunctioning global markets. Indeed, the Treasury White Paper ‘Reforming Financial Markets’, published under Gordon Brown’s Government in July 2009, set out an analysis of the crisis which focused in detail on the complexity of financial investment products, the interconnectedness of the world financial sector, flaws in the analysis of risks, incentives in bankers’ remuneration, and failings in bank corporate governance. But it made no mention of why UK households were desperate to get onto the ‘property ladder’ and prepared to take on such high levels of mortgage debt relative [78] to their incomes in the first place. It did not acknowledge Britain’s personal debt crisis, only the financial crisis, and these are not the same thing at all.

We had received some warnings. For example, in 2006, the special chapter of the OECD’s *Economic Outlook*, ‘Has the rise in debt made households more vulnerable?’, began with these words:

“Over the past decade, household debt has risen to record levels in a number of OECD countries. The large size of these debt run-ups, coupled with, in several instances, changes in the characteristics of some of the relevant instruments, are estimated to have raised the sensitivity of the household sector to changes in interest rates, asset prices and incomes. In this sense, the household sector may have become more vulnerable to adverse shifts in these variables.”

⁷⁴Housing Benefit for private tenants is called Local Housing Allowance. In its emergency budget of 22 June 2010, the Coalition Government set out a number of cuts to LHA, including caps on the total amount payable and changes to the way that LHA entitlement is calculated. These changes were estimated to make savings of around £1 billion. For further details see Beatty, C., Cole, I., Kemp, P., Marshall, B., Powell, R. and Wilson, I. (2012). *Monitoring the impact of changes to the Local Housing Allowance system of housing benefit: Summary of early findings*. Research Report 798. London: Department for Work and Pensions.

⁷⁵<http://www.homesandcommunities.co.uk/affordable-homes>

THE OECD'S OBSERVATIONS were especially applicable to the UK, where aggregate household debt, comprising both mortgages and consumer credit, had grown to exceed our combined household income. Indeed, household expenditure reached 100 per cent of aggregate income in the third quarter of 2006 and rose as far as 104.3 per cent in the first quarter of 2008. It then contracted sharply following the 'credit crunch' in the latter part of that year. This period of household overspending was reminiscent of the one that had occurred during the Lawson boom. However, it was more intense: going higher but not lasting for as long.

Just like the Lawson boom, it would also be brought crashing down by increases in interest rates. Between August 2006 and July 2007, the Bank of England raised base rates incrementally from 4.5 per cent to 5.75 per cent. This added around £84 per month to the cost of servicing a £100,000 mortgage. The period was also characterised by rising fuel and food prices, which further squeezed household budgets. Because households had taken on so much more debt relative to income than in the 1990s, the level of interest rates and the cost of essentials did not have to climb so far to have the same level of impact. The extent to which credit commitments become a problem is a factor of the amount of debt and the cost of that debt (the interest charged), [79] relative to disposable income. Low levels of debt with very high interest rates or high levels of debt with low interest rates can amount to pretty much the same problem unless the amount of money in our pockets is increasing, which it most certainly wasn't. Likewise, even relatively low levels of debt and interest rates can become a problem if disposable income reduces sharply, as it is doing for most households today.

Real help for households?

UNLIKE THE CONSERVATIVE GOVERNMENT IN 1990, the Labour Government under Gordon Brown did not simply turn its back on those households faced with the prospect of repossession action. Repossessions did increase sharply. Over 79,000 mortgage possession actions were taken out by lenders in the first half of 2008, and the total number of outright possession orders made by courts in the period July to September 2008 was 15,603. Back in the third quarter of 1991, the number of possession orders made peaked at just over 20,000, and it appeared that we were heading for a repeat. But this time the Government intervened.

On 2nd September 2008, announcements were made which included:

- A 'billion-pound package for housing' from Department of Communities and Local Government (DCLG), including the establishment of a £200 million mortgage rescue scheme to support 6,000 borrowers facing repossession by providing them with interest-free loans and an opportunity to sell and rent back their properties to housing associations; and
- A Department for Work and Pensions reform of Income Support Mortgage Interest payment rules, which was implemented from April 2009 – this reduced the waiting time before

claimants became eligible for support with mortgage payments from 39 weeks to 13 weeks and raised the limit on house values covered by the scheme to £175,000.

[80] On 22nd October, Gordon Brown stated that Government was “determined to do everything we can to help homeowners avoid repossessions” and announced details of “new guidance for the judiciary to halt or adjourn court action on repossessions, unless alternative options that help the homeowner ... have been fully examined.” This referred to a ‘pre-action protocol’ to be followed by lenders prior to instigating repossession proceedings which was issued the same day by the Civil Justice Council. Also released the same day was industry guidance from the Council of Mortgage Lenders which provided further details of the alternative options to be considered.

Whilst welcoming these interventions, I was also cautious about their prospects for success. In a report published in November that year, I noted:

“... responses from government should focus on restoring mortgage affordability and providing greater protection to those borrowers who need help to reschedule their mortgage payments over the long term as a result of negative equity. In the light of the recent rapid rise in unemployment, more help will also need to be targeted at households where one member of a couple loses their job.”

AT THE TIME, I argued that mortgage affordability was the main driver of repossession actions. The basic truth of this should be obvious. People tend not to pay when they can’t afford to do so. But there was no official monitoring of mortgage affordability taking place – no ratio or measure used by Government, the FSA or the Bank of England to guide their policy and regulation of the industry. I therefore had to look elsewhere. Fortunately, the Halifax published data on the average mortgage repayment as a proportion of male, full-time earnings, so I plotted this measure for each quarter from 1989 onwards on one axis and the number of mortgage possession actions on the other. The resulting chart indicated a clear correlation between the two, with mortgage possession actions rising and falling in line with the affordability measure, albeit with some time lags. The chart also showed that, although we were [81] still some way off the problems of 1990/91, when the mortgage payments to earnings ratio hit 65 per cent and mortgage possession actions reached an all-time high, we were climbing steadily towards that territory again,⁷⁶ with the ratio hitting 47.3 per cent in the final quarter of 2007. In Northern Ireland, which was experiencing an exponential rise in mortgage repossessions at the time, the ratio had been above 63 per cent for three-quarters of the year.

⁷⁶Of course, there are limitations in using a measure based on full-time male earnings for this purpose, but it was the best data that I could get hold of. An alternative dataset was held by the Department for Communities and Local Government. This held information on household expenditure on housing costs, broken down by types of housing tenure, which provided a better indication of overall shifts in affordability. Unfortunately, the most recent dataset available from this source at the time was for the year 2006/07. Nevertheless, the DCLG data, which includes council tax as well as mortgage payments, confirmed the overall picture. Between 2002/03 and 2006/07, households with mortgages increased their expenditure on housing costs as a percentage of their disposable income by an average of 6 per cent (from 23 per cent to 29 per cent). The number of households paying out in excess of 30 per cent of their disposable income on housing costs also increased significantly over this period (2.8 million households in 02/03 to over 4 million households in 06/07). As far as I can determine, this dataset is, unfortunately, no longer being published by DCLG.

The traditional means of reducing the cost of mortgage repayments would be to reduce Bank of England base rates, in the expectation that these lower borrowing costs would be passed onto borrowers. However, this was not happening for those in the greatest need of help. Certainly, base rates were reduced, and dramatically, from December 2007 onwards, but if someone is in arrears or in negative equity, then it is difficult for them to switch to the lower interest mortgage products that are on offer to better-off borrowers. For those with high levels of equity in their properties and those on base rate tracker mortgages, the costs of borrowing fell significantly. However, for those in arrears, who now found it impossible to switch lenders and were trapped on standard variable ^[82] rates, there was no benefit from the base rate cuts. Even in the midst of a crisis, or perhaps especially so, the mortgage industry had managed to find a way to penalise those who were the least well off.

This regressive nature of loan pricing has major effects, as it drives those who are least able to pay into a position where they are forced to sell their properties – either doing so themselves or through the mechanism of repossession. The buyers for these are often people choosing to become small-scale landlords who have access to buy-to-let mortgages. In fact, close to three-quarters of all privately rented homes are owned by individuals or couples with five or fewer properties in their portfolios. The process therefore leads to a concentration of wealth. With house prices rising and the cost of buy-to-let mortgages passed on to tenants in the form of higher rents, it is also driving up housing costs for those that cannot afford to buy.

The extent of this problem is considerable. In 1999 there were just 73,200 buy-to-let mortgages outstanding, which together comprised less than 1 per cent of the total mortgage market. However, by 2012 the number of buy-to-let mortgages had risen to nearly 1.5 million, accounting for approximately 13 per cent of all mortgages. According to the Council of Mortgage Lenders, 40,000 buy-to-let mortgages, worth a total of £5.1 billion, were provided between April and July 2013 alone, with much of the funding for this coming from the Bank of England's Funding for Lending Scheme, which has injected £17.6 billion into our credit markets since it was launched in April 2012.

This money could, and should, have been put to better use. Rather than being used to drive forwards a process of wealth concentration, it should have been used to help those households with the greatest financial difficulties. Back in 2008, I called on Government to introduce a programme to help people in financial difficulties to restructure their mortgages at lower interest rates and to bring down the cost of repayments relative to income. Over in the ^[83] US, there were some positive moves in that direction. In October 2008 the US regulator, the Federal Deposit Insurance Corporation (FDIC), had taken control of failed lender IndyMac and had implemented a programme of loan modifications to ensure that no IndyMac borrower should have to pay more than 38 per cent of their income in mortgage repayments. I thought the percentage a high one, but it was clearly a step in the right direction, and I took some heart from the statement by the FDIC's head, Sheila Bair, that at least in the US:

“A clear consensus is emerging that broad-based and systematic loan modifications are the best way to maximize the value of mortgages while preserving homeownership – which will ultimately help stabilize home prices and the broader economy.”⁷⁷

BANK OF AMERICA also followed suit (albeit that this followed court action against it by representatives of sub-prime borrowers) by announcing an \$8.4 billion programme to help up to 400,000 households that took out sub-prime loans prior to December 2007. Repossession actions were halted pending the announcement of a ‘systematic process’ of offering new loans to these customers which will limit payments to 34 per cent of borrowers’ income in the first year of the new agreements. Writing at the time, I noted that:⁷⁸

“Actions so far announced to help hard-pressed mortgage borrowers in the UK are pale in comparison. The funding for mortgage rescue schemes announced in September aims to help only 6,000 borrowers (which is only 4 per cent of the total number of mortgages that are currently in arrears) and the scheme appears likely to suffer from overly complex administrative arrangements with a range of agencies involved in its implementation. It is also notable that the UK mortgage rescue scheme relies upon borrowers agreeing to give up a share of their properties to registered social landlords.”

[84] IN SIMILAR VEIN, I also remarked that despite it now being in Government hands, the number of properties being repossessed by Northern Rock in October 2008 had nearly doubled on the previous year (2,215 to 4,201). Whilst Northern Rock responded to the criticism by stating that it only used repossession as a last resort, it was clear that no plans were being developed to support large-scale mortgage restructuring of the types that were being introduced in the US.

In the years since, the US Treasury has gone on to develop a number of mortgage restructuring programmes which have now assisted nearly 5 million borrowers to avoid repossession. Chief amongst these has been the Home Affordable Modification Programme, which was introduced in early 2009 and enhanced further in 2012. The programme provides funding to support lenders to modify mortgage contracts to reduce the monthly payments of borrowers that are struggling financially, including by reducing the interest rate and, in cases where the borrower is in negative equity, to write off a proportion of the outstanding debt.

Where are we now?

THE BROWN GOVERNMENT moved swiftly to try to head off the immediate threat of a return to the level of mortgage repossessions witnessed following the collapse of the Lawson boom in 1990. However, following the election of the Coalition Government in May 2010, there have been reductions in the amount of help available to mortgage borrowers that have lost their jobs and who are in receipt of income-related benefits. The Government cut the interest rate used to calculate the level of support for mortgage interest from 6.08 per cent to 3.63 per cent in October

⁷⁷Sheila Bair, quoted in “Banks alter loan terms to head off foreclosures”, *New York Times*, 31/10/08

⁷⁸Gibbons, D. (2008). *Responding to the mortgage crisis*. Centre for Economic and Social Inclusion

2010, and it has also announced that the Mortgage Rescue Scheme, which, as predicted, has been bedevilled with administrative problems, is scheduled to end in March 2014. Indeed, the scheme has already effectively ended in London as a result of a recent decision by the Greater [85] London Authority (GLA) in October 2013. No new applications are currently being accepted as the GLA redirects funding for the scheme, which it considers too expensive to administer, toward the building of new homes.⁷⁹

This reduction in support comes at a time when the number of households in mortgage arrears remains high at around 300,000, as does the number in negative equity, where the value of the house is less than the outstanding amount of the mortgage. In 2009, the Bank of England estimated that approximately 700,000 households were in this position. Although the headline repossession figures have not reached the peak levels of the 1990s, the extent of arrears and negative equity may be causing more people to voluntarily abandon their properties by handing the keys back to lenders. According to figures released by the FSA, the number of these 'voluntary possessions' has increased significantly and in 2009 accounted for 26 per cent of all houses being taken back by lenders, compared to just 8.5 per cent in 2004.

This position is bad enough, but unless action is taken to reschedule mortgages and write down considerable losses on loans, then it is inevitable that future interest rate increases will cause a further surge in arrears and mortgage repossessions. The Halifax affordability index for 2013 indicates that average mortgage repayments have now fallen back significantly and currently stand at just 27 per cent of earnings. This is the lowest level since 1999. Whilst the index does not reflect the fact that people in arrears will be paying a higher interest rate on their mortgages than the average and so underestimates the problems that they are facing, it is also clear that this reduction in mortgage servicing costs has only come about as a result of a lengthy period of maintaining base rates at historically low levels and by subsidising mortgages through the Funding for Lending scheme.

Any increase in interest rates in an environment where there [86] is a continuing downward pressure on wages will be catastrophic for many households. According to the Bank of England, around one-quarter of all mortgagors pay out between 20 and 35 per cent of their pre-tax income on housing costs. In addition, 8 per cent of all mortgagors are required to make monthly repayments equivalent to more than 35 per cent of their income. These high levels of housing costs relative to income are already placing a significant strain on household budgets. However, if base rates increase by just 2.5 per cent, then the proportions of mortgagors under financial pressure rise dramatically. Those required to pay between 20 and 35 per cent of their income would grow to 40 per cent of all mortgagors, and the proportion paying out over 35 per cent of their income would double to 16 per cent. Over half of all mortgage borrowers would therefore need to spend at least one-fifth of their pre-tax incomes on housing costs.

⁷⁹<http://www.theguardian.com/money/2013/nov/23/london-councils-scrap-mortgage-rescue-scheme>

The Bank of England has belatedly woken up to the failings of its Funding for Lending Scheme and announced that this will cease to be available to support mortgage lending from January 2014, from which time it will be purely focused on lending to businesses. This is welcome in so far as the scheme will no longer be available to drive forward the process of wealth concentration by subsidising buy-to-let mortgages, although it may also lead to an increase in mortgage rates generally.

In addition to the plaudits gained from his reining-in of the Funding for Lending Scheme, many commentators also welcomed the previous announcement from the new Bank of England Governor, Mark Carney, that base rates are unlikely to be increased until unemployment falls below 7 per cent (currently forecast for early 2015). Whilst consideration of unemployment levels prior to determining base rates is an interesting development at the Bank, the fact is that an unelected Governor has, in effect, determined what constitutes an acceptable level of unemployment for the UK. In addition, it is not clear that the Bank will consider the potential increase in repossession levels, with its consequent implications for [87] the further concentration of wealth, when making future base rate decisions. In many respects, the announcement from the Bank that base rates are likely to rise in early 2015, combined with Government's withdrawal of support for people in mortgage difficulties, continues to look like a deliberate policy to prepare the ground for a process of wealth concentration on a grand scale. At the very least, the Treasury should set out the full range of indicators that it wishes to see the Bank of England take into account, and report its views upon, when making future base rate decisions.

The most effective means of protecting against a future repossessions' crisis would be a major programme of mortgage restructuring along the lines of those developed by the US Treasury, and the Government and the Bank of England should urgently design a scheme to provide financial support for this. However, in the US, the restructuring programmes are voluntary, and not all lenders are participating in them. An improvement could therefore be made by placing lenders in the UK under a statutory requirement to offer to reschedule mortgages prior to initiating repossession proceedings, and by providing courts with the power to rewrite mortgage contracts, for example by reducing the interest rate and the amount outstanding, if the lender cannot demonstrate that they have properly considered this option.

The 'interest-only' mortgage timebomb

TAKING EFFECTIVE ACTION to help people avoid the misery of mortgage arrears and repossession is only one of the many tasks which now confront us. We also have to deal with the legacy of the widespread mis-selling of endowment and other 'interest-only' mortgages. According to a recent report from the Financial Conduct Authority (FCA) (which, together with the Prudential Regulation Authority, has now replaced the FSA), there are around 600,000 interest-only mortgages set to mature within the next seven years. Further to this, between 2017 and 2032 we can expect [88] to see around 40,000 interest-only mortgages maturing each year where the

borrower is over 65 years of age. Half of these borrowers do not have an 'adequate plan' in place to repay their mortgages, and 12 per cent of all interest-only mortgage borrowers are also currently in negative equity, meaning that the most likely outcome for many will be the forced sale of properties and a heavily indebted retirement. Indeed, around one in 10 of interest-only mortgage borrowers currently also have unsecured consumer credit debts in excess of £25,000.

The figures indicate that the promise of home ownership to provide security in retirement will prove to be illusory for many of our future pensioners. Pulling together a plan to meet the demand for suitable accommodation for these households is now an urgent priority, yet the Government and the regulator have been content simply to advise borrowers that they need to make their own arrangements to pay off their mortgages. This fails to take into account that many of the interest-only mortgages are likely to have been mis-sold, with inflated projections concerning the likely return on investment vehicles sold alongside the mortgages used to tempt borrowers into taking them out. The FCA does not appear to have looked at this aspect of the problem. As the Radio 4 'Moneybox' presenter, Paul Lewis, reports:

"One surprising FCA conclusion is that there was no mis-selling of interest-only mortgages. Its new Chief Executive Martin Wheatley told me 'This is predominantly a wakeup call, saying you do realise interest-only is exactly what it says: there will come a point when you have to repay capital.' Was there mis-selling? 'We have not found mis-selling. That has not been the focus of our investigation.'"

WHETHER MIS-SOLD OR NOT, it is clear that Government is not willing to intervene even though there will be widespread social consequences and increased pensioner poverty as a result of the prior expansion of interest-only mortgages. Perhaps the easiest solution for pensioners who find themselves in difficulties as their mortgages mature would be for local authorities and housing [89] associations to buy up these properties and convert the mortgage borrower into a social housing tenant, but this would require a significant capital programme which the Government has so far shown no interest in providing. It would also likely require mortgage lenders to write off a proportion of their loans in respect of people who find themselves in negative equity once the property has been sold to a social landlord. Again, it is a question of who pays? Unfortunately, Government is currently standing on the side of financial institutions rather than with the people. What we need is not the abolition of the Mortgage Rescue Scheme, but a simplification of its administration and greater capital investment to ensure that it is capable of providing the scale of help that will be needed in the period from 2015 onwards.

The dangers of Right to Buy

RATHER THAN PROVIDE capital for local authorities and housing associations to assist people that are in difficulty with interest-only mortgages, Government has instead prioritised the reinvigoration of the Right to Buy scheme, which is set to further reduce the stock of social housing. The Coalition's changes have included a substantial increase in the level of discount

available to tenants on the price of their home. Prior to April 2012, the maximum level of discount available was capped at between £16,000 and £38,000, depending on which region of the country the property is located. However, this has now been lifted to £100,000 in London and to £75,000 in other regions, providing a much greater financial incentive for tenants to purchase their homes. The Government has also set out plans to reduce the qualifying period before people become eligible to apply for Right to Buy from five years to three. The increase in the level of discounts is already having a huge impact, with Government reporting that 10,000 properties were sold under Right to Buy in the period since April 2012 – a trebling on the number sold in 2010/11.

[90] In its media statements, the Government has indicated that these homes will be replaced on a 'one-to-one' basis. However, the rules governing the replacement of homes are complex, and it is likely that the new scheme will further deplete stock and negatively impact on low-income communities.

To begin with, local authorities receive only one-third of the receipts from sales, with the remainder going to the Treasury. This funding is then further depleted by a requirement that local authorities enter into an agreement with Government that they will only use 30 per cent of those receipts to fund the building of new homes – a measure which requires them to borrow money against future rental income to get the new homes built. In areas where house prices are depressed this will not be possible because the level of discount offered to the tenant will be high relative to the value of the home. For example, if a house is sold for £150,000 with a discount of £75,000 to the tenant, then the sale realises a maximum of £75,000 (in fact, it will be less than this once the costs of the sale process are factored in). Only one-third of this amount (£25,000) is provided to the local authority, and only 30 per cent of this (£7,500) can be put toward the cost of building a new home, with the remainder having to be borrowed.

Secondly, if local authorities themselves cannot enter into an agreement to build new homes on the basis of the scheme on offer to them, then the Government has indicated that it will transfer the 30 per cent of sales revenue to the Homes and Communities Agency with the intention of providing a one-to-one replacement. However, investments by the Agency are unlikely to be in the same areas which have lost stock. There is, in fact, no requirement that the Agency replace stock in areas most affected by Right to Buy, and it is therefore likely that the most desirable council homes will be sold off only to be replaced by much cheaper housing in areas where land prices are currently very low. As the District Councils Network commented in its response to the Government's proposals:

"We have concerns that it will take some of the best social stock away [91] from district councils in some of the better areas. Lack of available land near to town or urban centres could lead to homes being built on land away from services such as shops, schools, GPs etc. Social housing should not be pushed away from the town centres and its associated community support networks."

IN THIS RESPECT, the scheme is likely to lead to a future ghettoisation of social housing tenants. The scheme is also likely to lead to rent rises. The fact that local authorities will have to borrow money to get new homes built as opposed to being able to utilise 100 per cent of sales receipts means that rents will necessarily need to cover the additional interest costs associated with the new builds. There is also an indication from Government that it will consider new homes with rents of up to 80 per cent of market value to be 'affordable', but this is higher than many existing council tenants are currently paying.

There also remain incentives for sub-prime mortgage lenders to move into the market with products designed to asset-strip lower-income communities, as happened in the late 1980s. Although the scheme provides that tenants who have bought their homes under Right to Buy need to pay back the discount they received on its price if they sell the property within a five-year period, this is not the case if they are repossessed. In the event of repossession, it is the mortgage lender who has first call on the receipts from any sale. This means that mortgage lenders have an incentive to make loans irresponsibly and to hike up fees and charges for people falling into arrears to strip the high levels of equity out of these properties. Poor practices in the past have included using the mortgage to clear previous rent arrears and/or to consolidate unsecured debts, as well as the inclusion of high brokerage fees and payment protection insurance premiums in the mortgages. These premiums then attract interest over the lifetime of the mortgage and can add significantly to the total cost.

Finally, there are clearly delays between the sale of properties and the building of replacement homes – even if the 'one-to-one' ^[92] replacement elements of the scheme were to work, there is no way of providing instant replacements! As a consequence, the recent rapid increase in sales of council properties is now contributing to an increase in homelessness. Indeed, Shelter reports that homelessness rose by 5 per cent in the last year and is now at its highest level since 2004, with increasing numbers of families placed in bed and breakfast accommodation due to a shortage of social housing stock.

Towards a responsible housing market

BRITAIN URGENTLY NEEDS TO EXPAND affordable house building programmes, provide rescue schemes for heavily indebted and insecure mortgage borrowers, and bear down on private sector rents. However, we are marching in the opposite direction entirely. If continued, our current policies will drive us towards a mortgage repossession crisis, the further concentration of wealth, and rent increases. These will then likely feed back as higher Housing Benefit expenditure and create further political pressure for cuts to entitlements for private rented tenants. At the same time, what remains of our ambition for greater provision for affordable housing is likely to feed the ghettoisation of working-class households. These processes are already well under way. What can be done to reverse them?

The primary requirement is to restrict the expansion of mortgage credit so that it more closely relates to the level of house building that is taking place. Failure to do so will drive up house prices, not only making home ownership even more unattainable for the majority of households, but also, through an expansion of buy-to-let mortgages, impacting on private rents. However, the mechanisms for restricting the further expansion of mortgage credit are currently limited. The main method, in use since the abandonment of direct controls over bank lending, is to increase the cost of credit by raising base rates. This would limit the growth in house prices but would do so by making mortgages less affordable and would lead to [93] an increase in repossessions. The social costs of pursuing this policy would be horrendous.

An alternative would be some form of return to controlling bank lending levels, either by placing direct limits on the permissible amount of mortgage lending for individual institutions such as existed prior to 1973, or through the design of a type of 'corset' (attempted in the period from 1974 through to 1978), or by requiring banks to hold more capital relative to lending (referred to as 'prudential requirements'). The danger with these methods is that banks have strong financial incentives to evade them, through, for example, the use of off-balance-sheet accounting mechanisms.

A third approach, and the one which is preferred, is therefore the imposition of well enforced responsible lending requirements which prevent loans from being given to those that cannot afford them and which, if set tightly enough, will ration the amount of mortgage credit that is made available. If combined with ambitious house building programmes, this will allow the cost of homes to fall over the longer term. A corollary to this policy is that house prices only need to fall relative to household disposable income to make them more affordable. However, in the current climate, with the cost of many essentials rising, and wage growth at very low levels, this would require a significant reduction in mortgage lending and a major house building programme.

To be clear, this strategy will require state expenditure. Private investment is unlikely to be available if the cost of homes, and therefore the value of housing developments, is reducing over time. However, there is a possible positive side-effect, as this is likely to incentivise private investment into other areas of the economy where returns are higher – specifically in industry and enterprise. At the moment, lending to businesses, especially small to medium enterprises (SMEs), is being crowded out because of the higher returns being made by lending to support buy-to-let and Right to Buy mortgages. A forward-looking economic strategy for Britain should include a target to ensure that returns on investment [94] in sustainable energy, research and innovation, and other industrial and enterprise priorities are always at least as high, and preferably higher, than lending to households, either in respect of mortgages or consumer credit. Providing cheap funds and guarantees to mortgage lenders, as the Coalition Government is doing with its Help to Buy Schemes and the Bank of England has been doing through Funding for Lending, is precisely the opposite of what is required.

In fact, responsible lending requirements are due to be tightened, although this has not happened yet. A major review of the rules relating to mortgage lending was conducted by the FSA and its successor, the Financial Conduct Authority, between 2009 and 2012, with the final requirements published in October of that year. These will be implemented from April 2014 onwards and will require that lenders verify the income of the borrower in all cases and take into account their committed expenditures and basic household needs, as well as make an assessment as to whether borrowers will be able to continue to afford the repayments in the event that interest rates rise. In addition, interest-only mortgages will only be permissible where there is a 'credible repayment strategy' in place.

However, these final rules are a watered-down version of the initial proposals, which were strongly supported by Citizens Advice and Shelter but which met with considerable opposition from the Council of Mortgage Lenders. In particular, the initial proposals pointed to the need for lenders to adopt a more rigorous approach to the assessment of household disposable income, including the use of statistical models to calculate reasonable levels of essential expenditure for households of different sizes and compositions. This held the potential to develop a standardised approach to the assessment of affordability but was opposed by lenders who wanted greater discretion – something which has now been provided for in the final rules. As Shelter points out:⁸⁰

"This approach is a considerable concession to lenders, and ... we urge the [95] FSA to keep this under review and introduce an industry-wide standard if lenders' own methods are not protecting consumers adequately ..."

IN OCTOBER 2012, the FSA also moved to provide some assistance to people who were trapped in negative equity, requiring that lenders cease discriminating against these borrowers by treating them less favourably than other customers – for example, by failing to pass on cuts in mortgage rates. However, it has not taken steps to address the regressive nature of mortgage pricing, where those with the greatest of wealth and highest levels of equity benefit from the lowest prices. In this respect, there is a need to limit the extent to which interest rates vary between the cheapest and highest prices in the market. For example, as at the time of writing, a five-year fixed-rate mortgage from Barclays carries an interest rate of just 2.88 per cent provided the mortgage is no more than 60 per cent of the value of the home. In comparison, a five-year fixed-rate mortgage at 95 per cent loan to value from Leeds Building Society carries an interest rate which is twice as high, at 5.19 per cent.

It is regrettable that the main responsible lending rules have taken so long to be brought into effect, as they are a step in the right direction. However, they are unlikely to be sufficient. Lenders remain incentivised to downplay levels of required household expenditure in a rising market, and 'discretion' will inevitably be used to weaken underwriting criteria in these circumstances. In

⁸⁰Shelter (2010). *Response to the FSA Mortgage Market Review*

addition, the rules are not being accompanied with plans to significantly expand housing construction over and above the rate of growth in mortgage credit⁸¹ or to limit the expansion of mortgage [96] credit relative to the growth in earnings. Mortgage pricing will also remain regressive – providing greatest benefit to those with the highest levels of existing wealth.

Pursuing a deliberate policy of restricting access to mortgage credit, and of reducing house prices over the long term, represents a major political challenge, and it is clear that the Coalition Government has balked at pursuing it. In January 2011, in an interview with the BBC, the then Housing Minister, Grant Shapps, identified a need for house prices to fall relative to earnings. Although household disposable income would be a better measure to use than earnings (which is just one contributor to overall household income and where increases can be offset by rising costs in other areas of the household budget), this was fundamentally the correct policy position to take. The problem is that precisely the opposite is happening as a result of the policies now being pursued. House prices rose by 6.9 per cent in the year to October 2013, whilst average wage growth including bonuses has collapsed from around 5 per cent in 2007 to just 0.4 per cent today.

A policy of pursuing a relative fall in house prices would need to be properly explained within the context of a wider, radical housing strategy designed to lower housing costs over the long term and to provide financial relief for the majority. To do this requires that tighter responsible lending requirements are combined with the restructuring of mortgages, including the write-off of an element of mortgage debt to prevent households from falling into negative equity. These losses will need to be borne by financial institutions in recognition of the fact that it has been their actions which have brought us to the current crisis.

There is also a strong case to abandon Right to Buy, and to develop a replacement which provides tenants with a 'Right to a Share'.

[97] It should be possible to adapt current Low Cost Home Ownership schemes for this purpose. These provide tenants with the opportunity to obtain a stake in their homes and pay rent on the remainder to housing associations, but there is a confusing array of schemes available, and they have been too focused on helping people to 'get onto the property ladder' (often in respect of new-build properties), rather than seen as a means to encourage people to obtain a sense of belonging in their communities as well as to help them build up financial assets over the long term.

⁸¹There has been a recent increase in the number of housing developments taking place as private developers sense a chance to cash in on rising house prices, but the level of this investment pales in comparison with the expansion of mortgage lending. Indeed, it needs to be recognised that relying on house price increases to pull in investment in home construction is a strategy designed around an expansion of mortgage credit and can only maintain an increase in house prices not reduce them. Comments such as those made in October 2013 by the current Housing Minister, Kris Hopkins, that housebuilding is now at its highest rate in 10 years conveniently ignore the fact that even this level of growth is incapable of reducing prices, given the expansion of mortgage credit that is currently taking place.

Further to this, the conditions that are attached exclude many from pursuing shared ownership as an option. The 'Help to Buy – Rent to Buy' scheme in Braintree in Essex is typical of many existing low-cost home ownership schemes. It is only available on new one- and two-bed flats, and to enter into shared ownership of a one-bed flat, the applicant is required to obtain a mortgage for 80 per cent of its market value, as well as to take out an 'equity loan' for the remaining 20 per cent. The equity loan is interest-free for the first five years, but in the sixth year the resident must pay 1.75 per cent in interest on this, and this further increases in the following years at a rate of RPI plus 1 per cent. An applicant must therefore be able to obtain a mortgage for a significant sum in the first instance (which rules out those with impaired credit records) and be able to meet a significant growth in repayments over the lifetime of the loan. Again, the intention is for the resident to attain full ownership of the property and for these, eventually, to become available on the open market for resale. The full proceeds of these sales then accrue to the new owners and are not recycled to build more affordable accommodation.

Other types of schemes are available, including, in London, the First Steps scheme supported by the Mayor. This provides for existing council and housing association tenants to make payments into a savings plan towards a deposit, which can then be used to obtain a mortgage to purchase a share in the property. However, it still requires significant savings in advance of a stake in the house [98] being signed over to the resident and requires people to be able to obtain a mortgage on commercial terms to cover the proportion of the property that they wish to buy.

In my view, there is a need to consider how every social housing tenant could be provided with a stake in their homes, to strengthen communities and encourage the build-up of assets whilst protecting levels of social housing stock for future generations. A 'Right to a Share' scheme should therefore be developed, not as a means of extending home ownership, but as a mechanism to build sustainable communities. For example, a scheme could be developed for tenants to purchase a stake in the value of their homes up to a maximum value of around 75 per cent. These stakes could either be purchased through the use of mortgages or, to facilitate the scheme for lower-income households, through agreed overpayments on the rent account. The important difference with the First Steps programme in London would be that a share of the property would be transferred to the tenant once a relatively low level of savings had been reached (perhaps just 2.5 per cent of the value of the home) and no mortgage would be required to achieve this. Should the tenant wish to move house at any point, then the landlord should have first refusal on buying back these shares at the market value at that point in time; otherwise the house can be sold on the open market. Importantly, the monies raised through the scheme should be ring-fenced for house maintenance programmes and community projects and

developments, for example by creating Community Land Trusts⁸² to develop employment and leisure facilities of benefit to the neighbourhood.

Whatever the final design of such a scheme (and there would need to be clarity concerning the obligations that purchasing shares [99] in the property would bring, for example in respect of the cost of future repairs that may be required), it is clear that there is a need to undertake this with a set of key principles in mind. Specifically, these should be: to provide the widest possible access; to accommodate the changing needs of households over time; to ensure that households build up assets of value over their lifetimes; and for social landlords and other community-based groups to be able to utilise funds derived from the schemes in tangible projects of clear community benefit. These principles could not be in greater contrast to the highly individualistic aspirations underpinning Britain's 40-year-long obsession with home ownership, and which is now contributing toward little other than a growth in wealth inequality and social divisions.

⁸²Community Land Trusts are non-profit, community-based organisations that develop housing, workspaces, community facilities or other assets that meet the needs of the community, are owned and controlled by the community and are made available at permanently affordable levels. For further details see www.communitylandtrusts.org.uk/

Chapter 4: All-consuming credit

[101] BRITAIN'S PROBLEMS DO NOT ONLY STEM from her lengthy obsession with home ownership. Our economic position in the world has been considerably damaged by the reliance of too many households on credit – initially as the means to achieve a 'consumer lifestyle', and more recently as a means of bridging the gap between falling wages and the rising cost of essentials. Consumer credit has a number of valuable qualities, particularly in so far as it can be used to manage temporary cash flow difficulties and support the purchase of 'big ticket' items. However, there are also many downsides to its use, and the way in which the financial services system operates in the UK is regressive, with too much of its cost borne by those in the greatest financial difficulty.

This chapter examines these issues in more detail. It starts by charting the growth in consumer credit use from the early 1990s to the present day and reflects on the impact of this on the wider economy, specifically in respect of Britain's trade balance. This reveals that many of our current problems stem from the high household demand (fuelled by the ready availability of consumer credit) for imported goods and the over-reliance of household consumption as a source of economic growth. This is also likely to have had major environmental consequences, and the chapter looks briefly at how we could use credit products to incentivise the purchase of [102] environmentally friendly goods rather than as a means of supporting unsustainable consumer lifestyles.

The chapter then proceeds to critique the regulation of consumer credit, which has been centred on increasing the transparency of terms and conditions in credit contracts and the financial capability of borrowers to ensure that they make sensible decisions. This approach fails to address the fundamentally predatory and regressive nature of the system as it currently exists in the UK. Finally, the chapter ends by looking at the Coalition Government's record and assesses the extent to which we are addressing our longer-term economic problems or simply entering another round of debt-fuelled consumption which will likely be swiftly followed by a further, even more damaging, recession.

Consumer credit comes of age

AS OUTLINED IN CHAPTER 2, consumer credit grew considerably under the Thatcher Governments of the 1980s, boosted by the emergence of credit card lending which was heavily marketed as a means of achieving access to a consumer lifestyle. Although this market was still in its relative infancy by the time Thatcher left office in 1990, the decade had seen a strong growth in lending, and consumer attitudes to the use of credit were becoming much more relaxed. The demand for goods and services created by this expansion of credit was also becoming of great significance to the performance of the economy as a whole. On coming to office in 1979, the total amount of

outstanding unsecured lending conducted by banks had been around £5 billion. However, by the end of 1990, this had ballooned to nearly £43 billion.⁸³

This growth in bank-driven consumer credit lending was [103] particularly apparent during the Lawson boom of the late 1980s. In the four years from the Big Bang reforms of 1986 to the onset of the recession in 1990, total outstanding amounts across all forms of consumer credit more than doubled. Whilst this contributed to economic growth of approximately 5 per cent per year, it also fuelled an increase in imports and severely damaged Britain's trade balance. This is reflected in the UK's current account deficit, which measures the difference between the value of our exports and imports. Having stood at just 0.2 per cent of GDP in 1986, this deficit expanded to reach 4.9 per cent of our entire economic output by the end of 1989.

The subsequent recession of the early 1990s provided a brake on the growth of consumer credit for a period of approximately three years, and the period was characterised by a 'flight to quality' in much the same way as occurred in the mortgage market, with personal loans and bank overdrafts harder to obtain and many people excluded from the market due to their recent history of credit defaults and a loss of risk appetite amongst lenders. However, just as sub-prime mortgages were developed to tap into the growing market of the financially excluded, there were significant developments in the consumer credit markets which were to lead to a further, long, upswing in lending from 1994 onwards.

Credit reference agencies and credit scoring

CHIEF AMONGST THESE was the development of credit reference agencies which facilitated the sharing of information about the repayment history of borrowers, and more sophisticated credit scoring techniques which gave lenders greater confidence to make, and price, loans according to the risks they faced. On the face of it, credit referencing and scoring appears designed to enable lenders to make more responsible lending decisions – for example, by enabling them to assess the outstanding commitments of a borrower and to consider what is affordable in the light of these. The [104] fundamental driver for lenders to share information about their customers is to help them address the fact that their knowledge of a borrower's likelihood to repay is incomplete and is affected by the extent to which other credit and financial commitments, beyond the lender's own agreements, are in place. Without data sharing, an information asymmetry arises, in that the borrower has better information than the lender concerning their ability to repay. In the presence of information asymmetry, lenders are forced to either increase prices to cover a likely high level of bad debt and/or to ration access to credit – for example, by providing only a small amount of credit to a new borrower and making further advances conditional on prompt repayment. However, both of these mechanisms create problems of their own.

⁸³Source: Bank of England dataset: quarterly amounts outstanding of monetary financial institutions sterling net unsecured lending to individuals, seasonally adjusted.

Raising prices to cover high levels of default can lead to ‘adverse selection’ – the high prices are offputting to consumers who do not consider themselves a high risk and so lead to only those borrowers with the highest risks of default applying. In this situation, prices can spiral upwards in an attempt to cover the ever-increasing risks of default of those prepared to apply.

Credit rationing may mean that people who are otherwise good risks are unable to obtain the quantity of credit that they need. What is more, these consumers have to build up a relationship with a single lender to obtain higher amounts of credit and cannot easily switch to other firms in the market without going through this process of ‘step up’ lending all over again. That runs the risk of limiting price competition for two reasons.

Firstly, even if consumers are price-sensitive, they cannot exert pressure on prices due to the lack of a portable record of payments that they can show to other lenders. Secondly, new firms can be reluctant to enter the market due to the amount of time required to build up a reliable customer base and the initially high losses that would inevitably be incurred whilst attempting to do so. There are, therefore, strong incentives for lenders to share data, and this should, in theory at least, also benefit those consumers with ^[105] good repayment histories, as they should find it easier to obtain the amounts of credit they require and also be able to drive down prices as a result of competition between lenders for their business.

In the UK, data on borrowing patterns and repayment history is shared through commercial credit reference agencies⁸⁴ (CRAs) which also collate additional information from public registers and other sources, including, for example, utility providers. The starting point for all CRAs is to provide access to publicly available data that can be used by lenders to confirm the identity of a prospective borrower, and which provide basic information concerning their creditworthiness. This information includes records of insolvencies, court actions for debt, and electoral register details concerning the address of the borrower. This is then built upon by establishing ‘closed user groups’ of lenders who share information about their customers on a reciprocal basis. This means that companies wishing to search for information about an applicant’s repayment record on the CRA databases must also put the same level of information about their own customers onto the system in return.

In the mid-1990s, these databases mainly reported on ‘negative’ data, which would alert lenders to the potential risks that they faced when considering whether to advance credit, including information about the prior default history of a borrower. However, they did not generally include so-called ‘positive data’ – details ^[106] about the level of credit limits provided by, for example, credit card lenders to their borrowers. Nor did the CRA databases distinguish between borrowers

⁸⁴CRAs are now big global players. The first CRA to operate in the UK is now known as Experian, although when it started operations here in 1982, it traded as CCN. An amalgamation with TRW, the largest CRA in the US, in 1996, subsequently led to its renaming as Experian and it becoming a global leader in the industry. Today, it operates in Latin America, Asia and Eastern Europe as well as the US and UK, employing approximately 17,000 people in 44 countries. Its main competitor, Equifax, was created in the US as the Retail Credit Company and changed its name to Equifax in 1975. Equifax currently employs approximately 7,000 people in 15 countries through North America, Latin America and Europe.

who only paid the minimum monthly amounts off their debts and those that paid higher amounts. Despite these shortcomings, the CRAs provided a significant amount of information that was then used by lenders to devise a system of credit scoring – essentially a process of determining the risk of default associated with a particular borrower based on their previous repayment history and the information provided to the lender on the credit application. By analysing the actual prior repayment histories of their customers according to demographic characteristics and the information provided by CRAs, lenders could also then use this information to make an assessment of the likely risk posed by new applicants with similar demographic and credit profiles. The lender would also devise a ‘cut-off score’; if an applicant failed to attain the required score, then they would not be granted credit.

The technological advances made over the period of the 1980s and early 1990s gave a significant boost to CRAs, which, following computerisation, could now more easily store, analyse, and share information about borrowers with lenders. The lenders were also now better able to process this information alongside that provided by the applicant to construct and apply credit scores to assist with their decision-making. This drove forwards the automation of lending decisions and prompted a move away from the ‘relationship’ lending models previously employed by banks, whereby a customer seeking a loan would need to visit their branch bank manager and discuss their requirements and repayment prospects in person. Much cheaper channels to deal with applications, including call centres and subsequently the Internet, were opened up as automation of lending decisions was rolled out across the industry. This was also accompanied with a widespread programme of bank branch closures – particularly in poorer areas – to reduce [107] overheads, and Internet-only providers (including, for example, Egg⁸⁵) began to emerge.

Risk-based pricing and credit card securities

TWO FURTHER MAJOR CHANGES then took place, which gave a further boost to consumer credit lending from 1994 onwards. The first of these was the development of ‘risk-based pricing models’. Rather than simply use credit scores to determine whether someone should be granted or refused credit, these scores were increasingly used to determine the *price* of credit that people would be offered. In the same way that sub-prime mortgages targeted people with impaired credit histories and lower incomes for products at high prices, the credit card lenders saw the large pool of financially excluded as a money-making opportunity and started to devise ways of charging them higher prices to cover their risks. Although lenders advertised ‘typical’ low rates, it was now entirely possible for an applicant to be offered a much higher rate than this once the lender had made an assessment of their risk, creating a lack of transparency in pricing for

⁸⁵Egg was established by the Prudential as the first British Internet-only bank in 1998 and was floated on the London Stock Exchange in 2000, with Prudential retaining a majority share. In 2006, Prudential bought back the remaining shares and delisted the company from the stock exchange, as a precursor to then selling the company to CitiGroup the following year. However, it has subsequently been split up, with its credit card business sold to Barclaycard in 2011 and its savings and mortgage portfolio now part of the Yorkshire Building Society.

consumers as the actual price being offered to them only became apparent at the end of the application process. Further to this, consumers were also often penalised by searching around for the best price, as multiple applications for credit within a short space of time showed up on their credit file with the CRAs and were often interpreted as an ^[108] indication that someone may be in financial difficulty within the credit scoring process.

Secondly, the process of securitisation – the packaging-up of credit card debt to sell on as investment products – also released significant amounts of capital for investment to support the expansion of credit cards in the UK. Securitisation of credit card lending started in the late 1980s in the US. For example, Citibank started to issue securities based on future revenues from its credit cards in 1988. These securities are created by the lender agreeing to place the amounts that it will receive from interest and fee payments on the credit cards it has issued within a trust. This trust then sells shares in the expected pool of repayments to investors and returns the value of these shares (less the management costs of the operation) to the credit card lender. By doing this, the card issuer is able to quickly raise money against the value of future repayments and so invest this in activities to further expand its operations. By the mid-1990s the model was starting to be exported to the UK. Capital One – which specialises in offering ‘sub-prime’ credit cards – was founded in 1988 in the US and began its UK operations (headquartered in Nottingham) in 1996. Its first sale of securities arising from credit card agreements in Britain came two years later.

The introduction of both risk-based pricing and securitisation led to a rapid expansion of credit card lending throughout the late 1990s and early 2000s. Between January 1997 and the same month in 2002, the total amount of outstanding credit card balances increased by 164 per cent from a little over £15.5 billion to around £41 billion.⁸⁶ Even though the number of potentially eligible credit card borrowers had been expanded by providing products aimed at those on lower incomes and/or with previous defaults on their credit histories, the market was close to saturation point. The average number of credit cards in issue increased over the same five-year period from just under 33.5 million to over 54 million in a country with an adult population of around 50 million.

^[109] Competition for borrowers became fierce. However, this competition was focused not on ‘good’ payers, but on people who failed to repay their card balances at the end of each month. The nature of the credit card industry is such that those who repay in full at the end of the interest-free period (up to 56 days in some cases) receive their credit for free, whilst those who struggle to repay are subject to interest charges, and, in the event that a payment is missed, to substantial additional penalty fees. In this respect, these products are clearly regressive in that the costs involved in providing free credit to those that are able to afford to clear their balances are met by those who are in worse financial shape.

⁸⁶Source: British Bankers Association, credit card statistics dataset

Competition played out by lenders targeting borrowers who were not able to clear their balances and offering them the opportunity to switch their card provider at no cost. 0% balance transfer deals became commonplace. Credit limits were then frequently increased by the new lender to encourage people to continue to spend on their cards and so fail to pay down the balance of their debt by the time the interest-free period had expired. In this way, credit card lenders sought to trap borrowers in debt for lengthy periods of time, so increasing the level of expected return and the value of the securities being sold to investors.

Consumers suddenly found that the amount of credit available to them had increased significantly. Following the transfer of the initial balance to a new card provider, the borrower now had two credit cards and had now considerably increased the amount of credit that they could obtain. There were no controls put in place through the credit referencing system to ensure that the first lender closed the initial account. In fact, the lender that had had their balance paid off as a result of the transfer often then raised the credit limit on the initial card to entice the borrower to start using it again. Consumers were able to transfer balances on a regular and repeated basis, and they were actively encouraged to do so by marketing offers from the industry. In 2004 the total amount outstanding on credit cards had risen to £50 billion, and balance [110] transfers accounted for 14 per cent of the value of all new credit card transactions made that year – double the level of just three years earlier. Many people, under financial pressure, rotated their debt until such time as the stress of the situation became too much for them to bear, and a number of debt-related suicides started to feature in the media.

In one case, reported in March 2004, a 37-year-old man was reported to have committed suicide after having acquired 19 credit cards and run up an outstanding debt of £70,000, despite receiving an annual salary of only £22,000. The media reports revealed that the debt problems being caused by balance transfers and unsolicited increases in credit limits were out of control. Commenting on the suicide, Malcolm Hurlston, the then Chairman of the Consumer Credit Counselling Service (which has subsequently been renamed as StepChange) revealed that:⁸⁷

"In the past week we have counselled one client with 39 cards and another with 37. Although 19 may be extreme, it is by no means exceptional."

A SECOND, HIGH-PROFILE SUICIDE was then reported in October of the same year,⁸⁸ when a 51-year-old fork-lift truck driver with a weekly take-home pay of only £340 hanged himself, having accrued £100,000 in credit card debt. His suicide note to his sister read:

"Please forgive me for what I am about to do and that is to commit suicide. I've run up large debts with credit card companies and loans for the last 15 years. Now I can't pay

⁸⁷<http://www.telegraph.co.uk/news/uknews/1456602/Father-killed-himself-over-debt-of-70000-run-up-on-19-credit-cards.html>

⁸⁸http://news.bbc.co.uk/2/hi/uk_news/england/cambridgeshire/3708512.stm

the bills, and the different companies won't leave me alone. Can you please get the police to come and find me in the bungalow."

THE COVERAGE OF CREDIT CARD DEBT-RELATED SUICIDES resulted in pressure on the Government to act. Reforms were also called [111] for by the Treasury Select Committee, which was then chaired by John McFall, and which had launched an inquiry into the credit card market a year previously. In a speech made on 22nd April 2004,⁸⁹ he clearly accused the credit card industry of irresponsible lending practices and called for improvements in data sharing to address this:

"All lenders must share positive and negative data with credit reference agencies. Someone could be out of their depth, with 17 or 18 credit cards, but if they were making the minimum repayment on each one, nothing would show up at the credit reference agency, so there would be no assessment of how likely they were to sleepwalk into disaster. That must be addressed."

IN MARCH 2005, by which time the amount of credit card debt outstanding had grown further to £63.1 billion, and the number of cards issued to a staggering 71.5 million, the Government finally responded and made a number of commitments intended to get the industry to improve its practices. These commitments included not only the sharing of positive data concerning the number of loans and balances outstanding, together with information about available credit limits, but also measures intended to ensure greater transparency of pricing, for example by requiring lenders to standardise the calculation of the APR interest rate and by providing customers with a summary box of the fees and charges associated with the different cards on their agreements.

The Department of Trade and Industry relied on the sector to clean up its own act in these respects. Changes were subsequently made to the voluntary Banking Code of Practice, which was supported by the British Bankers Association and the major credit card lenders, and an industry-led project was also taken forward to introduce positive data sharing. In March 2005 a revised version of the Code (which had first been developed in 1997) was put in place. This included a commitment to provide a summary box [112] of key information to consumers, but did not prohibit unsolicited increases in credit limits, nor did it require that lenders close down accounts where a balance transfer had been used to clear the outstanding balance. The only concession in these areas was a commitment that lenders would allow people to 'opt out' of receiving unsolicited increases in their limits if they expressly requested this. Even though little progress had, in fact, been made, the then Minister responsible for consumer credit regulation, Gerry Sutcliffe, applauded the industry's efforts to self-regulate in a Parliamentary debate held on 28th June:

"... the industry has done much through improvements to the banking code to improve the processes through which credit limit increases are made. The changes were

⁸⁹http://hansard.millbanksystems.com/westminster_hall/2004/apr/22/credit-card-charges#S6CV0420P1_20040422_WH_5

included in the new version of the code, published in March ... The Government welcomes effective self-regulation by business when it improves the quality of business practices, serves to protect consumers and enhances the services that they receive. Effective self-regulation is as critical to the proper functioning of the market as formal regulation through legislation. The industry is on notice on the matter, and we look forward to its taking an effective approach to address the concerns expressed by hon. Members, which have existed for some time.”

WHILST THERE WAS NO EVIDENCE that the industry had, in fact, responded effectively to concerns about unsolicited increases in credit limits, the Minister may perhaps have been impressed by the rapid progress that was being made to introduce positive data sharing into the UK, which was achieved by all of the main banks and credit card lenders before the end of the year.

However, one could question the intentions of the credit industry on this point. Although the introduction of positive data sharing is widely thought to be important as a means of preventing irresponsible lending, this is not necessarily the case. More information does not automatically lead to more responsible lending decisions. It depends entirely on how the information is used. As the development of sub-prime mortgages and credit cards had already shown, lenders were much more likely to use the information available [113] to them to identify low-income borrowers and target them with predatory products than they were to avoid lending to people who would have problems repaying.⁹⁰ Indeed, in the context of credit card lending, the latter group are the only source of profits.

The academic literature concerning the pros and cons of ‘positive’ data sharing has been reviewed by the Australian Law Reform Commission (ALRC), as part of an extensive inquiry into the effectiveness of its privacy legislation which reported in 2008. What is notable from that inquiry is that the support for more comprehensive data sharing, and the use of ‘positive’ data, came not from consumer agencies wishing to see more responsible lending decisions, but from the consumer credit industry:⁹¹

“Credit providers and credit reporting bodies argued strongly for a wider range of information – such as current credit balances and loan repayment histories – to be collected and disclosed in reports to lenders, on the basis that such information is required for credit providers to make good decisions about an applicant’s ability to service the requested level of debt. The industry was very active in supplying the ALRC with studies, surveys, reports and economic modelling, suggesting that an increase in the ‘positive’ information available to lenders would facilitate better risk management

⁹⁰See, for example, Marron, D (2007). ‘Lending by numbers: credit scoring and the constitution of risk within American consumer credit’. *Economy and Society*. Volume 36, Issue 1.

⁹¹Australian Law Reform Commission (2008). *For Your Information: Australian Privacy Law and Practice* (ALRC Report 108). Sydney: ALRC. <https://www.alrc.gov.au/publication/for-your-information-australian-privacy-law-and-practice-alrc-report-108/>

practices, which in turn would open up the field to greater competition and drive down the cost of credit – especially for low risk and responsible borrowers.”

WHILST THE LENDERS and credit reference agencies painted themselves as the paragons of virtue, now desperate to have the tools with which to make more responsible decisions, the Australian consumer agencies remained sceptical as to their real intentions. They referred to a number of studies which highlighted how the additional information would be used by lenders to further ^[114] segment the consumer credit market; continue the drive toward more risk-based pricing; and result in the targeting of borrowers in financial difficulty with offers of high-cost, predatory products. As a consequence, they argued, successfully, that any extension of credit reporting must also be accompanied with clear requirements on lenders to use the additional information to support more responsible practice. In its final recommendations, the ALRC spelt this out by insisting that more comprehensive credit reporting should only be allowed once the Australian Government was satisfied that “there is an adequate framework imposing responsible lending obligations in Commonwealth, state and territory legislation.”

Although the credit card industry was running rampant throughout the period from 1997 to 2006, there was also an expansion in other forms of lending, notably personal loans, bank overdraft credit, and, to a lesser extent, store cards. In the month following Tony Blair’s first election as Prime Minister, the total amount of outstanding unsecured credit was in the region of £85 billion, of which around £16 billion (18 per cent) was down to credit card lending. In the five years that followed, the total amount owed on unsecured credit agreements surged upwards by 84 per cent to £157 billion, and credit card lending increased its share of the market to 27 per cent. By the end of 2006, the total had risen further to £190 billion, and the credit card share to just over one-third.⁹²

This long consumer credit boom was underpinned by low ^[115] interest rates, which kept the cost of servicing credit commitments low for many households. Bank of England base rates were cut steadily from 7.25 per cent in October 1998 to stand at just 3.5 per cent by July 2003. This impacted on the cost of consumer credit. Average interest rates on credit cards with outstanding balances fell from nearly 18 per cent in 1999 to 13.5 per cent. The interest rates on personal loans and overdraft credit reduced by 2 and 3 per cent respectively. Although low interest rates gave the impression of affordability, the build-up of credit commitments over this period was to prove unsustainable when the Bank of England began to raise base rates as a means of addressing the housing market boom from late 2003 through to early 2008. By February 2008, the base rate had

⁹²All figures exclude student loans, which were initially introduced in 1990/91, as a mechanism to replace grant funding to help university students from low-income backgrounds with living expenses. This was done by freezing maintenance grants at their 1990/91 rates and by providing loans as a replacement as living costs rose. The process was then further accelerated in 1994/95 by reducing the value of grants and increasing loan rates. In 1998/99 the Blair Government expanded the loan scheme significantly by requiring that undergraduates also use these to pay towards the costs of their tuition, and subsequent changes to academic funding have meant that universities have been able to increase the cost of tuition fees considerably. The total value of student support loans made in the academic year 2011/12 for students in England was over £7.4 billion.

increased to 5.25 per cent, and many credit card borrowers were faced with effective interest rates on their now significantly increased outstanding balances of around 18 per cent. The financial difficulties for these households were compounded by the increased cost of food and fuel through to 2009.

Payment Protection Insurance and other scandals

THE LONG CONSUMER BOOM was associated with relatively low interest rates. However, this incentivised lenders to devise a number of other ways to maximise returns. Chief amongst these was the sale of Payment Protection Insurance (PPI). This became an extremely important source of revenue from 2001 onwards and was sold both in respect of personal loans and for credit cards. PPI was sold as a means of insuring the borrower against potential external shocks to their income, including unemployment and sickness. Policies promised to cover payments on credit commitments in these instances, therefore providing borrowers with greater 'peace of mind' – a common phrase used by sales staff at the time. In reality, PPI [116] was an insurance policy for the lender and only encouraged lenders to behave irresponsibly. After all, if the borrower's payments were covered in the event of the main triggers of default occurring, then literally anyone could be lent to on a virtually risk-free basis.

Of course, the fact that PPI policies were being sold alongside credit agreements that had been priced 'according to risk' made no sense at all. On the one hand, the presence of the insurance policy made the borrower virtually 'risk-free', but on the other, their likelihood of default, based on their prior repayment history (when PPI had not been available) was high, so they also needed to be charged a higher price for their credit despite the presence of the insurance policy. The credit system was, simply, ripping people off. By 2004, the *Guardian* reported that Barclays Bank was making 10 per cent of its global profits from the sale of PPI policies in the UK.⁹³

The rip-off operated in more ways than by failing to reprice loans once the insurance policy was taken out. For a start, the industry often 'front-loaded' the payment of the insurance premiums, particularly in respect of personal loans, and then incorporated the cost of these into the credit agreement, such that the borrower was paying interest on the cost of the premiums as well as on the principal of the loan. In its excellent 2005 report, *Protection Racket*, Citizens Advice pointed out that this practice could lead to the cost of insurance premiums amounting to as much as 56 per cent of the cost of the loan itself.

Secondly, PPI policies were often sold as if they were a precondition of getting a loan application accepted, with sales staff incentivised to make sales. As Citizens Advice put it:

"High pressure selling ... can force people to take out insurance that they cannot afford, do not want or need. These practices are widespread throughout the credit industry. Bad practice in the sale of PPI products is also linked to irresponsible lending. Citizens

⁹³<http://www.theguardian.com/business/blog/2012/sep/05/ppi-mis-selling-investigation>

Advice Bureaux often [117] report that people in financial difficulties are offered consolidation loans that they clearly will not be able to pay. In some cases these loans are rolled over with a new PPI policy sold each time.”

THIRDLY, THE POLICIES were also sold to people that simply could not qualify for assistance under the terms of eligibility. People with outstanding health problems or the self-employed, for example. These groups were often specifically excluded from cover, but the sales staff, working to targets and on commission for the sales, had incentives to gloss over these inconvenient details. It was also common practice for PPI claims to be routinely turned down, with a Citizens Advice survey of clients with debt problems in 2001 indicating that as many as 85 per cent of those claiming against their policy were being rejected.

Despite these problems being reported by Citizens Advice and other consumer agencies from as early as 1995, it took the FSA until December 2010 to introduce a decent set of rules. Given the length of time that lenders had been pushing PPI, it was no surprise that the British Bankers Association then attempted to prevent these from applying retrospectively, by taking the issue to the High Court. This case was resolved in April the following year, by which time PPI mis-selling complaints were being lodged with the Financial Services Ombudsman at the rate of nearly 5,000 per week.

At the time of the High Court hearing, it was anticipated that providing compensation for borrowers could cost the banks up to £4.5 billion. However, the reality has proved far more expensive, with recent estimates nearly three times as high. Although banks continue to drag their feet in making payments, justice finally appears to be being done, although, as Philip Inman wrote recently in his blog for the *Guardian*, there remains the fact that the perpetrators of this national disgrace have not yet been held to account:

“... there is still at least one investigation the FSA has sidestepped. All the major banks and insurers conspired to fix PPI premiums and prepared collective responses to difficult questions from the media and regulators. Bank executives regularly flew to Dublin where they ran their [118] PPI operations as a tax scam, doubling up the profits from selling the insurance in the UK. There will be records of who went and what their instructions were. It doesn't matter if some are now retired, they should be hauled before the regulator and asked to explain their actions.”

Credit card and bank default charges

AS IF THE PPI SCANDAL was not bad enough, the predatory and regressive nature of the financial services system was further revealed when the Consumer Action Group – a self-help organisation established by Dave Smith and Marc Gander who met in an online forum discussing bank charges in 2005 – started to provide sample letters and paralegal advice to the public concerning possible legal claims to recover excessive bank and credit card penalty charges.

The impetus for this exceptionally popular campaign came from Gander, who was an academic lawyer and who had personal experience of being hit by high bank charges. As a consequence, Gander researched the legal position and took the view that the levying of penalties, as opposed to the recovery of actual costs incurred as a result of defaults and bounced payments, was unlawful. The campaign exposed the fact that whilst the majority of people had access to free bank accounts and, if they repaid their credit card balances in full each month, free credit facilities, these were being heavily subsidised by excessive charges levied on those in financial difficulties. The banks and credit card lenders have established a perverse system whereby those in greatest hardship pay for the privileges of the better off.

Throughout late 2005 and 2006, the campaign took off in earnest, when the well-known broadcaster Martyn Lewis and the consumer group *Which?* both entered the fray, offering advice and tips for people on their websites to help them register claims against the banks. The Office of Fair Trading was also pressured into responding, issuing a statement of its position on credit card default charges in April 2006. This indicated that credit card lenders were [119] routinely charging as much as £25 for each instance that a payment was received late. In its view, this was manifestly unfair, and out of proportion with the actual costs that these late payments incurred for the lenders. Its statement indicated that consumers were cumulatively being overcharged by as much as £300 million per year, and it insisted that the level of individual charges be reduced to no more than £12. However, the OFT's statement indicated that individual consumers would need to seek their own means of redress to obtain compensation for prior over-charging, either by taking cases to court or by complaining to the Financial Ombudsman service. There was no attempt to force credit card lenders to proactively identify customers hit by high charges to provide them with rebates, even though the legal basis for the OFT's statement was a set of Unfair Contract Terms regulations which had been in force since 1999. On the basis of the OFT's calculations, as much as £2.1 billion in excessive default charges had been levied by the industry since that time.

The Office of Fair Trading (OFT) was also initially timid in reading across the findings from its review of credit card charges to those levied on bank accounts, where the average amount of charge for a bounced payment was £34 and there were also concerns about the high cost of unauthorised overdrafts. Although the April 2006 statement encouraged banks to consider the implications for their charging policies, the OFT did not take action until the following year, when it took a test case against seven banks and the Nationwide Building Society to the High Court. This was initially successful, with the court ruling that penalty charges fell within the remit of the Unfair Contract Terms regulations. However, the court decision was subsequently appealed by the lenders and overturned by the Supreme Court in November 2009.

There has followed a long wait for further action. In 2008, pending the outcome of the Supreme Court decision, the OFT conducted a market investigation into current accounts, which found that:

[120] “... there seems to be a substantial cross-subsidisation from those consumers who incur insufficient funds charges to those who do not; and to a significant extent from ‘vulnerable’ low income and low saving consumers, to higher income, higher saving ones.”

FURTHER TO THIS, the OFT reported that the cross-subsidy amounted to at least £500 per year for each of the 1.4 million worst affected consumers. As a group, this is a cross-subsidy from those in financial difficulty to the better off worth £700 million per year.

In 2009, a follow-up report from the OFT indicated that the banks were becoming sensitive to public and regulatory pressure. They provided assurances to make the details of their charges more transparent and promised to make it easier for people to switch accounts. In 2011, a further progress update indicated that banks would also allow people to ‘opt out’ of having access to unauthorised overdrafts, and that the level of charge for bounced payments had fallen to an average of £14.

However, in its most recent review of the current account market, published in January 2013, the OFT reports that this has become more concentrated and that the banks are trying to make up for their lost revenues caused by the pressure to reduce bank charges. Lloyds Banking Group, Barclays, RBS, and HSBC provide three-quarters of all accounts, and whilst total revenue from unauthorised overdrafts and fees for bounced payments has fallen, this has been partially offset by a significant increase in revenue from authorised overdrafts, which increased from just £14 million in 2007 to £448 million in 2011 (the latest year for which data is available). The switch in revenue from unauthorised account charges to fees and interest associated with authorised overdrafts has been especially strong in 2010 and 2011, and if the trend over those two years has been maintained, then by now they will have entirely recovered their lost revenues from the reduction in back-end charges in this way. Finally, the 2013 report indicates that there has been a “low take-up” of the opportunity to opt out of unarranged overdrafts [121] and that some banks, notably HSBC and Santander, are still continuing to charge around £25 for bounced payments. Whatever the current ambitions of the OFT and the FCA, its successor from April 2014, it appears that unless there is an end to free banking for those who do not go overdrawn or incur bounced payments, the personal current account market will continue to operate on the basis of a cross-subsidy from those who are in poor financial shape to those who have the fewest problems.

Lack of competition in the store card market

STORE CARDS, WHICH WERE PROMOTED to people by offering discounts on clothes and other retail items to people who signed up to them at the till, have also been subjected to greater scrutiny in the recent period, and, once again, the providers have been found wanting. Until the end of the 1990s, these cards had been provided directly by retailers in an effort to encourage customer loyalty. However, in the early 2000s, two of the largest retail groups, JLP and Marks & Spencer, decided to outsource their provision to HSBC. Others, including Asda and Mothercare, soon

followed suit, with many of them selecting GE Capital as their preferred partner. The boom on the high street – in large part fuelled by easy access to credit cards – was in full swing by 2002, and although store cards, which could only be used in specific retail outlets, did not have the same flexibility, the market appeared to benefit from the generally increased use of credit as a means of paying for consumer items. By 2002, there were some 17.5 million active store card accounts, and the market was worth an estimated £3 billion. However, it had also become very concentrated, with the largest four providers accounting for 90 per cent of all store cards issued. The Treasury Select Committee began to raise concerns at that point and questioned whether consumers were getting a fair deal, particularly as the typical APRs on these cards were around 30 per cent.

Following a fact-finding inquiry by the Office of Fair Trading ^[122] in 2004, the market was referred to the Competition Commission which provided its final report in 2006. The Commission concluded that levels of market concentration, combined with a lack of price sensitivity amongst store card users, was contributing to unfair pricing and lending practices. This included not only the high up-front APRs but also excessive default charges, and the sale, alongside the cards, of payment protection insurance. This increased the cost of the credit, and take-up was high even though surveys among consumers found that they did not clearly understand the benefits that they might receive from it. For example, a survey conducted by the Commission during the course of its inquiry found that:⁹⁴

“Over 70 per cent of respondents admitted to not knowing what percentage of their balance would be paid each month by the payment protection element of the cover if they lost their income. A further 13 per cent thought (wrongly) that 100 per cent of the balance would be paid. Moreover, the survey evidence suggests that not all cardholders understood their cancellation rights in respect of the insurance they had taken out with their store card. Our survey also found that 38 per cent of respondents thought that they could not cancel the insurance agreement without cancelling the store card agreement.”

THE SALE OF PPI alongside store cards was particularly lucrative, with the Commission finding that this accounted for around 20 per cent of store card provider revenues in 2004. Concluding its inquiry, the Commission found that the lack of effective price competition in the store card market had cost consumers at least £55 million per year, and “possibly considerably more”, from 1999 onwards. However, its ‘remedies’ failed to provide any redress to those borrowers that had lost out as a consequence. Instead, the Commission focused on improving lender transparency about the costs of their agreements, including by providing a ‘wealth warning’ to borrowers about the dangers of only making minimum payments ^[123] if the agreement provided for an APR of 25 per cent or more. In addition, the Competition Commission also ordered store card providers to ensure that PPI was sold separately – so avoiding placing pressure on consumers to sign up at

⁹⁴Para 8.153, *Final Report: Store Cards Market Investigation*. Competition Commission 2006

the till – although by that time the death knell for PPI was already starting to sound, and the long boom in consumer credit was coming to an end.

The economic impacts of the consumer credit boom

THE LONG BOOM in consumer credit, which lasted from the start of 1994 and ended in the global crash of 2008, has severely damaged the long-term prospects for the UK economy. The boom certainly led to a long period of growth, but this masked a huge deterioration in the underlying health of the economy which will require radical action to remedy. Over the course of the boom, Britain's annual economic growth rates, measured by GDP per capita, were consistently higher than that of the US, France and Germany.⁹⁵ This growth was the result of greater household consumption. The average annual growth rate in household consumption per capita over the 12 years was 3.6 per cent in the UK compared to 2.6 per cent in the US, 1.6 per cent in France and just 0.9 per cent in Germany. Further to this, too much of our household spending went on imported goods. In 1995, we had a deficit on our trade in goods equivalent to around 1.7 per cent of GDP. By the turn of the new century, this had increased to 3.5 per cent of our economic output, and by 2005 it reached 5.4 per cent. This deficit in the trade of goods was high by historical standards, even when compared to periods in which consumer credit booms had previously taken place. During Heath's 'dash for growth' between 1970 and 1974, it had averaged around 2.5 per cent of GDP, and in the Lawson boom of 1984 to 1989, it was just over 3 per cent.

[124] In previous times, the worsening of Britain's trade balance in goods would have led to a significant downward pressure on sterling. However, our true position in the world was heavily disguised by both our trade in services (and particularly in financial services) and by income flowing into the country as a result of returns made on British investments overseas. In 2005, our trade in services created a surplus equivalent to about 1.5 per cent of GDP. Close to one-third of our exports in services was in financial services, indicating how important these had become to our overall economic position since the Big Bang reforms of 1986. We were also helped by the returns from overseas investment which increased significantly. Taken together, our trade in services and returns on overseas investment would have reduced our net balance of payments position to a deficit of just 1.6 per cent, although once our contributions to overseas aid and the European Community were added in, this rose by a further percentage point to 2.6 per cent.

The combined impact of our exports in financial services and the income received from overseas investment maintained sterling at a higher level than would have been justified on the basis of our trade in other goods and services alone. In fact, there was a significant and sustained appreciation in the value of sterling over the period. This had the effect of choking off what had looked like the beginnings of a recovery in the fortunes of British manufacturing following the

⁹⁵In fact, GDP growth per capita was higher over this period than for any other G6 country (France, Germany, Italy, Japan, US, and the UK).

recession of the early 1990s.⁹⁶ The contribution of manufacturing to the UK economy⁹⁷ declined from £186 billion in 1997 to around £150 billion in 2006, resulting in the loss of over a million jobs. Although the number of manufacturing job losses was offset by employment in an expanding service sector, these jobs were more likely to be short term, and they were often [125] part-time. They also required completely different skills. One of the consequences, despite a generally positive employment picture throughout the period, was a stubbornly high level of long-term unemployment which was also geographically concentrated in our traditional industrial heartlands – areas which were still struggling to recover from the impacts of the recessions of the 1980s and 1990s.

The high exchange rate did, however, keep the price of imported goods and services down, and inflation low. It therefore negated the need for increases to base rates. And, with inflation no longer the threat that it had once been, the New Labour Governments were not under the same pressure to constrain public spending as the Conservative Governments that preceded them. They were also politically less inclined to do so, despite having wedded themselves to low levels of income tax as a means of ensuring voter popularity.⁹⁸

Public spending was much higher than in the Conservative years and grew in real terms at an average rate of 3.2 per cent per year under New Labour.⁹⁹ Some elements of public spending grew as a result of deliberate, and progressive, political choices. ‘Education, education, education’ had been Tony Blair’s rhetorical statement of priorities during the election campaign of 1997, and this rose from around 4.5 per cent of GDP in that year to 6.2 per cent by 2008/09. Even more significant was the increase in health expenditure, which grew from 5 per cent to 8 per cent over the same period, partly as a result of an ageing population. However, the social security budget was the single biggest component of Government spending. This rose by 60 per cent in real terms¹⁰⁰ from [126] £114 billion in 1996/97 to £181.5 billion in 2009/10, accounting for around one-fifth of the entire increase in public spending over the period.

One of the underlying reasons for this increase was the structural change taking place in Britain’s labour market, which, if not entirely caused by the long credit boom, had certainly been accelerated by it. The decline of manufacturing meant a loss of both employer-funded apprenticeships and full-time jobs. Although more jobs were being provided by the growing service sector, these were often shorter term, low paid, and part-time. Government intervened

⁹⁶For details, see Cobham, D. (2006). ‘The overvaluation of sterling since 1996: how the policymakers responded and why’. *Economic Journal*, 116 (June), pp 185–207. Royal Economic Society.

⁹⁷Measured by Manufacturing Gross Value Added (GVA) at 2011 prices.

⁹⁸Specific commitments not to raise income taxes were given by Tony Blair in the election campaigns of 1997, 2001, and 2005.

⁹⁹This was roughly twice the annual level of public spending growth that was experienced from 1979 through to 1997.

¹⁰⁰The figures are for Great Britain and are measured in 2009/10 prices. The term ‘social security spending’ is used here to include spending on benefits by DWP as well as spending by other Departments on ‘cash transfers’ including Housing Benefit and Tax Credit, but excluding Council Tax Benefit. For further details see Hills, J. (2013). *Labour’s record on cash transfers, poverty, inequality and the lifecycle 1997–2010*. Centre for Analysis of Social Exclusion. London School of Economics

to support people to make the transition to this more 'flexible' labour market. Measures included the introduction of a system of tax credits in 1999, and investment in welfare to work schemes and in the vocational training and skills sector. Other political priorities, including a desire to reduce poverty amongst pensioners¹⁰¹ and in households with children, also had a major impact on social security spending over the period. Reviewing the New Labour record in 2013, Professor John Hills from the London School of Economics reported:¹⁰²

"For the working age population the emphasis was on education, training, 'making work pay' and support into work rather than real increases in social security benefits. By contrast, financial support for families with children through tax credits in and out of work was made more generous in real terms in pursuit of child poverty reduction targets, but alongside a series of other measures aimed at the early years and wider aspects of social exclusion ... Pensioners also benefited from increased support, but this was mainly on a means-tested basis ... Direct taxes were reduced to [127] some extent for those on low incomes, but increases for those with higher incomes were generally limited, until the response to the economic crisis from 2008 included an increase in the top rate of income tax first to 50 per cent for incomes above £150,000, but taking effect only from 2010-11, that is, mainly after Labour had left office."

THROUGH A COMBINATION of consumer credit-fuelled growth, high levels of public spending, and a failure to intervene on the currency markets to push down the value of sterling, we have now arrived at a position where not only are households in an extremely vulnerable position – with many budgets on a knife edge – but our manufacturing base has been dramatically undermined; our labour market has been transformed into a low wage, service-based economy, requiring the prop of high social security spending; and the importance of financial services to our trade balance significantly strengthened. It is these facts which have led the Coalition Government from 2010 onwards to focus on how it can 'rebalance the economy', support an 'export-led recovery', 'get Britain's debts under control', and ensure that there is no return to 'debt-fuelled consumption'.

Costing the earth?

BEFORE TURNING TO THE COALITION'S RECORD on these issues, it is worth noting how the personal debt crisis is linked to the wider, global, environmental crisis that we are also now experiencing. One of the main attractions of credit is that it allows us to spend now what we expect to earn tomorrow. However, if lots of households simultaneously use large amounts of credit to purchase consumer goods, then they are also bringing forward demand for the natural resources to make them. There is no doubt that consumer credit-fuelled demand can be good (at least in the short term) for retailers, as well as for labour (in terms of creating jobs). It can even contribute

¹⁰¹Spending on pensioners is the largest component of social security expenditure, with just under £50 billion spent on the state pension in 2007/08 – some 30 per cent of the total benefit and tax credit budget.

¹⁰²Source is as in footnote 100.

to the economic development of countries which are [128] selected to make those consumer goods on the basis of their cheap labour costs. However, the mass production of consumer goods also requires the use of natural resources, and in a credit boom these are prone to be used at a faster rate than they can be replenished.

Recent years have seen a growing interest in the concept of sustainable consumption, whereby households and businesses are encouraged to take account of the impact of their spending on the environment. This includes, for example, concerns about the production processes used in making some consumer goods, our use of energy, and selection of transport options. The basic aim is to encourage people to minimise their use of natural resources, either by reducing consumption or by using them more efficiently (for example, by insulating homes). Whilst much effort has therefore been put into understanding how different types of imports are produced and what the production processes and environmental impacts of these are, the impact of consumer credit – in terms of fuelling unsustainable levels of demand in the first place – has largely been overlooked.

Of course, a large part of the problem is that households expect to continue to enjoy unsustainable standards of living. According to the World Wildlife Fund, if everyone on the planet lived as we currently do in the UK, then this would require the resources of the equivalent of three earths. In common with other environmental groups, they therefore encourage households to take practical measures to reduce their environmental footprint, for example by recycling more and by buying second-hand rather than new items of furniture or consumer goods. However, they also indicate that replacing old energy-inefficient items with more environmentally friendly products could be helpful. Because of this, the function of consumer credit is likely to be double-edged. Certainly, using consumer credit as a means of promoting unsustainable living standards and the purchase of unnecessary items is damaging. On the other hand, providing consumer credit to support household investment [129] in, for example, more energy-efficient appliances or to pay for the insulation of homes is sensible.

As a result, it seems logical to try to find ways of targeting future credit use to these purposes. Following this principle, the Coalition Government introduced a 'Green Deal' from the end of January 2013. This provides loans for people to take up energy efficiency measures, which are then repaid through future savings on the fuel bills that result. The loans can be used, for example, to provide loft and wall insulation, double glazing, and the installation of solar panels. However, as Laura Mark at *The Architects' Journal* has recently reported,¹⁰³ the process for retrofitting properties to make them more energy-efficient through the Green Deal is overly complex. A detailed assessment of each property is required, and the terms and conditions of the financing, including the amount of the repayments, are uncertain for applicants until this has been conducted. Further to this, the loan stays with the property when the initial borrower moves out. The repayments are therefore expected to be made by the new resident, even though they

¹⁰³<http://www.architectsjournal.co.uk/news/green-deal-needs-incentives-to-make-it-work-says-industry/8653823.article>

did not sign up to the loan in the first place. And, as the loans are only expected to pay for themselves over a period of years, it is unlikely that anyone would want to take one out if they have a short- or medium-term expectation to need to move home. In addition, there are insufficient incentives for building firms to deliver the scheme, with firms calling for a reduction in VAT to address this. In fact, only 12 homes had completed the process and had energy efficiency measures installed in the first 10 months of the scheme.

These practical issues aside, there is also a fundamental problem with the Green Deal. This lies in its highly *individualised* nature, in which it typifies so much of what has happened in the UK over the past 40 years. The Green Deal considers that each one of us is responsible for the insulation of our homes, even though the benefits of preserving the natural environment accrue to us ^[130] all, and, indeed, to future generations. Rather than view investment in the energy efficiency of homes as something which needs to be funded by us all to help to preserve the planet, the Green Deal seeks to determine who will gain financially, in the relatively short term, and requires that they make the investment themselves – albeit by providing them with a loan to do so. In this way, it also reflects the thinking that lay behind the earlier shift from student grants to student loans. Grants, paid for out of general taxation, recognise that we all need to contribute to the costs of maintaining Britain's future economic competitiveness and cultural contribution in the world. Student loans, however, are based on the individual making an economic decision about whether to invest in their own future and ability to compete in the labour market – something which they may not be willing to do if the costs, and risks, are too high.

A collective response for green investment – paid through taxation or via a progressively funded system of carbon reduction targets for the energy companies – makes much more sense. This would eliminate the problems for individuals in deciding on whether they have a long-term commitment to staying in the same property and can afford the repayments, and would therefore lead to much better take-up, including amongst lower-income households which are more likely to be living in the properties in greatest need of insulation, including those in the private rented sector.

This appeared to be the route we were taking prior to the introduction of the Green Deal. Between 2008 and 2012, the carbon reduction programmes in the UK placed obligations on the energy companies to target the delivery of energy saving measures to priority households, including the elderly and those on low incomes. The programmes were successful in achieving 296 million tonnes of carbon reductions (just over 100 per cent of the target), although most of this reduction was achieved in the final year when the regulator encouraged more innovative approaches including the promotion of solid wall insulation, increased the intensity of its ^[131] monitoring activities, and set out in public how it intended to deal with non-compliance of the energy companies. However, although the scheme was successful in terms of carbon reduction, the

way that it was funded hit the poorest households the hardest. National Energy Action summed up the problem in 2010 as follows:¹⁰⁴

“The cost of these initiatives ... is recovered through charges on customer bills. This means that the funding programmes are inequitable and regressive in that those who can least afford to contribute pay the same towards the cost of the range of initiatives as the most affluent households.”

IN JANUARY 2013, the carbon reduction targets were replaced by the Green Deal and a new Energy Companies Obligation (ECO) on firms to continue to support energy savings measures, especially for households on lower incomes. However, the ECO continued to allow energy companies to recover the cost of their carbon reduction measures by placing a ‘green levy’ on household bills. According to a report in the *Guardian* in November 2013,¹⁰⁵ the largest six energy companies had levied upwards of £2 billion, whilst only conducting work to enable households to save half of that amount on their heating bills. There has subsequently been a debate about the impact of the levy on household budgets at a time when the companies are imposing inflation-busting price rises and reporting increased profit margins. Rather than bear down on these profits, the Coalition has looked to cut the amount of the ‘green levy’ by reducing the targets for insulation measures and presented this as a measure to help ‘hard working families’. In line with its continued promotion of home ownership, it has also announced that it will provide a £1,000 grant for energy efficiency measures to new home buyers. In this respect, it is clear that the Coalition has been prepared to sacrifice environmental protections in order to maintain the profits of energy companies and short-term popularity^[132] with voters. A more progressive means of paying for energy savings measures would have been to combine carbon reduction targets for the energy companies with caps on the cost of price tariffs offered to lower-income households.

As it stands, the attempt to impose social and environmental obligations without also constraining the ability of the energy firms to recoup the cost of these through their normal pricing policies has led to a greater financial burden being placed on those least able to afford it. The result has been a sharp increase in the number of households that are forced to choose between ‘heating or eating’, or alternatively that have turned to high-cost credit to fund the shortfall between income and the cost of essentials. As the *Guardian*’s Patrick Butler recently found during a visit to Liverpool:¹⁰⁶

“Food and fuel poverty is common in inner-city Liverpool, and so is debt. In fact, the two are increasingly intertwined. The cost of living pressures faced by low-income households, coupled with welfare cuts such as the bedroom tax, mean poor families are increasingly turning to payday loans to meet the cost of basics such as groceries, rent and electricity bills.”

¹⁰⁴Evidence to the Select Committee on Energy and Climate Change enquiry into Fuel Poverty.

¹⁰⁵<http://www.theguardian.com/environment/2013/nov/15/energy-firms-green-measures-big-six>

¹⁰⁶<http://www.theguardian.com/society/2013/oct/01/heat-eat-loan-liverpool>

ALTHOUGH A MAJOR PROGRAMME of investment is needed to get Britain's homes up to standard, it is possible to imagine some schemes that would help to incentivise sustainable consumption by individuals. For example, a number of credit cards currently offer 'cashback' rewards. These arise as a result of partnerships between retailers and the credit card provider to encourage people to use these to make everyday purchases or to shop in particular stores. However, they make no distinction between spending on environmentally damaging activities or on those which are likely to be of benefit. The Santander 123 credit card is a case in point. The card currently offers cashback of 3 per cent on all spending on petrol, rail transport and Oyster cards for use on London's Underground. This could easily be tweaked to incentivise rail and underground transport by increasing the cashback on these and/[133] or by removing or lowering the cashback on petrol spending. But it could also be further developed to provide cashback following purchases of environmentally friendly items, for example energy-efficient appliances. The technology to support this type of scheme is available. Both the MasterCard and Visa payment systems can currently track spending on cards and monitor the stores that customers are shopping in, although they do not, as yet, record the individual codes for the items that end up in the consumer's basket. However, if provided with these codes for certain agreed, energy-efficient, items, then the payment services systems could easily operate a cashback reward for these. Retailers would therefore simply need to design an accredited scheme and register their energy-efficient products to a central database for this to be checked by the payment systems to see if an 'environmental reward' should be credited to the consumer's account at the time of purchase.

Whether or not such a scheme ever comes to fruition, it is certainly the case that we will need to consider the impacts of consumer credit use on the environment in much more detail in future. As a simple statement of principle: if we cannot find ways to harness consumer credit to incentivise and support more sustainable lifestyles, then it would be better to place it under much more stringent controls.

The Coalition: from rhetoric to reality

ON COMING TO POWER IN 2010, the Coalition set out a Programme for Government, which correctly identified that:

"In recent years, we have seen a massive financial meltdown due to over-lending, over-borrowing, and poor regulation."

THE DOCUMENT WENT ON to commit the Coalition to rebalancing the economy, promoting responsible and sustainable banking, and providing greater assistance for people to manage their debts. As well as these general priorities, a number of specific promises [134] relating to Britain's credit markets were also included. These included giving regulators new powers to define and ban excessive interest rates on credit and store cards and to end unfair bank and financial transaction charges. However, the Programme for Government was then followed by a

review of ‘Consumer Credit and Personal Insolvency’ led by the Department for Business, Innovation and Skills which failed to deliver on either of these. Reporting in November 2011, the Department insisted that, rather than necessitating action by the regulators to ban excessive interest and unfair fee structures, the review had indicated that industry could instead be largely relied upon to clean up its own act and that:

“By working with industry we can make changes that improve things for consumers far more quickly than waiting for legislation ... we will regulate where necessary but our strong preference is to promote more responsible corporate and consumer behaviour through greater transparency, competition and by harnessing the insights of behavioural economics.”

THE SPECIFIC MEASURES introduced by industry included being more transparent to consumers concerning the charges they would face; agreeing to allocate payments to the highest interest bearing balances on credit cards first (e.g. on cash withdrawals); and providing a service to allow consumers to switch their current accounts more easily.

The reference to ‘the insights of behavioural economics’ referred, for example, to commitments given by the banks to provide text alerts to people who were close to their arranged overdraft limits to prevent them from incurring additional charges for unauthorised borrowing. In this way, it was considered that it would help people avoid the common trap of under-estimating the cumulative impact of spending on their accounts, which often leads to people incurring additional charges. Government also indicated that most problems could be addressed by encouraging the industry to make ‘enhanced transparency efforts’ by setting out the fee structures for accounts in a clearer way, thereby making it easier ^[135] for consumers to compare prices and encouraging them to switch accounts. As the Government put it:

“... all personal current account customers will receive an annual statement detailing how much they have paid for their bank account over the previous twelve months. The annual statement will act as a trigger point for consumers to stand back and consider whether they are getting good value for money from their current account and, if not, to consider switching to another provider.”

THE COALITION’S STATEMENTS have also placed considerable emphasis on the responsibility of borrowers to avoid becoming over-indebted and to use credit more wisely. In fact, this has been a continued theme in government statements concerning the extent to which households have been using consumer credit over the past 10 years. As Professor Toni Williams from the University of Kent has pointed out,¹⁰⁷ this has been part of an international effort sponsored by financial services firms and non-governmental organisations. However, the rationale for supporting financial education is not necessarily one which seeks to limit the use of credit and financial services more generally. Instead, it is about encouraging households to take more

¹⁰⁷Williams, T (2011). ‘Framing the future of financial education’. *Journal of Responsible Credit*, Vol 1. No. 3. Centre for Responsible Credit

individual responsibility for the types of outcomes that would otherwise be expected to be delivered by the welfare state:

"In 2003, the Organisation for Economic Co-operation and Development launched a 'Financial Education Project', sponsored by Prudential plc's corporate responsibility programme. This project justifies public sector action to improve consumer decision making on the basis that such action benefits financial consumers, expands the markets of financial firms, reduces the costs of regulating financial markets and remove a significant obstacle – consumer illiteracy and inertia – to privatisation of economic security against life's risks and disruptions; by these means, increased financial literacy alleviates pressure on the public purse."

[136] IN THE UK, the FSA threw itself behind the development of financial education with some gusto. It developed a National Strategy for Financial Capability in 2003 and started to implement this from 2006 onwards. Reviewing the FSA's policy documents from the time, Williams noted that its emphasis on financial education reflected a major shift in approach – away from the failure of markets to deliver fair outcomes to households, which would require regulatory intervention, and onto the failure of individuals themselves to 'navigate' through the minefield of rip-off products and predatory practices to achieve their own ambitions, and help to regulate, through the mechanism of competition, the market as a whole:

"The financially capable consumer is expected to choose more of the right financial products and fewer of the wrong ones, to develop a taste for financial planning and to eschew dependence on the state for economic security. She has the confidence to navigate markets for consumer financial services and the competence to distinguish between good products and bad ones, between reputable firms and 'lemons'. According to this theory, a population of competent and confident financial consumers should then have the power to pressurise firms to compete, to innovate and to satisfy them, not only by supplying the financial products that consumers want, but also in how firms conduct their business in retail consumer markets."

THIS FINANCIAL EDUCATION 'PROJECT' now often acts as a counterpoint to calls for improved regulation of lenders. For example, just as the full extent of the damage caused by the long credit boom was becoming apparent in October 2008, Andrew Lilico, Director of Europe Economics and former Chief Economist of the right-wing think tank, Policy Exchange, blogged on the Conservativehome website:

"... at the end of the day mustn't our policy stance include some commitment to the principle of self-reliance – at the very least for well-heeled well-educated middle class people? We can't seriously believe, as a Party, that it isn't ultimately up to borrowers, rather than lenders, to decide for themselves how much borrowing is or is not prudent? Indeed, shouldn't one of the Conservative responses to the current crisis be to ask whether [137] government intervention and regulation have not, in some way, enfeebled

personal responsibility in this area, leading to over-borrowing precisely because people (not the government) did not take enough responsibility for their own actions?"

IN THE YEARS since the economic crash, the financial education project has expanded enormously, whilst there has been precious little further direct intervention in the operation of consumer credit markets, beyond increasing levels of information to help 'savvy' customers make better choices. The national strategy is now delivered by the Money Advice Service, which had around £40 million to fund its activities to promote better financial capability in 2011/12. This included the delivery of an online 'financial health check' planning tool intended to provide users with a personalised action plan to help them achieve their financial goals in life. In addition to the work of MAS, the banks themselves are also investing directly in financial capability programmes. In the past three years, Barclays Bank has invested £15 million in its MoneySkills programme, which is intended to provide young people from disadvantaged backgrounds with help to improve their 'financial skills, knowledge and confidence'. Similarly, Lloyds Banking Group has established a £4 million 'financial capability and personal money skills programme' which is targeted at helping tutors in the Further Education, and Adult and Community Learning sector talk to their students with confidence about money management issues. Further to this, we also now have a Big Lottery programme worth £31.7 million to 'improve financial confidence' amongst social housing tenants, and, in July 2013, the Prime Minister confirmed that financial education will be included in the national curriculum from September 2014 onwards.

Whilst it is difficult to argue with the objective of helping people to acquire good financial habits such as regular saving and to encourage them to plan for the future, the concern with financial education programmes is that these are displacing the focus of attention from the extraordinarily regressive and predatory nature of [138] the financial services sector as a whole, and developing a climate in which the financial behaviours of households are seen as the main problem.

The cost-of-living crisis and a return to debt-fuelled consumption

CONTRARY TO THE STATED PRIORITIES of the Coalition to rebalance the economy and help people to manage their debts more effectively, it is clear that we are, once again, witnessing an expansion of consumer credit, with negative consequences for the economy as a whole. In the wake of the economic crash, the balance of payments crisis has deepened. In the first 12 months following the election of the Coalition Government, the trade deficit (including both goods and services) stood at around £27 billion. However, in the last 12 months for which data is available, the deficit has increased to over £31 billion¹⁰⁸ – a rise of 16 per cent. The forecast is for even worse news to

¹⁰⁸Office for National Statistics, *Trade in goods and services balance (seasonally adjusted)*. The comparison is of the 12 months from the second quarter 2010 through to the first quarter of 2011 with the same quarters in 2012 and 2013.

come. According to the European Commission, Britain is expected to post the largest deficit of any major industrial country in 2014. As was reported recently in the *Daily Telegraph*:¹⁰⁹

“With the exception of the late 1980s, Britain has not run a current account deficit of this magnitude since the Second World War. It raises concerns that the recovery is being fed by a premature return to bad habits of house price inflation and credit-driven spending rather than a revival of manufacturing and productive investment.”

THE GROWING DEFICIT is a product of three things. Firstly, we are ^[139] still heavily reliant on imported goods. Secondly, our traditional surplus from the trade in services has fallen as our over-reliance on exporting financial services has come home to roost. Financial services exports have nosedived since 2008, when they contributed around two-thirds of our overall surplus in services. Worth around £41 billion in 2008, these have now dropped by about 16 per cent.¹¹⁰ Finally, we have also witnessed a collapse in earnings on our overseas investment. This contributed a surplus of over £25 billion in 2011 but made a net contribution to the current account of little more than £1.5 billion in 2012. These desperate trade figures have caused the pound to lose around a quarter of its value against other currencies since 2008. This has forced the cost of imports up – notably in respect of food and fuel which has subsequently hit low to middle-income households hard. Real wage levels have fallen. Many households have therefore had to draw upon their savings to make up the difference, and many others have reverted to using consumer credit for this purpose. Although the economy has recently returned to growth, this has almost entirely been underpinned by further consumer credit use and household consumption. According to the Bank of England, net unsecured lending (excluding student loans) increased by 4.7 per cent in the year to October 2013.

The rising cost of imports and the increase in credit use are both inflationary pressures within the economy. As in the case of the Thatcher administrations, the response of the Coalition is to bear down on these through the introduction of savage cuts to public spending. In his Autumn Statement, delivered in December 2013, the Chancellor, George Osborne, set out his plan to reduce the size of government spending to its lowest level since 1948. Larry Elliott in the *Guardian* reported that the coalition has already cut spending on public services by 8 per cent but now intends, by 2018/19, for this cut to go as deep as 20 per cent. He rightly accuses the ^[140] Government’s actual economic policy of being a million miles from its rhetoric:¹¹¹

“Osborne says Labour lost control of public spending. He wants a ‘government that lives within its means, in a country that pays its way in the world’. His way of ensuring the books balance involves pouring money into property speculation rather than

¹⁰⁹<http://www.telegraph.co.uk/finance/economics/10427783/Britain-to-have-worst-2014-trade-deficit-in-industrial-world-on-EU-forecasts.html>

¹¹⁰<http://www.ft.com/cms/s/2/a10a649a-098f-11e3-ad07-00144feabdc0.html#axzz2n5qcAHBN>

¹¹¹Elliott, L. (9/12/2013). ‘The Chancellor’s policy: more poverty, worse public services’. *The Guardian*.

productive investment, and by locking the UK into a low-productivity, low-investment, low-wage economy in which poverty rises and public services deteriorate.”

ALTHOUGH ELLIOTT BALANCES the conclusion of his article by pointing out that the electorate is yet to be convinced that Labour has a better economic plan, it is clear that many commentators are simply playing party politics when explaining the economic decline of Britain. The reality is far more complex, and the similar roles of successive Conservative and Labour governments in supporting an expansion of credit use have been greatly overlooked. The repeated cycles of credit boom and bust from 1973 onwards have underpinned an economic decline and rise in wealth inequalities which will now be tremendously difficult to reverse. Concepts of individual rather than collective responsibility have also now been deeply embedded within British society. These have provided the ground for yet more austerity measures, as ‘hard working families’ are pitted against ‘scroungers’. As this and the preceding chapter have demonstrated, the inter-relationship between weakened state provision and the expansion of credit must also now be recognised. Reducing the role of the welfare state in the past has only served to make households even more reliant on financial services. This is not the way forward now. The dominant role of the financial services industry in the UK economy, with its predatory and regressive nature, must be addressed, and soon.

Chapter 5: The crisis for low-income households

[141] THE PERSONAL DEBT CRISIS is hitting low-income households the hardest. Wages have failed to keep pace with rising fuel, food and transport costs, and austerity measures, including both public spending cuts and welfare reforms, are taking the most from those that can least afford it. We are definitely not ‘all in this together’. In fact, for the high-cost lenders – comprising door-to-door (or ‘home credit’) moneylenders, rent-to-own (RTO) stores such as Brighthouse, pawnbrokers, and payday lenders – this has been a boom time.

Payday lending has grown particularly rapidly. According to the OFT, the payday market was worth approximately £2.2 billion in 2011/12, up from an estimated £900 million in 2008/09. The number of people becoming trapped in a spiral of repeat credit use has grown as the sector has expanded. In a recent review, the OFT found that lenders are failing to properly assess whether borrowers can afford to repay the loan on time and are earning a large part of their revenue by then ‘rolling over’ or refinancing loans. In the long term, the repayments on high-cost credit only serve to make it more difficult for low-income households to pay for essential services and maintain a reasonable living standard. Many become ‘credit dependent’ and borrow ever-larger sums of money [142] simply to pay off previous loans and release a little spare cash to cover basic living costs. Ultimately, this cycle of borrowing cannot be sustained, but by the time the borrowers finally default, the lenders have made a tidy profit.

This chapter looks at how improvements in high-cost credit regulation should be taken forward, including why we need to cap the total cost of credit in more than just the payday lending market and place requirements on banks to re-engage with low-income households and communities to support the expansion of more affordable and sustainable alternatives. It also looks at what more we can do at the local level to improve welfare provision and provide help for those in poverty. In doing so, the chapter draws on my own experience of campaigning on these issues for a period of 15 years – initially through the formation of the Debt on our Doorstep campaign and later through the work of the Centre for Responsible Credit.

Debt on our Doorstep

I BECAME HEAVILY INVOLVED in dealing with the debts of low-income households after 1997, when I moved jobs from the Citizens Advice Bureau (CAB) in Warwickshire to take up a position as the manager of a debt advice service for Redditch Borough Council in the West Midlands. Most of my CAB work had involved advising people who were experiencing short-term and occasional periods of unemployment and who, when they were working, had access to ‘mainstream’ credit markets – including mortgages, personal loans from the banks, and credit cards. Whilst losing their jobs made it difficult to maintain payments, there was still a good chance that once back in work they could recover financially and start to pay down their debts. In contrast, the new job entailed receiving referrals from local authority housing officers and staff in the Council Tax

recovery section. I was now predominantly dealing with council tenants, some of whom had been out of work ^[143] for long periods of time. However, the majority of tenants had been working at some point. In fact, they frequently moved in and out of low-paid employment, creating havoc with their claims for benefit and household finances. These groups had rarely been able to access mainstream credit markets but were nevertheless over-indebted. In most cases, their lines of credit came from high-cost moneylenders who called at the doorstep every week to collect repayments and sell new loans. However, other forms of credit were also reasonably common, including debts to the high street RTO stores that sold washing machines, other electrical items, and furniture on hire purchase. Making repayments to these lenders often left people struggling to afford other essentials, including rent, fuel and council tax.

Towards the end of 1999, I was invited to meet a group of lone parents to talk about their experiences. The group relayed to me how the moneylenders – chief amongst which was the company Provident Financial – sent their agents around the housing estates offering shopping vouchers for a couple of hundred pounds on credit terms in the run-up to Christmas. The agents often promoted these as a means of buying presents for the children. Although the interest was high, the repayments would be quite low because these were spread over 26 weeks. Many members of the group said they found it difficult to turn these loans down because they felt guilty about not being able to provide their children with a ‘proper Christmas’. However, they also felt they had fallen into a debt trap. Having taken a voucher on credit, they would then have an agent calling every week at their home to collect the repayments. On these visits the agent would actively promote further borrowing. These additional loans would cost as much as £65 for every £100 that was borrowed and, because the agents were paid on commission according to how much they collected, there was an incentive for them to encourage people to take out loans for higher and higher amounts. Having customers who were repaying £10 or £15 or more each time they called was clearly better for them ^[144] than collecting just £5 per week, as was typically the case with the initial voucher loans.

In fact, the introductory offer of shopping vouchers on credit was just a method of getting around the law. The Consumer Credit Act 1974 prohibits cold-calling at someone’s home with the intention of persuading them to enter into a credit agreement. But it allows people to call if they are offering goods or services (for example, double glazing) and the credit is then sold as an ancillary means of funding the purchase of these. So the moneylenders cold-call in the first instance by offering shopping vouchers rather than cash loans. The agreement for the shopping voucher loan would then contain clauses to allow the repayments to be collected from the doorstep and would sign the customer up to receive further offers of cash loans.

Because the agents were paid on commission by what they collected, they were never keen to see a loan fully repaid as this could possibly lead to them losing a customer. They therefore encouraged customers to take out loans to pay off previous borrowing, which extended the term of the loans and the length of time that they were in debt. Whilst some of the new loan would be

released in cash, much of it would stay with the company – paying off the outstanding interest on the last loan and ratcheting up the level of debt and the amount of the weekly repayment. Pretty soon the borrower was in deep, paying out a high proportion of their weekly income to the agents. This inevitably left them short and unable to pay household bills or, in some cases, feed and clothe themselves and their children properly. Many of the lone parents I met had missed meals to ensure their children did not go hungry. Many also had prepayment meters fitted to collect arrears that had been run up on their gas and electricity bills. The tariffs on these were often expensive, which sometimes left them unable to ‘feed the meter’. In winter, this meant their homes were often cold for long periods of time – something which affected both their mental and physical health.

[145] The group also told me how many of them lurched from one financial crisis to another, and when the Council chased the payment of rent or council tax, they would turn to the moneylenders for even more credit to pay these off. It was a vicious circle from which many of them struggled to escape, causing an exceptional level of stress and, ultimately, making it harder for them to do the things necessary to improve their lives in the longer term. Although many of the people I met spoke of their desire to undertake training and move into work, the experience of being in debt to the moneylenders was debilitating and eroded their confidence to take positive steps towards this.¹¹²

The ‘revolving’ of loans was one problem. But the cost was also a major issue. Although the weekly repayments might start off low, the interest rates were high. I found it remarkable that Provident Financial was charging £65 for every £100 it was lending, when mainstream consumer credit was so cheap. The cost of borrowing a couple of hundred pounds on an overdraft from a high street bank and repaying this over the course of a year would typically be less than £15. The poorest were paying over four times more than those on higher incomes for their credit. All other things being equal, this can only lead to greater wealth inequality.

The experience of listening to that group of lone parents in Redditch made me want to raise the profile of the issue. Until this point, most media coverage of debt issues was firmly focused on the mainstream markets. Personal finance columns in the newspapers [146] at the time were predominantly concerned with ‘best buys’ for mortgages, credit cards, and personal loans from the banks. There was virtually nothing about the credit conditions faced by poorer working-class households.

I started work in Redditch in May 1997, the month which had also seen the election of a Labour Government led by Tony Blair. In March 1999, the Prime Minister had made a commitment to

¹¹²Subsequent qualitative research conducted with unemployed people in Greater Manchester has confirmed that money and debt problems negatively impact on jobseeking behaviour by distracting them from seeking jobs as well as constraining their ability to undertake jobsearch activities effectively, for example because lack of money prevents travel to training or interview. Being in debt also means that people are unsure as to whether they will be financially better off after taking a job because creditors will seek higher levels of repayment. See Gibbons, D. (2010). ‘Out of Work and Out of Money’: Manchester City Council.

eradicate child poverty by 2020.¹¹³ I therefore thought there was a good chance that the Government would want to address the problem of high-cost moneylending. By this point in time, I had also started to take an active role in the national trade association for debt advisers – the Money Advice Association – and was asked to operate, on a voluntary basis, as their press officer. Following my meeting with the group of lone parents, I suggested to the Association that we begin a media campaign to highlight the problems caused by high-cost moneylending.

This was not without its difficulties. There is a lot of stigma about debt. People do not generally want to talk about their debts to the media, feeling ashamed and personally responsible for any of the financial difficulties that they face. Being in debt can be an isolating experience. Yet the media often wants to present ‘case studies’ or human stories alongside any general research findings and calls for the Government to act. It took some time to find people that would be willing to appear in the media to talk about their experiences. Nevertheless, we managed to find some borrowers who were willing to participate in the campaign and issued a media release highlighting the problem in the run-up to Christmas of 1999.

As part of the campaign, we decided to call for Government to cap the cost of credit on doorstep loans. This was a controversial move, and not all debt advisers in the Association were comfortable with it at the time, fearing that a cap on credit costs would make moneylending unprofitable and so lead to people having no means of obtaining small sums of credit in the future. For some in the [147] Association there was a concern that this would mean that people would turn to illegal money lenders – an argument which the lenders also used to avoid the regulation of their prices.

We also faced the difficulty that Provident Financial was at that time a sponsor of the Money Advice Association, providing funding to support the Association’s training programme for new advisers. The Association was itself in some financial difficulty, having previously taken on an expensive and long-term lease on premises in Holborn in London but having subsequently suffered from a reduction in funding. There was a clear risk that the campaign would lead to the loss of funding from Provident, which would compound the Association’s problems. Nevertheless, the Chair of the Association – a deeply committed adviser called Mark Mansfield who was at that time working for Newcastle City Council – was prepared to back the campaign and deal with the fallout as it happened. The press release went out and received a lot of coverage, including on the main BBC television news and radio broadcasts.

The repercussions were immediate. Provident Financial wrote to the Association demanding an apology and intimating that it would withdraw its funding unless they were provided with advance notice of all future press releases. A short time later, the National Executive members of the Association were invited to Provident’s headquarters in Bradford where senior management told us of their concern for the future of our ‘relationship’ with the company. There followed a split on

¹¹³http://news.bbc.co.uk/1/hi/uk_politics/298745.stm

the Association's Executive with a number of us arguing that we could not be held to ransom by the credit industry and that it was a core part of our role to raise policy issues and call on Government and the regulators to intervene. Others at the time felt that the Association should not engage in public policy work but should focus more on the 'professionalisation' of the industry, by providing training programmes and written materials to help advisers do their job with individuals more effectively.

But the media coverage we had received on the issue proved that there was a wider world in which debt advisers needed to operate. ^[148] Messages of support had come in from churches, trades unions, lone parent groups, local authorities, and many other civil society groups. Niall Cooper, the Director of Church Action on Poverty, and his campaigns officer, Alan Thornton, were particularly supportive. In parallel to the work of the Money Advice Association, they had been running projects on local estates to assess the damage being done by high-cost money lenders and, shocked by what they had found, were keen to bring the experiences of borrowers to the attention of policy makers. Niall and I therefore decided to join forces and to launch a new campaign, which, although supported in name by the Money Advice Association, would be independent from it. The name we came up with in early 2000 was 'Debt on our Doorstep'. ¹¹⁴ With a grant of just £5,000 from Oxfam, we set about building the Debt on our Doorstep network and developing our policy positions and campaign materials.

An early example of the methods we used was a survey of residents living on the Meadow Well estate in North Shields. The estate, which was extremely deprived, hit the headlines in 1991 when the deaths of two local youths during a police car chase had sparked a riot. In the years following this, the estate had been provided with regeneration funding to improve conditions, and we had been contacted by a local resident, Margaret Nolan, who had been trying to offer, through ACE Credit Union, a practical, affordable alternative to high-cost lenders for people on the estate. We designed a basic questionnaire which was then used by Margaret and local volunteers from the estate, who went door-to-door asking people about the extent of their debts with Provident, Shoppacheck, and the other moneylenders that were operating there. The results were astounding. The moneylenders were collecting more ^[149] than £10,000 each week from the 180 households in our sample. This was an average of £55 per week from people whose average income was found to be just £200 per week. Given the high rates charged by moneylenders, half of the total being collected related to interest payments alone. If the 180 households surveyed were representative of the estate (and there was no reason to suggest that they were not), then as much as £2.7 million in interest was being taken out of the estate each year – a higher amount than was being invested at that time by Government in the regeneration of the area. As part of the media coverage for the survey, the BBC's 'Working Lunch' programme managed to talk to a former agent for one of the moneylenders working on the estate, reporting that she had been 'put

¹¹⁴The name Debt on our Doorstep referred both to the fact that moneylenders called at the home to collect repayments and also to the Jubilee 2000 campaign, which at the time was calling for action to write off the debts of developing countries. In this respect, we were trying to focus attention on the contribution of debt to poverty levels in the UK.

under pressure' by her employer to keep people borrowing and increase the amount of loans to maximise profits.¹¹⁵

We also started to research the experience of other countries to inform our policy proposals, finding that both Germany and France had caps on the cost of credit and did not appear to suffer from the same types of high-cost lending that we have in the UK. We were extremely fortunate to receive advice from Professor Udo Reifner at the University of Hamburg concerning the operation of interest rate ceilings in Europe, who responded to an e-mail sent to him one Sunday evening after I had come across his work on the Internet. Through Udo we were put in touch with a wide network of academics and campaigners across Europe, and this was eventually to result in the foundation of the European Coalition for Responsible Credit at a conference in Brussels in 2005.

Although primarily in touch with colleagues in Europe, Debt on our Doorstep's programme was also developed with the input of John Taylor, Maryellen Lewis, and their colleagues in the US National Community Reinvestment Coalition – a not-for-profit organisation dedicated to helping local communities take [150] advantage of the Community Reinvestment Act. This was a piece of legislation originally enacted in the US in 1977, but boosted by changes made by the Clinton administration, which required banks to demonstrate how they were helping to meet the needs of low-income communities. The Act had subsequently resulted in significant flows of capital from banks into local projects which provided affordable mortgages and loans to people in working-class neighbourhoods.

Back in 2000, and mainly on the advice of Udo and John, Debt on our Doorstep therefore adopted the twin aims of achieving *both* the capping of credit costs and the imposition of requirements on banks to better meet the needs of poorer communities. Reflecting our over-optimism in Government at the time, we set ourselves a target of just one year to achieve both of our aims.

Debt on our Doorstep quickly attracted the support of hundreds of credit unions, community groups, churches, housing associations, local authorities, trades unions, and debt advice agencies. It grew from the lived experience of people using high-cost credit. They told us that something needed to be done, but the question arose as to why the existing law was not protecting them and why affordable alternatives were not available. As well as looking at potential solutions from abroad, we therefore looked at how our own law was operating and at what other alternatives existed.

The Moneylenders Act of 1927 had previously provided that the courts should consider an interest rate of 48 per cent or more to be excessive and gave them the power to rule in those instances that the debt could not be recovered from the borrower. However, this had been replaced in 1974 by the Consumer Credit Act, which gave the courts greater discretion – supposedly so that they could consider interest rates of less than 48 per cent to be excessive if the particular circumstances of the case warranted this. However, when we looked at how this

¹¹⁵http://news.bbc.co.uk/1/hi/programmes/working_lunch/2959524.stm

law was operating, we found that very few cases had been brought. People on low incomes are reluctant to take court action against their lenders for two main ^[151] reasons. Firstly, they are generally unfamiliar with, and intimidated by, legal proceedings and would not want to start a process which could lead to them having to pay legal costs should they lose. Secondly, given their frequent problems in making ends meet, they are also unlikely to want to forego their only line of credit – no matter how expensive it may be. These two factors seriously limit the effectiveness of any court-based system designed to protect low-income consumers.

We also found that the provisions under the 1974 Act were not effective even when cases had been brought to court. Before help could be provided to the debtor, the 1974 Act required judges to determine that, given the particular circumstances of the case, an agreement was 'extortionate'. This included making a finding that the interest rate was 'grossly exorbitant'. However, this term was not defined, and judges were reluctant to intervene if the cost of the loan had been made clear to the borrower at the time. In effect, the courts appeared to be saying that if the borrower knew what they were getting into, then the contract was fair and the lender was entitled to whatever rate of interest they could get away with charging.

We felt that this focus on transparency of terms and conditions missed the fundamental point that borrowers, in a desperate financial position, were being exploited. Of course, they knew the terms and conditions – it was just that they felt they had precious little choice but to take out credit to make ends meet. For us, it wasn't a question of transparency, but of concern for the social outcomes that arose from those contracts. To our mind, regulation had to balance the notion of freedom to contract between two parties with a concern for the wider impacts of those loan agreements on our communities. We therefore considered that it was in the broader public interest for the OFT to cap prices and introduce other restrictions, including placing sensible limits on the number of times that loans could be rolled over, or on the level of the repayments relative to the borrower's income.

^[152] As well as campaigning for greater responsibility in lending practice, we also recognised the need for people to be provided with an alternative to the high-cost lenders. At the time, people in receipt of income-related benefits could apply for help from the Social Fund, which provided interest-free 'budgeting' and 'crisis' loans, and 'Community Care Grants'. The Social Fund was supposed to help people in urgent need to pay for food or fuel, or to obtain essential household items such as cookers, beds, and basic furnishings. However, the repayments for budgeting and crisis loans, which were deducted directly from benefits, were often quite high because of the short length of these loans. Even though they were interest-free, they were often seen as less attractive than a loan from a moneylender because the weekly repayments were higher. Further to this, the criteria to obtain grants was restrictive, with people generally having to prove that they were under 'exceptional pressure'; needed a grant because they had recently moved out of some form of institutional care; or were at risk of going into care if the grant was not provided. In

addition, the process of applying was bureaucratic and the outcome uncertain – neither of which are attractive features to someone who needs urgent help.

The banks and mainstream credit lenders were also failing to provide a real alternative to the moneylenders. As Chapter 4 has detailed, their ‘flight to quality’ in the 1990s left many lower-income households high and dry and was a clear factor contributing to the growth of the high-cost credit sector. Even where ‘sub-prime’ products such as credit cards were available to households, these could also be very expensive if people took a long time to pay down their balances or missed payments and incurred additional charges. Many low-income households had also found the process of managing a bank account (for example, when they moved into work and required one to receive their wages) dispiriting and a source of debt problems due to the fees charged by banks for bounced direct debits or for exceeding overdraft limits.

Credit unions and CDFIs

[153] POSSIBLE ALTERNATIVES DID exist in the form of local credit unions and Community Development Finance Institutions (CDFIs). Credit unions, which are owned by their members, grew out of the 19th century co-operative movement to provide a vehicle for lower-income households to save and borrow on affordable terms. Credit union membership represents a significant proportion of the population in many other countries including the US, Canada, Australia, and the Republic of Ireland. However, membership here has remained very small. Reviewing the position in 2005,¹¹⁶ we found that there were around 400 credit unions but that their combined membership in England stood at just 350,000 – an average of less than 1,000. This compared to the 1.5 million customers of the single largest moneylending firm, Provident Financial, and was dwarfed by the scale of the high-cost credit market as a whole. Part of the reason for this was that credit unions were constrained by a very tight cap on the interest rates that they could charge. This was originally set by the 1979 law which governs them at 12.68 per cent APR: just 1 per cent per month. This cap made it very difficult for credit unions to tolerate anything other than exceptionally low default rates, and, as a result, they have historically been very cautious lenders. Indeed, in 2005, credit unions often required people to build up savings with them before they would make loans – something which people trapped in a cycle of borrowing from high-cost lenders could often not afford to do. In addition, credit unions could only accept members that had a ‘common bond’ – for example because they lived in the same local area or worked in the same occupation. Most of these common bond areas were very small (limited to specific wards or estates rather than city-wide), although a number of the occupational credit unions were national and had significantly larger memberships as a result.

[154] In 2005, it was also clear that the movement had lacked any significant financial investment. In many cases, local unions were operating from poor quality premises and without any effective information technology. In fact, they were often reliant upon volunteers to provide any sort of

¹¹⁶Cooper, N. & Rossiter, J. (2005). *Scaling Up for Financial Inclusion*. Debt on our Doorstep.

service at all. Whilst the dedication of these volunteers was without question, and some of the most committed opponents of high-cost lending were to be found amongst their number, there was simply no way that the movement could compete with the multi-billion-pound moneylending sector.

The presence of the very low interest rate cap on credit unions forced people to look at other possible vehicles for lending to people on low incomes, and at Community Development Finance Institutions in particular. CDFIs are governed by a different legal framework from credit unions. This means that they cannot take savings, but they can receive investments (including, for example, from central government and local authorities) to lend this on, and there is no cap on the interest rate that they can charge when doing this. In 1999, the Government established a 'Phoenix Fund' which by the summer of 2004 had provided £20 million of funding for CDFIs to lend onto small businesses in deprived communities due to the widely reported problems that these experienced in obtaining loans from the mainstream banking sector. Although initially focused on small business lending, the sector therefore provided a possible means of making loans to households at rates which, although above the credit union cap, were still more affordable than the loans being provided by the doorstep moneylenders. However, this provision also then needed to be knitted together with other services to allow people on low incomes to gain access to the savings, banking and insurance products that they also needed alongside loans. The fact that there are different legal frameworks for credit unions and CDFIs has made it harder to provide the joined-up services that people on low incomes need.

Although we considered that credit unions and CDFIs held the potential means to deliver more affordable financial services to [155] low-income households, there was no overarching strategy to guide their development and get them to the scale required. In 2005, we therefore called for a national Financial Inclusion Agency to be established by Government and for this to develop a strategy capable of transforming credit unions and CDFIs into a force capable of providing a real challenge to the high-cost lenders. We considered that such an agency could use the prospect of match funding from local authorities and Government regeneration funds to lever in financial contributions from banks and support a major up-scaling. Regrettably, successive Governments ignored this call and have instead pursued a piecemeal approach to the development of the sector, periodically announcing limited funding programmes and carrying through some elements of legislative reform, including the incremental raising of the interest rate cap on credit unions – although this currently stands at just over 26 per cent and still significantly constrains their ability to provide a more affordable alternative to payday lending. Whilst these funds and measures have been welcomed by the sector, they have clearly proved woefully inadequate to get the movement to the scale of operation required.

This is not to say that credit union membership and CDFI provision has not improved. There are now just below 1 million credit union members in Britain, and, due to a programme of mergers and the extension of common bond areas, particularly in the larger cities, a number of credit

unions have got much stronger. This is a considerable improvement on the situation in 2005. However, the level of growth is overshadowed by that witnessed in the high-cost lending sector as more and more people have fallen out of the financial mainstream. Provident Financial now has in excess of 1.8 million customers taking loans from the doorstep and it has a further 900,000 using its high-cost credit card product provided under the Vanquis Bank brand. In addition, the RTO stores, pawnbrokers, and payday lenders have also expanded rapidly in the period. The simple fact is that, without a much more radical approach, our ^[156] credit unions and CDFIs will never be able to compete with the legal loan sharks.

Stopping the exploitation of low-income households

THE DEBT ON OUR DOORSTEP CAMPAIGN ran under that name for approximately 10 years. It was followed for a brief period by the Better Banking campaign and most recently by the Stop Legal Loan Sharks campaign, which is pursuing better regulation of the high-cost sector under the leadership of Stella Creasy MP, and by the Community Investment Coalition, which is calling for banks to make a bigger contribution to affordable provision in low-income communities. Particularly in the first decade of the campaign, we received little direct financial support and much of the work was done by people offering their expertise and time on a voluntary basis. My own work for Debt on our Doorstep was always done alongside my day jobs, firstly in Redditch and later as the Head of Advice and Economic Development for Leicester City Council. Despite having had little in the way of financial resources, we nevertheless proved to be a committed and effective group, maintaining the issue of the exploitation of low-income borrowers on the policy agenda, including by provoking the need for inquiries and reviews into the operation of high-cost credit markets and lending practice and by securing changes to legislation. The remainder of this chapter now sets out the main milestones and lessons from the campaign over the past 10 years and, drawing on this experience, concludes with recommendations for further action.

The Competition Commission inquiry into doorstep moneylending

^[157] IN 2003, DEBT ON OUR DOORSTEP published a discussion paper¹¹⁷ pointing out that low-income households were being exploited because of their, often desperate, need for cash and that the moneylending firms therefore did not need to compete on price, but only on the speed at which they could provide loans. The paper called for the OFT and the Competition Commission to intervene. The call was taken up by the National Consumer Council later in the year which led, in June 2004, to a 'super-complaint' being submitted to the OFT. This subsequently resulted in a full-blown Competition Commission inquiry started in September of that year. The inquiry took two years to complete but eventually found in our favour, concluding that the prices charged by moneylenders were higher than they needed to be and, indeed, would be in a properly functioning, competitive market. After much wrangling with the lenders, the Commission

¹¹⁷Gibbons, D. (2003). *Capping prices in the home credit market*. Debt on our Doorstep.

estimated that the lack of effective price competition was costing low-income borrowers *at least* £75 million per year.¹¹⁸ In the six years since we had started our campaign through to the Commission's final report, over half a billion pounds had been taken from our poorest communities because of the exploitative pricing of loans.

But what could be done to fix the problem? Whilst the general findings of the Competition Commission were a vindication of our campaign, the 'remedies' that it subsequently implemented were disappointing. At the time of its report in 2006, the mainstream consumer credit markets were booming, and it felt that there was a reasonable prospect of helping people on lower incomes move from the high-cost sector towards the cheaper forms of credit that [158] these offered. It therefore identified a need for low-income borrowers to be able to build up their credit records through the use of high-cost loans so that 'good payers' to the moneylenders could be identified and offered more mainstream types of credit. However, at the time of the inquiry, it was apparent that moneylenders did not share information about the repayment records of their customers through the credit reference agencies. The Commission therefore proposed that a 'data sharing remedy' be put in place – forcing any moneylender of a reasonable size to report this information. Not only did the Commission believe that this would make it easier for borrowers to gain access to more mainstream forms of credit, but it also hoped that new moneylending companies would be able to access this information, making it easier for these to enter the market and compete on price terms with existing firms. The theory was that new firms, armed with better knowledge of the repayment records of their potential customer base, would have fewer risks of default than previously and so would be able to enter the market with greater confidence about their ability to make profits. It was then hoped that these firms would improve levels of competition and drive down prices.

Whilst we supported the data sharing remedy in principle, it relied on both an effective means of sharing information about the repayment histories of low-income consumers being put in place, and on mainstream lenders, which did not collect payments from the doorstep, accepting 'good payers' with the moneylenders as customers that they would want to have. Neither of these has happened.¹¹⁹ Firstly, the way in which data was shared was inadequate to enable 'good payers' to be separated out from those that missed repayments on a regular basis. Credit reference agencies were established to report on mainstream types of lending, which [159] are repayable on a monthly basis. But moneylenders collect weekly repayments. To report their customer repayment history, the moneylenders therefore had to aggregate four weekly repayments into one monthly report. However, the Commission agreed that loans from the moneylenders should only be reported as in arrears if all four weekly repayments in any one month had been missed. In large part this was because some missed payments in the month could be due to a failure of

¹¹⁸The original Competition Commission estimate was that excessive prices were costing consumers around £150 million per year.

¹¹⁹For a more detailed assessment of the limitations of data sharing as a means of benefitting low-income borrowers, see Gibbons, D. (2012). *Does increased data sharing really benefit low income consumers?* Centre for Responsible Credit.

the agent to turn up and collect them. The result of the 'data sharing protocol' that has been put in place is that a borrower can miss up to three weekly repayments in any one month and still be reported as up-to-date. This affects the credibility of reports from moneylenders in the eyes of more mainstream lenders. Secondly, even a good repayment history, properly reported, with a moneylender is unlikely to be predictive of the ability of borrowers to maintain payments on a more mainstream type of agreement. This is because the collection process used by moneylenders is intensive. They call on the doorstep for their money every week. In contrast, mainstream lenders require the borrower to ensure there is sufficient money in a bank account once per month to cover their repayments. As a result, a good repayment record with a moneylender is unlikely to be viewed as sufficient to warrant access to more mainstream lending.

We also had little faith in most of the other remedies brought in by the Commission. These focused on greater transparency, such as providing borrowers with more regular statements about the cost of their borrowing and the creation of a website, Lenders Compared, which was expected to encourage them to look up the different costs being charged by firms in the hope that they would then seek out those with slightly lower charges and switch to these. In our view, these 'remedies' were based on the Commission's ideological belief that more information leads to greater price competition. The remedies flew in the face of everything we knew about the desperate financial position of borrowers driving their willingness to take loans at virtually any price.

[160] One of the Commission's remedies did, however, appear to offer some hope. This involved providing borrowers with a rebate on the interest they were charged when a loan was rolled over or refinanced. The Competition Commission identified that repeat loans and rollovers are much cheaper for lenders to make than the initial loan to a new customer. A lot of the initial cost of making small loans is taken up by insuring against fraud – checking out that the borrower is who they say they are – and, because they are new borrowers, the lender knows very little about them, so there is a higher risk of default. But once the relationship has been established, these costs fall dramatically. Yet there was no reduction in the cost of credit being charged for the second, and indeed many, subsequent loans. The Commission sought to address this directly by requiring that the amount of interest repayable on the first loan be reduced if a second loan was taken out to pay this off. According to a recent evaluation¹²⁰ of the Commission's package of remedies, this is the only measure which has had any concrete impact on borrowers – reputedly benefitting them by around £35 million per year.

This appeared to have been a major success for the campaign, although even on the Commission's best estimate it addresses less than half of the annual value of the consumer detriment it identified during the inquiry. However, without a cap on the overall cost of credit (which the Commission rejected as a remedy) the lenders appear to have taken steps to recover

¹²⁰Competition Commission (2013). *Understanding past market investigation remedies: home credit*.

the loss of revenue from rollover loans by putting up prices. Provident Financial, which now has around 70 per cent of the market, has raised its prices from £65 to £82 per £100 loaned since the Commission's remedies were put in place. And, of course, there was no attempt to make Provident or any of the other moneylending companies pay back the excessive interest that they had charged since the start of the two-year-long inquiry, despite us arguing that the firms should be subject to a ^[161] 'windfall' tax to take back £150 million of profits and use this to fund credit unions and more affordable alternatives.

The Consumer Credit Act 2006 and the OFT's Irresponsible Lending Guidance

WITH HINDSIGHT, THE COMPETITION COMMISSION INQUIRY can only be considered a time-consuming failure. It failed to deliver justice to low-income borrowers. But it did serve a useful political purpose for the Government, which was able to refer to the existence of the inquiry as a reason for sitting on its hands in respect of legislating for a cap on credit charges.

In December 2003, the Department of Trade and Industry announced a review of consumer credit legislation on the basis that the 30-year-old Consumer Credit Act 1974 needed to be modernised. In doing so, the main aims of the Government were expressed as encouraging 'innovation and competition' whilst also providing 'appropriate protection' for consumers.

In her foreword to the White Paper setting out the Department's proposals, the then Secretary of State, Patricia Hewitt, noted:

"It is simply not possible to escape from poverty if what little you have is asset-stripped by predatory lenders. And this White Paper sets out tough measures to police and crack down on loan-sharks and other such rogue lenders."

ALTHOUGH THE GOVERNMENT RECOGNISED that the provisions of the 1974 Act concerning 'extortionate' credit agreements had been ineffective, they rejected calls for a cap on credit costs, with a section in the White Paper noting:

"The Government is not yet persuaded that the introduction of interest rate ceilings for the UK is the right approach to provide protection from excessive credit costs."

IN THIS RESPECT, the Government set out a number of concerns, ^[162] including possible evasion tactics by lenders, and that people may end up being denied access to credit and would resort to using illegal loan sharks. Nevertheless, it promised that it would undertake further research into the experience of credit caps in other countries, and that it would bear in mind the outcomes from the super-complaint about door-to-door moneylenders that had at that time been submitted by the National Consumer Council.

Pending the outcome of the research and the super-complaint, the DTI also proposed amendments to the grounds on which the courts could intervene to help borrowers. The White

Paper proposed replacing the requirement that the courts find an agreement to be 'extortionate' with an 'unfair credit relationship' test. As well as being able to take the cost of the loan into account, this would also allow the courts to reopen agreements if these had been entered into without a proper assessment of whether the borrower could afford to repay.

The Government also proposed to put in place a Financial Ombudsman service, which offered a less formal and cheaper means for consumers to make complaints about their lenders and obtain compensation. Whilst this went some way to addressing the barriers of going to court, it did not address the underlying problem of low-income borrowers largely being unwilling to complain or take direct action against their moneylenders.

Finally, the review also opened up the possibility of placing conditions on the licences of consumer credit lenders. The 1974 Act required all lenders to be licensed by the Office of Fair Trading, but a lender had only to demonstrate that they were a 'fit and proper person' and pay a small fee to become eligible to trade. There were no specific requirements that lenders then conduct themselves responsibly – for example, in terms of ensuring that people did not become trapped in a cycle of continuous borrowing as a result of the cost of the agreement or because of a failure to properly assess whether a borrower could realistically afford to take on credit.

DTI research into the impact of interest rate caps in other countries

[163] IN THE EVENT, the promised DTI research was to prove another disappointment. In fact, following meetings with officials in the Department throughout 2003 and 2004, it had become clear to us that they were implacably opposed to the idea of capping prices. The DTI's research was commissioned from a small consultancy called Policis, and the report delivered in the autumn of 2004. Its main conclusion was that the caps on credit costs that were present in Germany, France, and in a number of US states resulted in low-income households finding it harder to access small sums of credit. In particular, they pointed to the fact that high-cost, sub-prime forms of credit were not available in either Germany or France, and the report argued that the development of these forms of lending in the UK provided low-income households with access to credit, which Policis considered was actually beneficial to them. Further to this, Policis argued that putting in place a cap on interest rates in the UK would cause low-income households to become excluded from credit and result in more people turning to illegal loan sharks.

Although the findings of the Policis report were accepted by the DTI at the time, they have subsequently been critiqued and the research methods heavily criticised. This was particularly the case in Germany, where the findings were met with nothing short of astonishment. In October

2004, Professor Udo Reifner wrote to colleagues in the International Association of Consumer Lawyers and to the DTI itself to express his misgivings about the research:¹²¹

“All of the empirical evidence available [to us] shows that societies with any form of usury ceilings or other forms of interest rate regulations which prevent exorbitant pricing in this area have very low exclusion rates while [164] countries with no, or at least no effective, limits like the UK and the USA have enormous problems in providing access to financial services.”

CENTRAL TO REIFNER’S CRITIQUE was the fact that Policis had misunderstood the basics of the German and French approaches to regulation, which provided for their banks to have a monopoly over the advancing of consumer credit. The vast majority of consumer credit in both countries was therefore provided in the form of overdrafts, which were widely available. Yet Policis claimed that it was the price caps that were in place in France and Germany which had prevented the development of sub-prime markets and was resulting in lower-income households struggling to obtain credit. They had simply not understood that the French and German banks had been granted a privileged position and that it was this, and not the presence of caps on cost, which had prevented the development of sub-prime consumer credit markets in those countries. Further to this, because of the absence of a cap in the UK, Policis argued that the development of sub-prime markets in the UK was positive for consumers because these were becoming “... increasingly diverse and competitive, exerting downward pressure on price.” In fact, no real evidence was provided by Policis that the development of high-cost lending in the UK was beneficial to consumers, especially as much of the lending was simply being used to roll over previous borrowing and trap people in debt. Neither did Policis provide any convincing evidence to support the claim that prices were coming down.

Perhaps most importantly, however, the Policis report attempted to make a general case against price caps without properly considering the importance of the *level* at which caps are set or why, in credit markets, a cap could be used to ensure more responsible lending practice. The Policis report argued that using price caps would inevitably lead to a restriction in credit supply and implied that this would inevitably be a ‘bad thing’.

Of course, it is *possible* for price caps to result in a restriction of supply in any market in which they are used. This is especially the [165] case if the cap is effective (i.e. it is constructed in a way that cannot be avoided by firms) and if the level at which it is set prevents firms from making any profit. There would then be no incentive for the firm to continue to operate. But this merely indicates that it is the level of the cap that is critical; in markets where price competition is limited, caps can be used to eliminate excessive profits rather than eliminate profits in their entirety.

¹²¹Reifner, U. (12/10/2004) ‘Comments on the DTI study “the effects of interest rate controls in other countries”: preliminary remarks from a German perspective’.

Secondly, the cost of credit is highly reflective of the risk of default that lenders are taking. A major component of the cost of lending is covering the failure of customers to repay. It is here that lenders have a choice. They can either adopt procedures to ensure the loans they make are affordable for the borrower in order to keep default costs down, or they can take less care in their loan decisions and cover large default losses by charging high prices to those that do repay them. Capping prices can therefore force lenders to make more responsible lending decisions. As they are unable to rely on high prices to cover large-scale defaults, they have to become more cautious. Of course, this would mean that some people will no longer be able to access credit. Indeed, that is the very point, as these will be those borrowers with the highest risk of default – in other words, they are often people who cannot realistically afford to repay. In this sense, one of the main aims of price caps is to reduce access to credit for those people that cannot afford it and who are otherwise at risk of exploitation. A second problem then arises as to how we can help those people who are identified as unable to afford to take out credit. No-one would want to see them forced to turn to illegal loan sharks, but providing them with high-cost, legal loans is not a solution to their problems. Indeed, allowing legal loan sharking to occur as a response to the threat of illegal moneylending makes no sense at all. Imposing a cap and accepting that this will mean some households will not get credit on a commercial basis means we also have to consider what other forms of help we can provide to them.

Despite these criticisms, the DTI continued to rely on the Policis ^[166] report, and upon the fact that the Competition Commission inquiry was then taking place into doorstep moneylending, as the basis for its opposition to price caps. In 2005, the Government introduced a new Consumer Credit Bill to Parliament to enact the proposals that had been set out in its earlier White Paper. During the debates on the Bill in 2006, Adam Price – then a Plaid Cymru MP for whom we had drafted a Private Members Bill to provide the OFT with the power to cap prices a year previously – took up the issue on our behalf:

“The Minister [had previously] said ... that he was prepared to look again at the independent research on interest rate capping. I know that he has received a briefing on the issue from Debt on our Doorstep. It is an extensive literature review that goes back over 40 years of experience in interest rate ceilings. It goes into much more detail than the Policis research, which ... is highly flawed. Could we have a timetable for the review that the Minister has promised? Will the Government commission further independent research, because of the doubts that are widely shared about the robustness of the Policis research?”

THIS CALL FOR A REVIEW of the evidence base was also supported in the debate by the Conservative MP, Ed Vaizey, and by Norman Lamb from the Liberal Democrats. However, these calls were rejected by the then Consumer Minister, Gerry Sutcliffe, who continued to hold faith in the ability of the proposed unfair credit relationship test to make a difference:

NORMAN LAMB: *“Will the Minister ... commission more authoritative research?”*

MR. SUTCLIFFE: *"I shall not give an answer to that today. I want first to be able to examine the Bill's impact and the way in which the unfair relationship test, about which there has been some disagreement, works."*

IN REALITY, THIS was to mean a long wait. The unfair credit relationship test was not implemented until April 2007, and no formal review of its effectiveness took place until after the election of the Coalition Government in 2010.

In the interim, there has been further criticism of the Policis ^[167] report. For example, a study conducted in 2009 by Veronika Thiel for the New Economics Foundation reiterated Professor Reifner's criticism that the Policis report made the mistake of ascribing its findings to the presence of price caps when other factors were likely to be just as important:

"The price cap is seen as the singular explanatory factor ... This is despite the fact that inter-country comparisons of consumer credit markets are very difficult to make, and that differences will have more complex roots than only interest rate caps. Research that provides arguments against interest rate caps overlooks this wider picture. A more nuanced analysis of credit regulation, income levels, social welfare provisions, and cultural attitudes to credit is missing from the discussion."

THIEL ALSO DELIVERED the devastating conclusion that the Policis report "does not appear to adhere to basic standards of social science research" and set out a number of detailed complaints about the research methods used by Policis in an appendix to her report.¹²²

The Irresponsible Lending Guidance 2008

THE PASSAGE OF THE CONSUMER CREDIT ACT of 2006 was another missed opportunity. We would now have to wait until there was sufficient evidence to evaluate the effectiveness of the new unfair credit relationship provisions of the Act before we could push again for the introduction of caps on the cost of credit.

However, we had managed to make some progress to ensure greater responsibility in lending by successfully arguing that the OFT should be required to consider whether lenders were acting responsibly when assessing them for a licence. This call was adopted by Citizens Advice and, in March 2006, the requirement was put into the Consumer Credit Bill following an amendment to ^[168] this effect in the House of Lords. This was to subsequently lead to the development of OFT guidance as to what it would consider to be 'irresponsible' lending practice over the course of 2007, with the final guidance published in 2008.

The development of the OFT's 'Irresponsible Lending Guidance' was a major step forwards. The Guidance covers all steps of the lending process – from advertising, the entering into contracts, and practices to recover debts. However, we were particularly interested in the sections within

¹²²See Appendix 1 in Thiel, V. (2009). *Doorstep Robbery: why the UK needs a fair lending law*. New Economics Foundation.

the Guidance concerning how lenders should assess the affordability of their loans. In the Guidance the OFT indicated that lenders should take into consideration the potentially adverse impact that a loan agreement can have on the borrower's overall financial situation, and that:

*"... before granting credit, significantly increasing the amount of credit, or significantly increasing the credit limit under an agreement for running account credit, creditors should take reasonable steps to assess a borrower's likely ability to be able to meet repayments under the credit agreement **in a sustainable manner**."* [emphasis in the original].

THE CONCEPT OF SUSTAINABILITY is elaborated further by the OFT as meaning credit that can be repaid by the borrower 'without undue difficulty' and 'within a reasonable period of time'. The OFT also provided a definition of 'without undue difficulty' as meaning the borrower is able to make repayments while also meeting other debt repayments and other 'normal/reasonable outgoings'. We considered that a great many loans made to lower-income households would not satisfy these criteria and that the Guidance therefore provided the basis for enforcement action against the licences of many high-cost lenders. However, we also had a number of reservations about the Guidance. In particular, there was no definition of 'normal/reasonable outgoings' and it was not clear what level of resource was being provided by the OFT to enforce the requirements.

The OFT's High-Cost Credit Review and Payday Lending Compliance Review

[169] THE DEVELOPMENT OF the Irresponsible Lending Guidance coincided with the onset of the credit crunch and the financial crisis. We identified these events as ones which would make the Competition Commission's remedies for the home credit market largely redundant because these relied heavily on the idea that data sharing would help people move onto more mainstream forms of credit. In fact, the data sharing remedy was not implemented until 2008, by which time the mainstream consumer credit markets had changed significantly and access to these had become restricted. There was now no real prospect of increased data sharing helping lower-income borrowers to access cheaper priced credit through this route, and we began to press for a review of the remedies as a result. This included a meeting with the then Chair of the Competition Commission, Peter Freeman. Unfortunately, neither the Commission nor the OFT were willing to reopen discussion about the effectiveness of the remedies, with the authorities arguing that insufficient time had been granted to assess their impact. In our view this demonstrated a failure to appreciate the full gravity of the crisis for low-income households and a lack of willingness to quickly adjust policy measures in response. It was a case of 'let's wait and see'. Our perspectives on this at the time were that it would take at least four years for the credit markets to return to anything approaching 'normality' and that the poorest households could simply not afford to wait that long. In the event, even this position has proved to be over-optimistic.

As our direct requests to the authorities revealed that they were not prepared to act, we had little choice but to press the point publicly, and later on in 2008 – and now working as the Head of Policy at the Centre for Economic and Social Inclusion – I was interviewed on the BBC's 'Politics Show' programme in the North West. As part of the item, one of the local MPs, Ian McCartney^[170] – who had followed Gerry Sutcliffe to become the Minister responsible for the regulation of consumer credit between 2006 and 2007 – was also asked to appear, along with a representative from Provident Financial. I had, in fact, written to Ian whilst he was a Minister urging him to cap prices. I reminded him of this whilst we both waited to appear on the programme. He recalled the letter and expressed some regret that he had not acted on it at the time, saying that he had been advised against caps by the officials in the Department who had insisted that this would lead to an increase in illegal lending. To his great credit, Ian had taken steps as a Minister to address that problem by establishing a number of projects up and down the country to help root out evidence of illegal loan sharking and increase the number of prosecutions. As we spoke, it became apparent that Ian, although no longer a Minister, was willing to support a call for caps to be implemented on the basis that the Competition Commission's remedies had not worked and that greater protection was now in place to prevent people from falling prey to the illegal sharks. During the programme he therefore committed to work with the campaign to pull together the case for caps and present this to Government. He was true to his word, and the resulting paper 'Protecting Low Income Borrowers in the Credit Crisis' was subsequently published in our joint names and formed the basis of a discussion with the new Minister, Gareth Thomas, and his officials towards the end of that year.

This meeting, and Ian's seemingly boundless energy in promoting the cause in Parliament, was to result in an OFT review of high-cost credit markets which was undertaken throughout 2009 and which led to the publication of a report in 2010. However, the outcome of the review was, once again, a huge disappointment. The OFT continued to emphasise access to high-cost credit over responsibility in lending and fair pricing, concluding that 'in a number of respects, these markets work reasonably well' and that if the sector did not exist then 'significant groups of people' would be 'denied access to licensed credit in the UK'. Once again, it was^[171] a case of arguing that people who could not realistically afford to repay their loans should be provided with loans at high cost for fear that they would otherwise go to illegal moneylenders. It was a circular argument that denied the fact that providing people who were already in financial difficulty with high-cost loans only made their position much worse. High-cost credit – whether legally provided or not – is no solution to the problem of poverty.

Although the 2010 review identified some potentially deep-seated problems due to a lack of effective price competition, it did not identify the need for further action in the home credit market pending more time for the Competition Commission's remedies to have an effect, and, although there was now considerable evidence emerging of problems caused by irresponsible lending in the payday lending sector, the review simply urged more data sharing by lenders and the development of a voluntary code of practice.

In the event, it took the payday lending industry over a year to produce a code of practice, and this was little more than a statement that they would comply with the requirements of the Irresponsible Lending Guidance. The OFT's 2010 Review recommended that payday lenders establish a code that included, amongst other things, a statement of policy on the rolling over of loans and rules of thumb on typical amounts to be lent to customers. However, the code launched by the payday lender trade associations in July 2011 failed to address these issues. In addition, the code contained no mention as to how compliance with its provisions would be monitored and enforced.

During the OFT's High-Cost Credit Review it had become apparent that there was a need to build an evidence base capable of challenging the previous findings of the Policis report and the pervasive view within Government and the OFT that greater transparency of contract terms, self-regulation, and efforts to promote competition would be sufficient to deliver a fair deal for Britain's low-income households. As a consequence, and with the support of Dave Simmonds and colleagues at the Centre for Economic [172] and Social Inclusion, we established the Centre for Responsible Credit (CfRC) in January 2010. The research programme included a focus on the operation of high-cost consumer credit markets, beginning with a review of the regulation of payday lending in other countries, including in the US and Canada where caps and prohibitions on rollover lending had been put in place in many states and provinces.

Our first report on payday lending,¹²³ published in October 2010, therefore highlighted those aspects of the US and Canadian approaches to regulation which we considered could provide an appropriate model for the UK, and called for the introduction of a package of measures, including restrictions on the amount of loan relative to the borrower's income; limits on the number of times that loans can be rolled over or refinanced; and caps on the cost of credit and on default charges. The report also pointed out that greater competitive pressure could be brought to bear on the cost of payday loans by limiting the fees and charges levied by banks for bounced direct debits and for unauthorised overdrafts. This was particularly important, as payday lending had grown in the UK due to a reduction in the availability of overdraft credit for low-paid workers and the levying by the banks of excessive fees and charges. This allowed many payday lenders to advertise their product as competitive when compared to an unauthorised overdraft. British regulators and the banks could also do more to help, and the report highlighted the results from a major, multi-million-dollar pilot, instigated by the US regulator, the Federal Deposit Insurance Corporation. This had encouraged banks to make small-dollar loans at low cost to people who would otherwise need to turn to payday lenders, and to combine these loans with the promotion of savings products and financial education programmes. Contrary to the complaints of many British banks that small value lending to [173] working-class households is not profitable, the US

¹²³Gibbons, D., Malhotra, N. & Bulmore, R. (2010). *Payday lending in the UK: A review of the debate and policy options*. Centre for Responsible Credit.

pilot revealed that these loans were viable, especially when the additional income from the build-up of savings was taken into account.

The report was launched during a period when consumer credit regulation was, once again, subject to review. The election of May 2010 had resulted in the formation of the Conservative and Liberal Democrat Coalition government and, keen to traduce Labour's record for allowing consumer credit borrowing to spiral out of control, the Department for Business, Innovation and Skills had launched a new Consumer Credit and Personal Insolvency Review. This initially indicated that Government was considering capping prices in the credit and store card markets – indeed, this had been a commitment contained in the Conservative Party's election manifesto. Following a campaign led in Parliament by Stella Creasy MP, the Department indicated that it would also consider evidence presented to it about payday and other high-cost credit lenders to determine whether it needed to take further action, including by capping prices in these markets.¹²⁴ In its subsequent response to the Review, published in November 2011, the Department indicated that it would commission further research into the potential impacts of price caps on levels of access to credit, and also noted the need for lenders to do more to address 'the upsurge of concern' about the rapid expansion of payday lending by enhancing its code of practice.

Despite these commitments, the pressure on the industry (and on Government and the OFT to act more decisively) continued to build. In late 2011 and early 2012, the Business, Innovation and Skills (BIS) Select Committee inquired into issues of consumer credit and debt management and pressed for action. It was during the course of this inquiry that the OFT agreed to conduct a detailed review of payday lender compliance with its Irresponsible Lending Guidance. [174] This review took place throughout the course of 2012, with the final report published in March 2013. Key findings from the review, which cost £1 million to conduct in 2012 and is set to cost an equivalent figure in respect of follow-up enforcement activity,¹²⁵ included that over a quarter of payday loans are rolled over or refinanced at least once and that loans which are rolled over or refinanced four or more times contribute nearly one-fifth of lender revenues. In addition, the OFT found that the majority of lenders were not conducting adequate affordability assessments, failing to treat borrowers in financial difficulty with understanding or forbearance, and were misusing Continuous Payment Authority mandates¹²⁶ to collect payments – in some cases leaving borrowers with insufficient funds to cover their most basic needs.

¹²⁴This commitment was given by David Willetts MP on behalf of the Department in response to a Westminster Hall debate called by Stella Creasy MP on 9th November 2010.

¹²⁵Figures provided to the author by e-mail from the OFT dated 15th May 2013.

¹²⁶A Continuous Payment Authority (CPA) authorises a business to withdraw sums from a customer's account without having to seek repeat authorisation for each payment. Problems arise because lenders repeatedly use the CPA to 'siphon' money from bank accounts often charging the consumer multiple fees in the process.

The enforcement action taken by the OFT in response to these findings has been well publicised.¹²⁷ Following the review, the OFT began writing to the 50 leading lenders, which together account for 90 per cent of the market, giving them 12 weeks to prove that they had taken steps to improve their practices. On 30th July, the deadline for all lenders had passed and the OFT released details of the impact of its action, revealing that three lenders had surrendered their consumer credit licences entirely and a further 11 lenders had stopped offering payday loans but continued to trade in other areas of the consumer credit market.¹²⁸

[175] In addition to leading to enforcement action against individual firms, the OFT's review made the important finding that:

"One in three loans is rolled over or refinanced, accounting for almost 50 per cent of revenues ... Lenders are not competing for these revenues. Customers in this position are largely captive ... Our evidence suggests that encouraging rollovers is a deliberate commercial strategy for some firms. For example, staff in two large high street firms told us that rollovers were regarded as key 'profit drivers' and that staff were encouraged to promote them – in one case this was even written into their training manual. In extreme cases, our inspectors found examples of customers having 12 or more consecutive rollovers."

The Financial Services Act 2012: the beginnings of a new approach?

THE BIS SELECT COMMITTEE INQUIRY of 2011–12 had forced the OFT's hand and resulted in an important review of payday lending practice, resulting in a *volte face* by the regulator which had only three years previously all but given the industry a clean bill of health. Now the OFT concluded that:

"The payday loans market is not working well for many consumers. Our review has found evidence of widespread non-compliance with the Consumer Credit Act and other legislation. Payday lenders are also not meeting the standards set out in our Irresponsible Lending Guidance."

HOWEVER, THE BIS SELECT COMMITTEE INQUIRY of 2011–12 was extremely important for another reason, as it had also come out in favour of caps on the cost of credit. This was the first time that capping credit costs had received such a high degree of political support. In its report, the Select Committee cited CfRC research concerning Florida's experience of payday lending regulation, which involved caps on the cost of credit combined with a real-time database of [176] agreements to prevent rollover lending in support of this. Contrary to industry claims that caps and restrictions on rollovers would put lenders out of business, the data on payday lending in Florida showed that the number of loans was increasing year on year, but that borrowers – who were only

¹²⁷See, for example, <http://www.theguardian.com/money/2013/mar/06/payday-lenders-reform-ultimatum-of>

¹²⁸On 14th August it was reported that a further four payday lenders had quit the market, bringing the total number to 18. <http://www.telegraph.co.uk/finance/personalfinance/borrowing/10243103/Four-more-payday-lenders-quit-the-market.html>

able to have one loan outstanding at any given time – defaulted in far lower numbers than in the UK. This meant that lenders could operate profitably under quite a tight cap of around \$11 per \$100 lent. This was less than half the average cost of payday loans in the UK.

The BIS Committee report indicated that politicians were finally losing their patience with the OFT's approach. The campaign for caps on the cost of credit was receiving considerable support from Stella Creasy MP, who had made the issue of high-cost lending a priority for action since her election in 2010. We worked with Stella to help draft a Private Members Bill to improve the regulation of high-cost credit markets, and the subsequent Consumer Credit (Regulation and Advice) Bill was given its first reading in November of that year. It was clear that there was support for its proposals to cap the total cost of credit, including default charges as well as headline prices, from MPs of all parties. Although the Government did not subsequently provide time for the Bill to progress further, Stella continued to advocate for caps within Parliament and increased the profile of the issue significantly by leading the End Legal Loan Sharking campaign, which was also supported by the centre-left group Compass. This subsequently led to the establishment of Sharkstoppers, which has organised local actions by mobilising campaigners to lobby for payday loan advertising bans at football grounds, on the London Underground, and on local authority computer systems in public libraries.

The failure of the OFT to effectively regulate consumer credit markets has now been reflected in the fact that it is to be stripped of its responsibilities in this area from April 2014. These will now transfer to the new Financial Conduct Authority. The role of the FCA has been defined by the Financial Services Act 2012, and [177] there were a series of debates concerning the powers that the FCA should have to protect consumers throughout the passage of the Financial Services Bill in 2011 and 2012. These included whether the FCA should have a power to cap prices, and in the very final stages of the Bill in the House of Lords, Parry Mitchell secured an amendment to this effect.¹²⁹ This was a momentous occasion in itself, but subsequent meetings with the FCA indicated that they were reluctant to use this new power. At the very least, they argued that they would need to make the case by commissioning more research on the issue. It was, at that point, unlikely that any cap would be introduced before the election in May 2015.

However, the inclusion of a power for the FCA to cap prices was not the only victory scored during the passage of the Financial Services Act 2012. Working through the Community Investment Coalition, we had continued to raise the need for Debt on our Doorstep's other aim of placing requirements on banks to meet the needs of low-income communities. As part of this work, we called for the FCA to be placed under a statutory duty to consider levels of access to financial services in deprived communities, and for banks and other lenders to be placed under a responsibility to disclose details of their lending patterns at a postcode level.

¹²⁹An amendment to this effect was moved in the Lords stages of the Financial Services Bill 2012 by Lord Parry Mitchell, and, under threat of losing the vote, this was accepted by Government. <http://www.bbc.co.uk/news/uk-politics-20531126>

These issues were taken up in Parliament on our behalf by the Labour front bench and also by the Liberal Democrat peers, Lord Sharkey and Baroness Kramer. Although our calls for statutory duties to be placed on the FCA and the banks were not successful, the Financial Services Act was amended to provide that the FCA can, if it wishes, ‘have regard’ to levels of access to financial services at the local level when considering how best to promote competition. In our view this is an important power and provides the grounds for the FCA to conduct an investigation into why there ^[178] is a lack of bank lending in low-income areas and why working-class households are not provided with alternatives to the high-cost door-to-door moneylenders, payday companies, pawnbrokers and RTO stores.

To inform this, we would have preferred banks and other lenders to have been placed under a statutory duty to disclose their lending patterns in local areas. This ‘disclosure obligation’ forms the bedrock of the Community Reinvestment Act in the US and has allowed local authorities and community groups to hold banks to account for their provision in low-income communities, securing billions of dollars of investment in credit unions, housing, and economic development projects. Unfortunately, we have so far been unable to secure a similar statutory obligation on financial services providers in the UK. However, during the passage of the Bill, Government provided a commitment to work with the British Bankers Association and other lender associations to bring forward a voluntary disclosure framework and to secure the release of data. In the event that a voluntary agreement could not be reached, then the Government committed to making this a statutory requirement and legislated for this during the passage of the Banking Reform Bill, which was proceeding through Parliament in 2013. Importantly, the Government committed to ensuring that the disclosure framework would be sufficiently granular to identify lending patterns at the neighbourhood level and would also allow the performance of individual banks and other lenders to be assessed, as well as provide an aggregated picture. These commitments have now been honoured, and the first release of this data took place on 19th December 2013. As at the time of writing, we are now working to provide a detailed analysis of lending patterns at the local authority and political constituency levels.

Lord Sharkey’s involvement in the campaign was to prove to have a further key impact – this time in respect of delivering a cap on the cost of credit that can be charged by payday lenders. During the passage of the Banking Reform Bill, Lord Sharkey submitted an ^[179] amendment which, if passed, would have required the FCA to implement a regulatory regime similar to that which exists in Florida, including a 10 per cent cap on the cost of credit. The amendment was due to be debated in the House of Lords on 26th November 2013. However, in a dramatic turn of events, and with the Government looking like it would be defeated, Chancellor George Osborne made an announcement on the 25th November that it would include a clause in the Bill to require the FCA to bring in a cap on payday lenders’ costs before the next General Election.

Once again, a call for action!

THIS HAS ALREADY BEEN A LONG CAMPAIGN, stretching out over a period of 15 years, but despite the legislative changes and the publication of bank lending data, nothing has yet improved for low-income households. They are still paying the highest price for credit. Public spending cuts and welfare reforms are also making their lives much harder. The 'bedroom tax' is penalising social housing tenants for the under-occupation of homes, even though there is a lack of suitably sized properties for them to move into. Cuts to Council Tax Support now require households on the very lowest incomes, which were previously exempt from local taxation, to make payments towards the cost of council services. In April 2013, the Government also abolished the Crisis Loans and Community Care Grant elements of the Social Fund and 'devolved' the budgets for these to local authorities in England and to the Scottish Government and the Welsh Assembly. This was done in the expectation that the funds would be used to support new 'local welfare schemes' capable of meeting the underlying needs of our poorest households. However, this policy of localism was accompanied by a savage reduction in the level of funding.

In 2010/11, the Department for Work and Pensions (DWP) spent a total of £368.4 million on Community Care Grants and crisis loans, with crisis loans accounting for 61 per cent of this ^[180] expenditure. However, expenditure on crisis loans fell by 41 per cent the following year as a result of a number of administrative measures taken by DWP, including reductions in the maximum amount and the number of permissible awards in any 12-month period. Total expenditure in 2011/12 was £274.3 million. Disregarding expenditure on crisis loans made that year for 'alignment purposes'¹³⁰ – the budgets for which have not been devolved – the level of spend on Community Care Grant and crisis loans in 2011/12 was just over £215 million. This compares to the 2013/14 budget of just £178 million, which was devolved to support local welfare provision – a cut of 17 per cent in that year alone.

The result has been the introduction of tighter eligibility criteria for assistance, including in some areas lengthy residence requirements before people can qualify for help. In many ways this is reminiscent of the Elizabethan poor law which saw people in destitution passed from one parish to another. Over 400 years later, in 2013, we now had a situation where over 350,000 people relied on handouts of food parcels in the period between April and September – a national scandal which could only worsen as the winter months approached.

As if this were not bad enough, there are more problems to come. The Government's flagship welfare reform scheme – Universal Credit – which seeks to encourage people to take greater personal responsibility for the management of their finances, includes measures such as the direct payment of housing benefit to social housing tenants rather than their landlords and the

¹³⁰Crisis loan 'alignment payments' were made in order to help bridge the gap between a new benefit claim being made and receipt of payment. These have been replaced with a new national system of Short Term Advances on benefit and the budget for these was not devolved to local areas. However, this has created further difficulties as a number of local authorities have insisted that people exhaust their entitlement to a Short Term Advance from DWP prior to qualifying for help from the local schemes, whilst DWP has referred people in the other direction.

payment of benefits on a ^[181] monthly as opposed to fortnightly basis, in arrears. There is obvious concern that in the current economic climate this will increase rent arrears and create further debt problems.

Credit use, no matter how 'affordable', is not a solution to these problems. But it is also clearly the case that high-cost credit use will exacerbate them further. It is impossible to avoid the conclusion that we need to better regulate the UK's high-cost credit markets and provide cheaper alternatives as part of a much wider campaign to improve the overall financial position of working-class households.

Much of the credit regulation aspect of this campaign is focused on the relatively new phenomenon of payday lending, but the main issues remain the same for other high-cost lenders, including those calling on the doorstep and the RTO stores which have not yet been subject to the same types of compliance review as the payday firms. We have recently been working with Paul Blomfield MP, who has been particularly effective in co-ordinating action both within Parliament and outside of it, including by submitting a Private Members Bill on high-cost credit regulation and launching a public 'Charter to Stop the Payday Lending Rip-Off' which is supported by a wide range of agencies including Citizens Advice, StepChange, *Which?*, and Church Action on Poverty. Although the headline focus of the Charter is payday lending, it calls for action right across the high-cost credit markets (see Appendix).

The evidence of the failure of self-regulation, transparency in terms and conditions, and the promotion of competition through data sharing initiatives is now abundant. Citizens Advice has reported a 10-fold increase in the number of people seeking advice about payday loan debt problems over the last four years. In the first six months of 2013, the debt charity StepChange helped 30,762 people with payday loan debt problems. This compares to 36,413 for the whole of the previous year. Further to this, StepChange report that over 20 per cent of those seeking help had five or more payday loans outstanding, and, in the January to June period, the ^[182] average monthly income of a StepChange debt charity client was just £1,298, whereas the average payday loan debt of those clients was £1,665 – revealing that it would be impossible for these clients to repay the debt within the usual monthly period of the loan agreements.

Importantly, many payday borrowers have also incurred priority debts – building up arrears on rent, council tax and with their energy suppliers. In these respects, StepChange reports¹³¹ that of the payday borrowers seeking help from them in the first half of 2013, more than one in five had outstanding council tax arrears; over 15.2 per cent had outstanding rent arrears, averaging nearly £1,000 per person. Around one in 10 was in arrears with their electricity or gas supplier. Commenting on the increase in payday loan debt problems, StepChange's Head of Policy, Peter Tutton, said:¹³²

¹³¹Figures provided by e-mail to the author on 13th September 2013.

¹³²<http://www.stepchange.org/Mediacentre/Pressreleases/Paydayloanproblemworsen.aspx>

“The problem of payday loan debts continues to worsen despite the introduction of new codes of practice by the payday loan industry. The fact that we are still seeing increasing numbers of people with five or more loans and clients with loans in excess of their monthly income clearly shows that payday loan companies are still failing to lend responsibly.”

INDEED, OVER THE period from November 2012 through to July 2013, Citizens Advice analysed customer feedback on 2,718 payday loans from 126 different payday lenders. This was conducted to monitor whether lenders were abiding by their own customer charter. The findings from this were truly shocking, with nearly three-quarters of all borrowers reporting that they were put under pressure to roll over their loan. This report followed an earlier media release made by Citizens Advice in May 2013 which revealed that payday lenders are breaking 12 out of 14 promises they made to treat customers fairly. And, at the beginning of August 2013, Citizens Advice reported the results from an in-depth analysis of 665 [183] payday loan cases, reported to its consumer service between 1 January and 30 June 2013, finding that at least 76 per cent could have grounds for an official complaint to the Financial Ombudsman.¹³³

Whilst the focus of these debt advice agencies has been on payday lenders, it is important to note that problems in other sectors of the high-cost credit market may be being overlooked.

Self-regulation in the rent-to-own market

THROUGHOUT 2011 AND 2012 the Centre for Responsible Credit worked with Church Action on Poverty, Thrive,¹³⁴ and the three leading RTO firms (Brighthouse, PerfectHome, and Buy as you View) to secure a set of seven key customer commitments.¹³⁵ These were:

- To ensure that goods are competitively priced;¹³⁶
- To use mystery shopping exercises to evaluate how prices are explained to their customers;
- To provide customers with a range of payment options;
- [184] To limit default charges to no more than the actual cost incurred to the company;

¹³³As a consequence, Citizens Advice launched a month-long campaign urging people to report problems to the Financial Ombudsman Service.

¹³⁴The Thrive project is a community organising project in Stockton-on-Tees established by Church Action on Poverty, and working in partnership with Durham University's Centre for Social Justice and Community Action. The project has successfully engaged local residents around issues of concern and, in 2011, identified a high level of use of rent-to-own companies in the area. The project then approached the Centre for Responsible Credit to provide it with technical assistance.

¹³⁵For a full account of the project see Gibbons, D. (2012). *Improving Practice in the Rent to Own Market*. London: Centre for Responsible Credit.

¹³⁶For example, the Brighthouse Charter committed the company to 'ensure our prices are competitive against comparable high street retailers'.

- To put in place policies and procedures to help people in financial difficulty and to refer customers in arrears to free, independent debt advice agencies;
- To develop clear policies for future complaints handling; and
- To provide clear annual statements of account.

THE SEVEN COMMITMENTS have been incorporated into customer charters, which the three firms undertook to promote to customers, both in store and on their websites. However, the main trade association – the Consumer Credit Trade Association (CCTA),¹³⁷ which had been involved in discussions throughout the lifetime of the project, refused to incorporate these commitments into its existing Code of Practice. Had it done so, these commitments would have been required of all CCTA members providing rent-to-own agreements, rather than be restricted to the three largest firms. In addition, the commitments would also have been subject to the CCTA's monitoring and compliance procedures.

In view of the failure of the CCTA to take this forward, the project therefore recommended that the three main firms develop their own 'proposals to ensure that they are effectively monitoring the operation of their customer charters, including through the commissioning of independent reviews and inclusion of the main results from these in their annual reports'. Unfortunately, this recommendation does not appear to have been acted upon, and there remains a lack of transparency concerning how far the commitments are actually being delivered.

Problems of affordability in the home credit market

[185] THE COMPETITION COMMISSION INQUIRY into home credit uncovered that there were considerable financial incentives for firms to encourage borrowers to roll over loans. As a result, it implemented changes to the level of Early Settlement Rebate that borrowers should receive in these cases. However, its recent evaluation of remedies indicates that this has not resulted in any significant reduction in the numbers of people refinancing their loans with the same lender.

In addition, media reports continue to highlight problems in this market. For example, on 4th April 2012 the *Daily Mirror* reported¹³⁸ on the case of an 86-year-old woman living in sheltered accommodation who was paying £61 per week from her £108 per week pension to Provident Financial in debt repayments. As the *Mirror* noted, this position had arisen from a long-term dependency on Provident loans:

"Since 2007 [she] has taken out 18 loans totalling £8,600, costing £6,354 in interest alone – that's £1,000 more than her annual pension. She's never once been clear of Provident debts, and the repayments have almost doubled from £33 a week. The loans

¹³⁷It should be noted that during the project, Brighthouse left the CCTA and joined the Finance and Leasing Association.

¹³⁸<http://blogs.mirror.co.uk/investigations/2012/04/86-year-old-olive-hands-two-th.html>

were used, according to [her son], to pay bills and to keep up payments to Provident, which allowed her to 'roll them over' 15 times."

THE REPORTING OF THIS CASE, part of the newspaper's long-running 'End Legal Loan Sharking' campaign, proved the catalyst for a cross-party group of MPs¹³⁹ led by the Chair of the All Party Parliamentary Group on Credit and Debt, Yvonne Fovargue MP,¹⁴⁰ to write to the Director of Consumer Credit, David Fisher, at the [186] OFT and request that the scope of the payday compliance review be expanded to include home credit lenders.

Unfortunately, this request was rejected, with the OFT citing resource pressures as one of the main reasons for this. This lack of resources for enforcement activity has been highlighted most recently by the Public Accounts Committee,¹⁴¹ whose inquiry into the regulation of consumer credit concluded in May 2013. In the clamour over payday lending, the long-standing problems with door-to-door moneylenders have been largely ignored.

Proposals for high-cost credit regulation

AS AT THE TIME OF WRITING, the payday lending industry is facing a Competition Commission inquiry and proposals have also been issued by the FCA to restrict the number of rollovers to two and to tighten up on requirements to conduct proper affordability assessments. It is now also going to be subjected to a cap on the cost of the credit which will be implemented in January 2015. It is, however, extremely difficult to have faith in either the Commission or the FCA's proposals (as they currently stand) as a solution to the problems that low-income households face.

The Competition Commission – as was the case when it investigated the door-to-door moneylenders – is focused on how to assist borrowers to become more 'price sensitive' and is looking at measures to make it easier for them to 'switch' between firms in the hope that this will drive down prices. However, it has already indicated that it will not be looking at issues of affordability. Given the outcomes from the inquiry into door-to-door moneylending, which was very similar in scope, it is unlikely that the Commission will address the underlying problem that lower-income households [187] are desperate for cash and will continue to accept loans at almost any price if these are made available to them.

As at the time of writing, the Financial Conduct Authority's proposals are subject to consultation. These may yet change as the result of public and Parliamentary pressure. However, it is clear that the proposals as set out are extremely timid and run the risk of unintended consequences. Firstly, the FCA is only required to bring in a cap for 'high-cost, short-term' agreements. As the proposals currently stand, the FCA is defining this as loans which have an APR of more than 100

¹³⁹The signatories to the letter were Yvonne Fovargue MP, Stephen Gilbert MP, Tracey Crouch MP, and Nic Dakin MP.

¹⁴⁰Yvonne Fovargue is the MP for the Makerfield constituency following Ian McCartney's retirement at the General Election in 2010.

¹⁴¹The Committee noted that the OFT spent approximately just £1 on enforcement activity in 2011/12 for every £15,300 lent to consumers.

per cent, and which are agreements for repayment within a 12-month period. The proposed definition also specifically excludes door-to-door moneylending agreements. The reliance on the APR measure is misconceived as the formula for calculating APR is very sensitive to loan term, and lenders can easily reduce the headline APR by lengthening the repayment period. Likewise, the stipulation that only loans of less than a year in duration will be included will simply lead to lenders bringing forward longer-term loans, or as has happened in Canada, developing open 'lines of credit' of no specific duration, which operate in ways that are similar to credit cards. It would therefore be far better if the FCA were to implement a cap across all forms of credit based on the total cost relative to each £100 borrowed. This would satisfy its duty to cap payday loan prices and also require it to use its power to cap prices in other areas of the market. Fundamentally, it would start to get to grips with the very regressive nature of consumer credit pricing. There should also be a tighter restriction on rollover lending and refinancing. Too much credit in the UK is advanced as a means of simply rolling forward existing debt, which increases the economic vulnerability of households and makes for growth in lender profits but serves no productive purpose. And it will be necessary to bear down on default costs and charges, which lenders will otherwise hike up to recover lost revenue from the cap and rollover restrictions.

The FCA must now heed the lessons from the US, Canada, and [188] Japan. In two recent reports submitted to the FCA and to the Department for Business, Innovation and Skills, we looked at the experience of these countries in regulating payday and other high-cost lending. The findings from these reports indicate that caps on the total cost of credit at between 11 and 15 per cent of the amount loaned are possible without putting lenders out of business, provided that these are accompanied with other measures to ensure that borrowers do not become over-indebted. These include making it simple for lenders to determine what is, and what is not, affordable by limiting the amount of the loan to a sensible level relative to the borrower's income; preventing borrowing from multiple lenders at the same time; and by prohibiting the rolling over and refinancing of existing debt. Low-income borrowers can and do repay small loans at reasonable prices provided they do not take out too many of them at any one time. We therefore have to ensure that this is what they are provided with.

To do this requires a real-time database of high-cost credit agreements to be established. Lenders then have to check the database prior to making any new loans. If the database shows that the borrower already has a loan outstanding, then the lender is prohibited from making a new one until this has been repaid. This approach has been demonstrated as particularly effective in Florida, where defaults have dramatically reduced as a result. Only one loan is allowed at any one time, up to a maximum of \$500. The database is used to enforce a 24-hour gap between loans, and there is a complete prohibition on rollover lending. As a consequence of these measures, loan loss rates in the State are less than 2 per cent, compared to around 14 per cent for payday lenders in the UK. This cost saving on defaults allows the price of credit to be capped at around \$11 per \$100 lent to ensure that borrowers benefit from this, as opposed to firms simply increasing profits at their expense. Contrary to the claims of opponents of price

caps, lenders have not gone out of business, and the volume of small-dollar loans has increased year on year.

[189] There are additional advantages to putting a database of the type used in Florida in place. In particular, this can be used to identify 'heavy' credit users and target them with offers of help – including referrals to debt advice agencies or offers of credit union services. Where people are rejected for credit by lenders once they have checked the database and found that a loan is already outstanding, this application can also be logged on the database and help provided, for example by referring the applicant to a free debt advice call centre. Significant investment needs to be made in debt advice for this purpose.

Proposals to create a viable alternative

ALTHOUGH THERE HAVE RECENTLY BEEN IMPROVEMENTS in credit union and CDFI provision in the UK, these remain small players when compared to the size of the high-cost lending sector. We desperately need to address this problem. However, the reality is that capital is flowing from our banks and financial institutions, not to credit unions and CDFIs, but to the high-cost lenders. In fact, our banks have been complicit in the expansion of high-cost credit in two ways.

Firstly, it is clear that the failure to provide low-cost overdraft facilities to people on low incomes, and the practice of charging high fees for bounced direct debits and for unauthorised overdraft facilities, have prompted many to turn to the payday and high-cost lending sector for credit. Secondly, banks have been investing in the expansion of high-cost lenders. Barclays Bank is part of a consortium which provides Dollar Financial (which trades in the UK as The Money Shop) with a \$235 million credit facility. The Bureau of Investigative Journalism¹⁴² reported in June 2013 that HSBC, RBS and Lloyds Banking Group have all also been engaged in [190] activities which have helped payday lending to expand, although much of the investment in high-cost credit firms is likely to be made via private equity companies and there is little transparency as to where the capital has originated from.

It is time to call our financial institutions to account. As described in Chapter 4, there needs to be a fundamental review of who pays for British banking, and a redistribution of the costs of this from those least able to pay to those who are most able. That would be facilitated in part by capping the charges that banks can make for missed payments and overdraft facilities, but it would not be sufficient on its own. We need to ensure that the banks and other financial services providers open their books and demonstrate how they are working to benefit low-income communities – either directly through the provision of affordable financial services, or indirectly through the provision of capital for lending on by credit unions and CDFIs.

The disclosure framework that we have managed to obtain is a start, but this will need to be broadened in scope and applied to all retail financial services providers (banks, building

¹⁴²<http://www.thebureauinvestigates.com/2013/06/13/the-money-pouring-into-a-boom-for-consumer-loans/>

societies and consumer credit lenders). It also needs to be strengthened. Putting the requirement on a statutory rather than voluntary footing would help – with the FCA required to rate the performance of the major banks regarding their provision in deprived communities, and with financial services providers placed under a clear obligation as part of their authorisation to trade to publish details of their provision at a postcode level on a quarterly basis. This requirement would, for example, apply to all providers of transactional accounts, mortgages, and consumer and business credit. In respect of banks, the requirement should include disclosure of the level of deposit taking, lending, and penalty charges levied in local areas.

More also needs to be done to help credit unions and CDFIs to expand. Some of our larger credit unions have the appetite to develop into regional ‘stakeholder’ banks, but there is currently no clear route set out for them to achieve this. Measures that could ^[191] be taken to assist in this respect include lifting restrictions to allow for larger common bond areas and facilitating credit unions to work more effectively together by allowing them to invest in jointly owned ventures. Removing the cap on interest rates that credit unions can charge would also allow them to develop products in direct competition with the high-cost lenders.

Other approaches also need to be considered. For example, local authorities and housing associations currently require rents to be paid in even monthly instalments. But it would make sense for households if rents were lower in winter (when heating costs are high) and higher in summer (when heating costs fall) to assist them with cashflow. Similarly, this profiling of repayments to better reflect the pressures that low-income households face at different times of the year could be applied to council tax.

There is also a strong case for investment to be put into the creation of a ‘rescue fund’ for people trapped in a spiral of high-cost borrowing, as this impacts on the ability of people to pay their rent, council tax, and fuel bills. Investment in more affordable credit, combined with the setting up of bill payment services by credit unions, and a ‘lock out’ from further high-cost borrowing whilst these loans are repaid, is likely to have a significant beneficial effect on local authority and housing association revenues and reduce collection costs. Urgent action is now needed to put a national scheme in place. Britain’s low-income households have already been waiting far too long.

Chapter 6: Fixing the ‘debt system’

[193] BRITISH HOUSEHOLDS ARE IN AN APPALLING FINANCIAL CONDITION. At the height of the credit boom, we collectively owed an amount equivalent to 160 per cent of our entire economic output. Although this has reduced slightly since the peak of 2008, our combined debt remains extremely high, at 140 per cent of GDP. What is astonishing is that the growing level of household indebtedness throughout the late 1990s and early 2000s – whilst certainly on the radar of policy makers at the time – was not considered by them to be a major problem.

This chapter charts the development of the UK’s strategy for dealing with debt problems, which particularly took shape from 2001 onwards. This reveals a deep-seated complacency concerning the extent of household vulnerability to possible economic shocks because the long credit boom was also contributing to growth and had resulted in low levels of unemployment. Although a cross-departmental ministerial group was tasked with pulling together a strategy to minimise over-indebtedness from 2003 onwards, the resulting action plans did not include measures capable of countering the steep rise in household credit use. As discussed in previous chapters, Government focused on increasing the transparency of credit agreements and improving the financial capability of consumers. At no point were the underlying reasons for increased credit use critically assessed. Indeed, high levels of indebtedness [194] – the extent to which households were using credit – were not seen as a problem whilst the nominal value of household assets (primarily in the form of house prices) was increasing. Growing indebtedness, which creates vulnerability to future shocks, was therefore not discussed as much as ‘problem debt’ or over-indebtedness – the actual level of financial difficulties experienced by households at any one particular point in time. Government therefore focused on the need for advice and the types of ‘debt solutions’ on offer to the minority of people experiencing debt problems during the credit boom, rather than on the overarching problem of the boom itself and on the scale of the crisis that we were creating for the future.

The chapter then proceeds by looking at the debt solutions on offer to people with problem debts, and critiques these by comparing them with systems in place in other countries. It also examines how cuts to debt advice provision and the failure, until very recently, to draw up a national strategy for debt advice has resulted in a fragmented ‘debt system’ in the UK, which is incapable of dealing with the extent of the crisis that we are now experiencing. Finally, the chapter discusses the need for a systemic approach – including the write-down of a significant proportion of outstanding debt – to help households build up resilience to future shocks, increase savings levels, and fuel future investment in Britain’s economy.

A strategic approach to tackling over-indebtedness?

CONCERNS ABOUT THE OVER-INDEBTEDNESS of households were consistently raised by debt advice agencies over the period of the long credit boom as the number of people approaching them for

help increased. Between 1997 and 2000, the number of people turning to Citizens Advice for help with consumer debt problems rose by 16 per cent to stand at just under 600,000. However, this rise in people seeking advice was contradicted by statistics relating to the number of formal court actions for debt recovery in England ^[195] and Wales, which fell slightly – from 1.1 million to 1 million¹⁴³ – over the same period. At the turn of the millennium, this therefore posed Government with a problem. Certainly, people were using much more credit than previously. In December 1997 the total amount of unsecured consumer credit outstanding was £87.5 billion. Three years later, this had increased by nearly 50 per cent to £127.4 billion. But formal actions for the recovery of debt and industry figures concerning the level of arrears remained low. In October 2000, the Government established a Task Force comprised of debt advice agencies and the main lender trade associations, and the regulators, to examine the evidence concerning levels of over-indebtedness and the causes of this. This Task Force, which subsequently reported in July 2001, highlighted that although credit use had increased:

“... aggregate statistics show that the number of consumer credit accounts in arrears has remained at around 5 per cent for the past five years. In addition, there have been reductions both in the number of mortgages in arrears and the level of repossessions, and actions taken in county courts related to debt.”

THE TASK FORCE recommended that Government undertake further research into the reasons for this apparent contradiction and noted that very little work had previously been conducted in this area. In particular, the Task Force found that there was not even a generally accepted definition of what constituted over-indebtedness.

Subsequent research into over-indebtedness in the UK was undertaken on behalf of the Department of Trade and Industry by Professor Elaine Kempson at the University of Bristol's Personal Finance Research Centre (PFRC). Her report, submitted in September 2002, was based on a survey of just over 1,600 households about their credit use and the extent of any debt problems. The findings indicated that whilst many more people had access to ^[196] credit facilities such as overdrafts and credit cards than had previously been the case, the vast majority of these were not experiencing problems making repayments, were using credit 'modestly', and were required to pay less than a tenth of their gross income on unsecured credit repayments. Further to this, in many cases the households in the survey were not drawing down the credit that was available to them. However, the Kempson report also indicated that there was a small group of 'heavy' credit users, accounting for about 5 per cent of the sample, who were paying out more than one-quarter of their gross income to their consumer credit lenders each month, or who were paying out over half of their income on a combination of both their mortgage and consumer credit commitments. These ratios were subsequently to be accepted as the main objective indicators of over-indebtedness, although they were later added to by subjective indicators as to how far households themselves reported that they felt their debts to be a 'burden', or 'heavy burden'. The

¹⁴³Figures from the *Final Report of the Task Force on Tackling Over-indebtedness, 2001*: Department of Trade and Industry

report therefore considered that this group of 'heavy users' would be vulnerable to debt problems in the event of an economic downturn. In addition, although the proportion of people experiencing problems with repaying their credit agreements was reported as low, it was clear that many more were struggling with household bills. Commenting on the causes of financial difficulty, Kempson noted:

"Despite low levels of unemployment, the largest single cause of financial difficulties was still job loss. Financial difficulties were also strongly associated with setting up home and having a family. The arrival of a new baby increased the risk of difficulties, as did relationship breakdown. Low and unstable incomes also increased the risk. Nearly half of households having financial problems attributed them to a loss of income and one in seven of households with financial difficulties said it was because they were living on low incomes that were inadequate to meet their needs."

HOWEVER, THE REPORT ALSO INDICATED that 'over-commitment' was beginning to become a problem for some households, with one in 10 stating that this was the cause of their financial difficulties:

[197] "... the more credit commitments households had, and the larger the proportion of their income that went on repaying borrowing, the more serious was their level of arrears on household commitments."

KEMPSON'S REPORT WAS FOLLOWED in 2003 by the publication of a Consumer Credit White Paper, which committed Government to working with industry and consumer agencies to both minimise the number of people becoming over-indebted, and to improve the support for people who had fallen into debt. To take this work forwards, a cross-departmental ministerial group was established, and the first 'Tackling Over-indebtedness Action Plan' was jointly published by the Department of Trade and Industry and Department for Work and Pensions in 2004.

Whilst the pulling together of government departments to consider the issue of over-indebtedness was in itself a step forwards, the resulting Action Plan was extremely disappointing. Indeed, the 2004 Action Plan opened with a celebration of credit's role in society:

"Credit is an integral part of our daily lives. It makes a vital contribution to the UK economy: driving economic activity by allowing consumers flexibility in how they choose to access the marketplace and manage their finances; and enabling resources to be put to their most efficient use. Economic stability based on sound fundamentals is bringing rising prosperity, record employment and low interest rates, all underpinning increased demand for credit. Manageable borrowing provides an immense benefit and, in the majority of cases, consumers are using credit successfully."

THIS STATEMENT WAS, OF COURSE, NONSENSE. The economy of 2004 was not built on 'sound fundamentals' at all. It was, as we now know, built only on credit. Resources were not being put to their most efficient use. Property speculation was rife, and much consumer credit was simply being used to roll over previous borrowing. Savings were being depleted as an increasing proportion of household income, particularly in poorer households, went on repaying debts.

Whilst low interest rates made growth in credit use affordable for most households, this would not last forever, and [198] there were emerging signs that many had started to crack because they were already over-committed.

Looking back, it is striking how Government persuaded itself that growing levels of indebtedness were unlikely to become a problem. It is not that the Action Plan did not acknowledge that there were risks to an expansion of credit use, but that these were considered low and manageable. For example, somehow the growth in indebtedness was no problem provided the nominal value of household assets (such as house prices) was increasing:

“Although the ratio of household debt to income has climbed to historically high levels, this needs to be viewed alongside developments in household assets. The ratio of household debt to total net wealth is currently estimated to be no higher than it was in 1995.”

This rationale was bogus for two reasons. Firstly, the amount of household borrowing is much more certain than the value of assets. So, in respect of a house for example, once a mortgage is taken out for £150,000 then the borrower is liable for that amount regardless of the fact that the value of the house on which it is secured may drop to only £100,000. In this respect, the liabilities of households are actual, solid amounts, whereas the value of assets is, until the very point they are sold, purely imaginary and as light as air. Secondly, the measure of ‘total net wealth’ includes private pension wealth, which is not realisable by households until their retirement and cannot be used to pay down debts until that point. As such, it plays no part in offsetting the real hardship that debt repayments can cause, particularly if incomes are being squeezed, as would be the case from 2006 onwards.

Nevertheless, Government convinced itself that it need not worry about the exponential growth in household liabilities. In another section of the Action Plan, it focused on the fact that interest rates and unemployment were both low:

“... interest payments account for just over 7% of household disposable income on average, significantly below early 1990s levels. Widespread household defaults have in the past occurred only in the face of a [199] significant rise in both interest rates and unemployment. Overall, therefore, maintaining macro-economic stability with low inflation, low interest rates and high levels of employment is expected to ensure that, for most households, existing levels of debt are sustainable.”

AS A CONSEQUENCE, the Action Plan focused exclusively on the minority of households that were at that time experiencing financial problems rather than on the tidal wave of debt problems that was starting to build for the future. In fact, as the 2004 Action Plan went on to report (albeit in an almost casual way, given its earlier paean to the benefits of credit), the minority already constituted one in five households who said in surveys that they were in financial difficulties.

According to figures presented by Citizens Advice in the preceding year, the most common reason for these problems had become 'over-commitment' rather than job loss.¹⁴⁴

The Action Plan was, however, important in that it recognised how the impacts of debt problems incur costs for wider society, particularly through its interaction with physical and mental health problems and as a causal factor in relationship breakdown. These lead to increased pressure on public services, often delivered by local authorities and the voluntary and community sector. Likewise, when people have difficulties affording credit repayments, this often leads them to fall into arrears on other bills, including rent, council tax and utilities. This then increases the cost of these for other households.

Although the Action Plan did not get to grips with the root causes of growing household indebtedness and relied overly on measures to increase transparency of terms and conditions in credit contracts combined with the development of a national financial capability strategy as the means to help households avoid debt, it did result in a number of measures designed to help those in the greatest financial difficulties. Chief amongst these were reviews of the effectiveness of debt solutions that were on offer to people in financial trouble, and efforts to create a single 'gateway' to advice [200] services as well as a funding allocation of £143 million for debt advice over the period 2004 to 2011. In addition, the OFT was charged with taking forward a review of compliance with its guidance on debt collection, which had been published in 2002.

Effective debt solutions?

IT SHOULD BE NOTED from the outset that Britain does not have a single system of debt solutions. The system in England and Wales (hereafter referred to as the 'English system') differs significantly from that in Scotland, which has long maintained an independent approach. This section is particularly focused on the English system.¹⁴⁵

Debt solutions in the English system come in two main forms. These are the traditional 'court-based' solutions, which include bankruptcy orders, Individual Voluntary Arrangements (IVAs), and Debt Relief Orders (DROs), and out of court arrangements, which include temporary forbearance arrangements such as the freezing of interest and acceptance by creditors of token payments, where, for example, someone has lost employment, and long-term agreements based on the ability of the debtor to repay through agreed Debt Management Plans (DMPs). The major distinction between the two forms is that the court-based solutions require formal legal proceedings, but in return provide access to at least some element [201] of debt write-off, whilst

¹⁴⁴Citizens Advice (2003). *In too deep*.

¹⁴⁵The Debt Arrangement Scheme ('DAS') introduced in Scotland in 2011 is, however, an interesting model from which England and Wales could learn. This provides for an out of court repayment plan to be put in place by debt advisers and for all fees, charges, interest and enforcement action to be stopped at that point. It therefore works like a DMP, as it does not offer any write down of the debt, but because the DAS is standardised in that each repayment plan must be approved by a DAS administrator, the calculation of disposable income and monthly repayments are likely to be more consistent than is the case in respect of fee charging debt advice companies in England and Wales.

the latter are less formal and have typically involved an expectation that debts will be repaid in full – albeit over lengthy periods.

Court-based solutions

ONE OF THE MAJOR PROBLEMS in providing advice to debtors about the potential pros and cons of each solution is that there is a lack of transparency for debtors in how the formal court-based options will work out for them in practice. In particular, there are no standard calculators available to determine how much a debtor would be expected to pay back in the event of declaring themselves bankrupt, or whether their home (if mortgaged) would be protected. In fact, a great deal of discretion is provided to the official receivers appointed to oversee bankruptcies, and it has long been virtually impossible to guarantee any particular outcome for debtors who take this route. In part, this appears to be a deliberate strategy to dissuade people from declaring bankruptcy as this involves a significant write-down of debts. Although the debtor is required to make payments calculated as reasonable by the official receiver, this is only usually required for a period of 12 months, after which any outstanding debts are written off and the order comes to an end. There are other aspects of bankruptcy which are also likely to be off-putting for debtors,¹⁴⁶ including the cost of application (now at least £525, and rising in most cases to £700), and the fact that the impact on the debtor's ability to obtain credit is likely to last for six years (after which time the record of the bankruptcy on the debtor's credit file held by the credit reference agencies is removed).

[202] There are two main alternative court-based solutions to bankruptcy. The first of these, the IVA, was introduced by the Insolvency Act 1986. This allows debtors to negotiate a repayment arrangement, combined in most cases with a partial write-down of the outstanding debt, through a licensed insolvency practitioner. The agreement then has to be formally endorsed by the court. The duration of IVAs is significantly longer than for bankruptcies (typically five years), and the fees charged by insolvency practitioners can be high, with Citizens Advice reporting these as typically in the region of £5,000.¹⁴⁷ The intention of an IVA is to provide debtors with the opportunity to keep their assets (including their homes), in return for paying back a higher proportion of the debt than would otherwise have been the case. Where people applying for an IVA own their home, most IVA agreements include a requirement for them to get this valued in the final year of the agreement. If there is equity in the property, then they will usually need to raise a lump sum to put into the IVA by remortgaging their home. However, if it is not possible to remortgage, then the debtor will usually be expected to continue to pay their usual monthly contributions under the IVA for a further 12 months instead.

¹⁴⁶There are a number of others which also apply to specific groups of people: for example, some professions don't allow people who have been made bankrupt to continue to practise, and it is not possible to continue as the director of a limited company once the bankruptcy order has been made.

¹⁴⁷The fees for IVAs can either be paid up-front or some insolvency practitioners include these in the agreement, so that a proportion of the debtor's monthly payments over the course of the IVA is going to the practitioner rather than the creditors.

The second court-based alternative to bankruptcy was introduced following the review of debt solutions referenced in the 2004 Over-indebtedness Action Plan. This is the DRO, which aims to provide a quick and cheaper route to the write-off of debt, but it is only available to those on low incomes and with no assets. DROs were finally introduced by the Tribunals, Courts and Enforcement Act 2007 and became available from 6th April 2009, following lengthy consultations by the Department of Constitutional Affairs and the Insolvency Service. They provide for the discharge of debt after just one year, provided that the total amount of debt is less ^[203] than £15,000 and the debtor has a monthly surplus income after taking account of essential expenditure of less than £50. The debtor is also not allowed to have any assets or savings worth more than £300 or own a vehicle worth more than £1,000. DROs must be applied for by an authorised debt adviser, and there is an application fee of £90, although this can be paid in instalments.

Non-court-based solutions

IT IS APPARENT from even this cursory review of court-based debt solutions that there are significant barriers to obtaining a discharge from debts within a reasonable period of time for anyone who owes over £15,000 and owns a home. These barriers relate to the uncertainties involved in a bankruptcy and the high level of fees and lengthy repayment periods associated with IVAs. As a consequence, there has been tremendous growth in the number of people using out of court DMPs. These provide for an agreement to be struck with creditors such that interest on outstanding debts is usually frozen and the debtor is able to make a single monthly payment to the debt advice agency which then distributes this to the creditors. Although DMPs usually require the debtor to repay their debts in full, and can therefore be lengthy, they do not (at least as regards the free advice sector) involve any fees, as the DMP provider typically recovers the cost of their service from the credit industry through a 'fair shares' model, which involves the lenders paying back to the advice agency a percentage of the amount collected. For example, the StepChange debt charity (formerly called the Consumer Credit Counselling Service) receives approximately 10 per cent of the value of the payments that it distributes to the credit industry back under its fair shares deal.

However, the funding model for some DMPs raises concerns that advice agencies may have a conflict of interest. In particular, the fee charging debt advice sector, which now comprises over 500 licensed firms and which was estimated in 2009 to provide DMPs ^[204] for around 375,000 people, has been criticised for not providing best advice and encouraging people to take out DMPs rather than use insolvency procedures. Clearly, it is of greater financial benefit for these companies to have debtors on long-term DMPs, from which the firm derives a fee, than to advise debtors how to have their debts written off.

Likewise, there is a lack of standardisation across debt advice agencies when it comes to calculating the level of repayment that people can afford to make to their creditors. Whilst many

advice agencies have adopted a common set of minimum figures to use when calculating essential expenditure requirements for households of different sizes and compositions, these are not always used by commercial firms. Just as importantly, the common figures do not allow for households to build up savings but assume that all income above the amount required for the cost of essentials should be distributed to creditors. This means that households are not provided with the chance to build up their resilience to future shocks whilst they are on the plans.

The debt explosion (2005 to 2010)

THROUGHOUT 2005 AND 2006 the numbers of people in financial difficulty rose exponentially as the Bank of England started to raise interest rates as a means of addressing the boom in house prices, and as fuel and food price increases began to squeeze disposable incomes. The vulnerability of households to relatively small shocks was now becoming apparent as Britain witnessed a rapid rise in both the use of insolvency procedures and DMPs. Personal insolvencies, even before the introduction of DROs, increased by 57 per cent in the 12 months from the introduction of the Tackling Over-indebtedness Action Plan through to the end of 2005. They rose by a further 44 per cent the following year, taking the number of people declared insolvent to around 30,000 per quarter. Just over 35,000 DMPs were also put in place in 2006 by the Consumer [205] Credit Counselling Service – a leap of 30 per cent on 2005. Although CCCS was the largest single provider of DMPs, it estimated that it only accounted for around 10 per cent of the total number of DMPs in place that year.

A number of the larger banks also started to post increased debt write-offs during the period. In the first half of 2005, Barclays reported that it had written off £706 million, an increase of 20 per cent on the same period in 2004, and the Government reported that the overall write-off rate for household debts across all banks had increased by 30 per cent that year. In the following year, it was apparent that there had particularly been an increase in the level of credit card debt being written off, with Government reporting that the write-off rate had increased to 6.4 per cent of total credit card lending in the second half of 2006 – up from 4.5 per cent a year earlier.

Despite the upward trend in these indicators, the Government continued to persuade itself that all was well. In its over-indebtedness monitoring report issued in early 2007, it remarked:¹⁴⁸

“A strong labour market, low rate of inflation and still historically low levels of interest rates, particularly prior to the recent increases in interest rate, still indicate an economy that continues to perform strongly. Against this continuing stable background, the strong growth in consumer spending over the last year is not to be unexpected.”

THE REALITY WAS TO BE VERY DIFFERENT. The upward trends in personal insolvencies, DMPs and debt write-offs continued throughout 2007, and the economy was sent into a debt-induced global downturn in 2008. By late 2009 and early 2010, as many as 35,000 people were being declared

¹⁴⁸<http://webarchive.nationalarchives.gov.uk/+http://www.berr.gov.uk/files/file39339.pdf>

insolvent every three months, and by the end of 2010 the Consumer Credit Counselling Service reported that it had over 110,000 people on DMPs.

Where now?

[206] TODAY, THE EXTENT OF OUR FINANCIAL PROBLEMS is crystal clear. According to a recent report from the Centre for Social Justice,¹⁴⁹ around 3.9 million households do not have sufficient savings to cover the rent or mortgage for more than a month, and average household debt (including mortgages) has risen to £54,000. The poorest households have average debts more than four times their annual income, with their average debt repayments amounting to nearly half their gross monthly income. Further to this, the Resolution Foundation has modelled what will happen if interest rates rise.¹⁵⁰ Noting that around 600,000 households now spend over 50 per cent of their disposable income on debt repayments, the models indicate that under a worst-case scenario, the Foundation believes that this number could double by 2017.

However, recent increases in the fees for bankruptcy applications have seen the number of people taking this route decline, and the numbers on DMPs increase further. In 2012 the StepChange debt charity administered £327 million of repayments through its DMPs on behalf of nearly 130,000 debtors. This shift from bankruptcy towards DMPs is a potential cause for concern, as the former provides for a swift discharge from debt and a considerable write-down of outstanding amounts, whilst the latter does not. This is a particular concern where DMPs are offered by commercial, fee charging, debt advice companies, which have expanded significantly in recent years. A review of DMPs conducted by the Ministry of Justice in 2009 found that the average repayment terms negotiated by commercial debt management firms required these plans to run for 12 years. However, in reality, debtors were able to sustain the payments for less than 36 months. Further to this, the OFT's *Debt Management Compliance Review*, which was completed [207] in 2010, found that the quality of advice offered by debt management firms was poor and more suited to the commercial interests of the firm rather than those of the debtor. Its 'mystery shopper' exercise found that 64 per cent of advisors gave advice without asking for disposable income figures, but despite this 42 per cent of advisors gave definitive recommendations to debtors to opt for a debt management plan.

A structured programme of debt write-off and rescheduling

An alternative approach to relying on individuals to find an appropriate debt solution would be for Government and the credit industry to step in with a programme of structured write-offs and debt rescheduling. As reported in Chapter 3, the US has come closest to adopting this approach with its Home Mortgage Affordability Programme. In the UK, a programme of debt write-down and restructuring could be achieved in two main ways. Firstly, quantitative easing and other Bank of

¹⁴⁹<http://www.channel4.com/news/debt-credit-money-mortgage-rise-economy>

¹⁵⁰<http://www.resolutionfoundation.org/publications/closer-edge-prospects-household-debt-repayments-in/>

England programmes, including Funding for Lending, could require that the cheap funds being pumped into the financial sector find their way to helping households in financial difficulties, with the banks obliged to use the funds to restructure existing household debt to make this more affordable. This could, for example, be used to ensure that mortgage repayments are reduced to around 30 per cent of household income as in the US. Secondly, when banks write down household debt on their balance sheets, this amount is written off against profit for the purpose of calculating corporation tax. However, many of these bad debts are then subsequently sold on to debt collection companies at a fraction of the actual level of debt, for which the borrower is still liable. The debt collection agencies then make their profits if they can recover more from the debtor than they paid the banks for the rights to pursue them. In some cases, debtors are therefore pursued for the entirety of their original liability despite the bank [208] having formally written this off against tax and the debt collection company having paid only a fraction of its face value. This latter fact has recently been illustrated in the US where, as part of the Occupy movement, the Rolling Jubilee project managed to purchase nearly \$15 million of debt from the banks for only \$400,000. It then subsequently 'abolished' this debt to release the borrowers from their obligations. Reporting on this in the *Guardian*, Adam Gabbatt noted:¹⁵¹

"The group is able to buy debt so cheaply due to the nature of the 'secondary debt market'. If individuals consistently fail to pay bills from credit cards, loans, or medical insurance the bank or lender that issued the funds will eventually cut its losses by selling that debt to a third party. These sales occur for a fraction of the debt's true values – typically for five cents on the dollar – and debt-buying companies then attempt to recoup the debt from the individual debtor and thus make a profit."

IT IS THEREFORE ENTIRELY POSSIBLE for Government to arrange a similar buy-out and write-down of debt through, for example, Royal Bank of Scotland, in which it has a controlling stake. The main argument against this type of intervention is that it would create a moral hazard – allowing debtors to escape the consequences of their own 'poor financial decisions', and somehow rewarding fecklessness at the expense of the responsible taxpayer. This ignores the long-standing and structural causes of the long credit boom and the fact that much of the outstanding debt is simply the accrual of interest on interest. The moral hazard argument was also overridden when it came to the financial sector, on the basis that 'saving the banks' was critical to the economy. The crisis for households is even more critical. We urgently need to restore the resilience of households if we are not to see further rises in homelessness and defaults on rent, council tax and other utilities, as well as increased mental health problems and relationship breakdown. These impacts all have implications for the taxpayer, and it would make economic [209] sense to limit their extent as far as is possible. According to the charity Crisis, the cost to the taxpayer of a single person becoming homeless is around £25,000. A programme of debt write-off and rescheduling would undoubtedly make sense in financial terms. Further to this, there

¹⁵¹<http://www.theguardian.com/world/2013/nov/12/occupy-wall-street-activists-15m-personal-debt>

would also be wider economic benefits as households would be able to move forward with greater confidence and would be able to build up savings. Steps would need to be taken to ensure that these were then intermediated by the financial system into investment in our economic priorities. The debt overhang on households is holding this process back. As such, a programme of partial write-offs and debt restructuring needs to be developed and promoted as part of a wider national renewal strategy.

At the very least ... better insolvency and debt management services

UNFORTUNATELY, BRITAIN IS NOT YET PREPARED to take such radical steps. If the position worsens, in the years ahead as expected, then it will need to reconsider its options. Without such a programme, we will undoubtedly have to contend with a long, drawn-out process of stubbornly high insolvency rates, mortgage repossessions, and recovery actions, and depressed consumer confidence for years to come. At the very least, then, we should do more to ensure that our insolvency and debt management systems are fit for purpose. There are a number of important lessons that we should learn from other countries to improve these.¹⁵²

[210] We need to ensure that debt recovery is subject to a moratorium pending the negotiation of debt repayment plans (as is the case in France) and provide an opportunity for at least a partial write-off of debts without requiring formal court involvement. This could be done by the FCA requiring lenders to co-operate with debt advice agencies and, once they have been contacted, cease enforcement action for a reasonable period to allow a DMP to be negotiated. The FCA could also standardise the terms of these, for example by requiring them to run for no more than three to four years, and that lenders write off any amounts outstanding after this period.

We also need to protect the living standards of debtors and ensure that they are able to live in 'conformity with human dignity' (as is the case in Belgium), for example by calculating debt repayments with reference to minimum budget standards or average income levels and ensuring that these are applied consistently by all debt management and insolvency agencies. The US Chapter 13 bankruptcy procedure may be a useful model in this respect, as repayments are calculated from the excess of their income over the median household income level of the State in which the debtor resides. In the Netherlands, a clear minimum income standard, based on socially acceptable levels of expenditure for different household compositions, is used. The level of expenditure set out by these standards is publicly available. In the UK, although some debt management agencies have signed up to using a standard approach when calculating the disposable income of debtors, these are not universally accepted, not used to calculate repayments in formal insolvency procedures, not publicly available, and are based on surveys of

¹⁵²It should be noted that the lengths of insolvency procedures vary significantly between countries. For example, discharge is not normally achieved in Germany for a period of six years, whilst in Canada discharge is available for first-time bankrupts with no surplus income (calculated using a standard formula) after just nine months. Where Canadian bankrupts have more than CA\$200 in surplus income, then they are expected to pay half of this excess to their creditors for a period of at least 21 months. The impact of these variations in discharge periods on the extent to which household debt is written off and on the economic growth prospects of different countries requires further study.

actual expenditure levels rather than on research into what is socially acceptable. As a consequence, the living standards of [211] debtors in England and Wales are likely to be worse than in many other countries.

Finally, we should ensure that we are incentivising debtors to take up employment, for example by adopting the 'payback' system from Germany. This ensures that debtors whose income increases during the period of their insolvency, and who go on to make a higher level of repayment as a result, are rewarded by receiving a proportion of these payments back at the end of the procedure.

Creating a coherent and well-resourced advice system

ALTHOUGH THE TACKLING OVER-INDEBTEDNESS ACTION PLAN put in place in 2004 indicated that Government wanted to establish a single 'gateway' to advice services, this was not, in fact, achieved, and the task of developing a national strategy for the provision of debt advice was finally given to the Money Advice Service in July 2011. Likewise, although the Government provided £143 million in funding over the period 2004 to 2011 to support telephone advice provided by National Debtline and face-to-face advice projects delivered by Citizens Advice, it is clear that this has been inadequate to meet the growing demand for services, especially as other funding sources for advice services including Legal Aid and local authority support has been cut. In April 2012, the *Daily Mirror* reported how local Citizens Advice services were being affected with its Chief Executive, Gillian Guy, stating that:

"It's now clear that cuts are beginning to disrupt our front-line services across the country, just as people struggle to cope with the impact of job losses, reductions in public services and a massive jump in the cost of living."

THE MONEY ADVICE SERVICE now represents the major funding agency for debt advice, raising its revenue from a levy on financial services firms. This levy applies to those firms regulated by the FCA, which includes the main banks but does not currently apply [212] to consumer credit lenders licensed by the OFT. However, in April 2014, the FCA will take over responsibility for the regulation of consumer credit from the OFT and the Money Advice Service levy will therefore extend to these firms also. Whilst these are welcome developments, it is frankly bewildering, after such a lengthy and sustained increase in credit use and debt problems, that it has taken until now to recognise there is a need for a national strategy for debt advice provision, and to provide a solid mechanism to fund this.

But as at the time of writing, we still do not have that strategy in place, and the funding levels remain inadequate. In its business plan for the provision of debt advice for 2012/13, the Money Advice Service set out how it would spend £34.5 million to temporarily sustain the direct delivery of debt advice services previously funded by the Department for Business, Innovation and Skills, and a further £2.2 million on the development of:

“... a new and more coordinated system for the delivery of debt advice – one that will enable more people in debt to find the right sort of help for their needs more quickly and easily. Built into this newly coordinated system will be the means to harness existing resources better, to bring everybody’s standards up to match the best, and to capture data in a way that will inform continuous improvement.”

THE NEW ‘DELIVERY SYSTEM’ was initially expected to be put in place by the end of 2013. However, the Service is only now consulting on its plans for 2014/15, and the budget for debt advice for the year remains unchanged because the FCA has not yet finalised its proposals for the levy on consumer credit firms. The Money Advice Service is now consulting on its business plan for 2014/15 and has indicated that it intends to enter into three-year funding arrangements with providers in England and Wales, beginning in October. However, it is clear that the pressure on resources is driving the Service to reduce face-to-face provision, which is expensive to deliver, and replace this with the cheaper options of phone advice or the provision of information over the Internet. [213] The proposed new agreements will therefore place providers under a requirement to direct customers to the most appropriate channel (website, phone or face-to-face) for their needs and “to ensure that face-to-face advice is used by those who most need it”, as well as to try to reduce future demand by “helping people who are over-indebted become more financially capable, with the financial skills, knowledge, and confidence to be able to cope with possible future income shocks.” Finally, the Service has also indicated that it will seek to increase the supply of debt advice by creating a ‘funders’ forum’, and using this to develop ‘consistent evaluation methods’, and ‘more joined up commissioning approaches’ to target the supply of debt advice towards those areas where there is particularly high demand. It can only be hoped, given the resource pressure on advice services, that this approach is successful in opening up avenues of further funding for provision. In particular, the impacts of debt advice and release from debt for households, together with the beneficial impact of this for public services and the wider economy, need to be more thoroughly evaluated and a strong business case for funding presented to Government.

Chapter 7: A manifesto for responsible credit

[215] BRITAIN IS IN THE MIDST of the greatest personal debt crisis in its history. Over a period of 40 years, the expansion of financial services, and of credit in particular, has contributed to a considerable decline in Britain's economic position in the world, as well as to the near-decimation of the welfare state and to the growth of a highly individualistic and unsustainable culture. Many households are experiencing acute debt problems. Many more are living on a knife-edge – extremely vulnerable to the slightest price or interest rate increase, to a fall in wages, or to the latest benefit cut. Our basic needs – for affordable and decent homes; for education; good jobs; and to obtain dignity in retirement – are all now contingent on our ability to gain access to financial services markets. Forty years ago, we would have looked to the Government for these things. The terms on which we access financial services markets are incredibly important. Yet recent years have demonstrated that, rather than focus on how to provide households with fair access and deliver up products designed to help people achieve their ambitions in life, the banks and consumer credit lenders have been overwhelmingly concerned with the development of predatory products and have put in place a system which is highly regressive and drives forward growth in wealth inequality. We need to change direction.

[216] Successive governments, wedded to low Income Tax and inflation, have been complicit in allowing Britain's decay to occur. From the late 1970s onwards, we have encouraged speculation in the housing market and credit-fuelled consumption, even as the foundations of our economy have fallen away beneath us. Our economic history tells us that this creates the conditions under which an attack on the welfare state takes place. The current Coalition stands in the tradition of the Thatcher governments. It uses an expansion of credit to create inflationary pressure and then, arguing that inflation is unacceptable, proceeds to bear down on this by cutting away with ever-greater ferocity at public spending and the remains of our welfare state. Promises of building an export-led recovery and of rebalancing the economy away from our reliance on financial services are hollow. Even after the largest economic downturn in living memory, we are once again stoking the housing market and relying on consumer spending to deliver economic growth, whilst attempting to hold back inflation by cutting services and support for the poorest. The economic strategy currently being pursued can do nothing other than lead to the further indebtedness of households, widening social divides, and to greater unrest. If we are to stop this sustained attack on the living standards of low-income, working-class households, then we will need to attend to two urgent tasks.

Rescue package for households as part of wider economic strategy

THE FIRST OF THESE is to design and agitate for a rescue package for households as part of a wider national strategy to renew the economy. At the very least, this should ensure the adequate funding of agencies to deliver a standardised debt management plan for households in financial difficulty. This plan should include the freezing of interest and discharge from debts after a

reasonable [217] period and must protect people's homes. However, there are good grounds for going further, and providing funds to systematically write down and restructure household debts, for example by buying up debts from banks and debt collection companies at reduced cost and passing on the level of savings on the face value of the liabilities to households. What was good for the banks must now be passed on to British households. There can be no excuse for saving financial institutions at the expense of people.

We also need to consider how we will provide assistance to those households approaching retirement who were either mis-sold interest-only mortgage products or who otherwise now find they are unable to pay off the mortgage on their homes. This will inevitably need to involve funding for Housing Associations to convert many of those worst affected into tenants in their homes.

We must also start to build houses on a significantly greater scale than we have done over the previous 40 years, and we will need to constrain levels of mortgage lending relative to the progress that we make in delivering these new homes. House prices must fall relative to earnings, and base rates should not be increased until we can be sure that this would not spark a mortgage repossession crisis. The economic and social costs of doing otherwise are likely to be horrendous. We should also immediately abolish the Help to Buy and Right to Buy schemes and look at ways to build more sustainable communities, including by providing social housing tenants with a right to build up equity shares in their homes and giving greater security and certainty over rental costs to tenants in the private sector. There is no doubt that such a programme will require public investment, and there will be a need to raise income tax to pay for this. There is a need to take collective responsibility for Britain's failures over the past 40 years, and to raise money through taxation for a programme of national renewal. We cannot cut our way back to health as the Coalition believes. Britain is in great need of investment. Indeed, there can be no renewal of our country without this. We must therefore call on everyone to make [218] their contribution. If Britain is to get back on its feet and 'pay its way in the world', then measures will also need to be taken to ensure that the returns from lending to business are never lower, and are often greater, than the returns that can be made by lending to households. This is likely to require public subsidy of lending to business, and the refocusing of the Funding for Lending scheme to provide this is a significant first step in this direction.

However, we should not forget the Bank of England's role in creating the personal debt crisis that we are now experiencing. As an institution, the Bank has played a highly political role in the past, and we should, therefore, be sceptical as to its motivations. Greater political control over the operations of the Bank, for example by setting out broader social and economic targets for it to report against, will be essential if we are to ensure it works to the benefit of us all and not merely the financial services sector.

Containment of credit expansion

OUR SECOND TASK is equally critical. We must not allow credit expansion to take place at anything like its previous level. Having provided households with respite from their debts, we also have to find ways of encouraging them to make greater savings and to channel this money into investment in businesses, other than financial services, which will improve our balance of trade. This is an economic priority that must remain in place over the long term. Tighter responsible lending requirements, particularly to prevent outstanding credit commitments from being further rolled over and bans on unsolicited increases in credit limits will need to be put in place, as will requirements that accounts are closed where outstanding amounts have been paid off as a result of a balance transfer. These are technical details. The principle is clear: we must stop the constant churning of debt, the paying of interest on interest on interest which is dragging households down. Relieving them from this burden will enable them to save again. A new 'national renewal ^[219] savings scheme' to make investment in business and local housing projects should therefore be established, and we should also look to restore the Child Trust Fund which incentivised parents to put savings into accounts for their children on the basis of matched contributions from the state. Never have we had a greater need to put something aside for the next generation.

At the heart of a national renewal strategy must be a series of measures to deliver a more progressive financial services system. This has to include, as a minimum, an end to 'free' bank accounts and credit card provision, and a reduction in the amount of revenues derived from people who go overdrawn or who cannot clear their credit card balances in full each month. Caps on the cost of credit also need to be expanded from the payday sector into other areas of the high-cost credit market, and banks must be challenged to demonstrate how they are supporting the development of credit unions and CDFIs to deliver more affordable provision. We also need to do more to ensure that, when credit is used, this is not bringing forwards the use of the natural resources at a rate which is faster than they can be replenished. In this respect, the credit industry should be challenged to bring forward ideas as to how they can reward consumers for making more sustainable consumption choices.

In the final analysis, we need to control the financial sector and restore it to its rightful place as a servant of government economic policy. We cannot prosper as a nation if our economy is reliant on household consumption and ever-increasing levels of personal debt. We have to direct more resources into creating much more sustainable economic foundations. Those resources must come from our banks. They will not be willing to create their own competitors and relinquish their dominant position. We will have to make them do so.

Appendix: The Charter to Stop the Payday Lending Rip-Off

[221] WE BELIEVE IRRESPONSIBLE PAYDAY LENDING and other high-cost credit is damaging the health and wealth of our country. Payday lenders are exploiting millions of people across the UK, trapping them in spirals of debt, and the problem is getting worse. Payday lenders are breaking promises they made in their own customer charter.

Self-regulation has failed. We call for effective regulation of payday lenders and high cost credit, which is properly enforced, to:

- Stop them giving loans to people who can't realistically afford to pay them back;
- Stop them repeatedly rolling over loans and creating spiralling debt;
- Stop hidden or excessive charges;
- Stop them raiding borrowers' bank accounts without their knowledge and leaving them in hardship;
- Stop irresponsible advertising and instead provide clear and transparent information;
- Require lenders to promote free and independent debt advice and ensure they co-operate with other services to help people get out of debt.

[222] We also want action to support the growth of credit unions and other forms of more responsible lending; we want banks to increase the availability of credit to people on low and middle incomes; and we want new research on capping the total cost of credit undertaken now.

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THIS BIBLIOGRAPHY HAS BEEN COMPILED for the 2026 digital reissue; the 2014 edition did not include one. It lists the books, journal articles, reports and official publications cited in the text and notes. Newspaper and broadcast reports, press releases, speeches, web pages, parliamentary debates, legislation and legal cases are cited in full in the footnotes and are not repeated here.

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