NAMING IT FOR WHAT IT IS

How we might reform our debt laws in the name of social justice

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Thank you for the invitation to share your journey with you. I want to acknowledge the work you do with vulnerable people, at a time when the economic challenges for so many are overwhelming. My task today is to bring a policy perspective to the context you work in, and I will conclude with policy outcomes we can all advocate for in order to address the issue of debt. Whilst working as the 'budget ambulance' at the bottom of the cliff, it is important to also work for change that will create the much needed barriers at the top of the cliff.

In 2008 the then Leader of the Opposition John Key was a guest speaker at The Salvation Army's Just Action Conference in Christchurch. In the Q and A session which followed his address a member of the audience asked him that if he was to become Prime Minister would place greater controls over moenylenders. Mr Key expressed some doubt that such controls were necessary because he thought that it was important that people had access to capital.

Mr Key's framing of the sort of debt being referred to then as capital is a little problematic in my opinion. To give him his dues Mr Key was responding to the question off the cuff so it is likely that his response was not as considered as it might be. Granted too, Mr Key has come from a merchant banking background where debt is probably seen as capital so it is easy to see how he might naturally frame all debt as capital.

But the sort of debt to which the questioner was referring to and the sort of debt which you as budgeters have to deal with on a daily basis is a long way from capital at least to the people who owe this debt. The idea of debt as capital implies that the debt will be invested into productive purposes in order to generate an income for the borrower/investor. The debt which is dragging down the families who become clients of budgeting agencies, is as you all know, not this sort of debt. The debt that you deal with every working day is a millstone around the necks of the people and families concerned and the terms under which the debt is provided are often harsh, onerous and downright usurious.

I use the term usurious without reservation. The idea of usury has a long tradition in both Christianity and Islam and as you probably know it is not an idea without problems. The Catholic Church prohibited the charging of interest as far back as the 12th Century placing a formal prohibition on charging interest with the threat that anyone who did so was not only banned from receiving sacraments but could not expect a Christian burial.

There are of course a number of problems with such a ban not the least of which is that if someone has to lend money without charging interest there is not a whole lot of incentive to take on such risks and to forego their own consumption to do so.

The idea of lending without interest gradually disappeared as a theological concept in the 19th Century and in the face of rampant capitalism and its handmaiden Calvinist Protestantism. As so often happens we adopted a theology or at least a moral philosophy which suited our ends.

But in my opinion the idea of usury still has currency. While it would be quite fanciful to imagine a world without lending based on interest, most of us would accept that there still should be a limit to the rate of interest required by lenders of borrowers. For those of us with assets and sound credit histories this limit is determined by the market. Such 'good credit risks' have a number of opportunities to borrow money and the marvellous invisible hand of the market ensures competition amongst lenders. This competition comes in the form of the interest charged on loans.

However as you know the people outside such arrangements face a far more limited and onerous set of options when it comes to getting credit. They face the secondary or even the fringe market of loan shops, moneylenders, pawnbrokers and loan sharks. They face terms and conditions on debt that are often exorbitant and even extortionary, and they face interest rates that are usurious and unwarranted.

These interest rates are unwarranted, in part, because the apparent risks which lenders face in making loans to unreliable borrowers are mitigated by the opportunities lenders have to enforce debt contracts. As you know, lenders have a number of remedies under the Credit Contracts and Consumer Finance Act including repossession and obtaining courts orders to enforce repayment. As you know too, moenylenders are adept at utilising these remedies and they are relatively inexpensive to apply especially if debtors put up little or no resistance. So why then, if remedies for recovery of debt are so easily applied, are the effective interest rates charged by secondary and fringe lenders five and sometimes ten times that paid by middle class New Zealanders on their mortgages. Surel,y the risks involved in such lending are not five or ten times that of mortgage lending?

The most obvious answer to such a question is because they can. Secondary and fringe lenders get to charge usurious interest rates and to apply extortionary terms because they can find people desperate enough to accept them. This is the 'dog eat dog'' law of the jungle' type of capitalism which the medieval church sought to limit through decrees against usury and unjust profits.

The Salvation Army and others have sought to bring some decency to the way in which consumer debt is contracted and enforced. We have lobbied consistently and extensively for changes to laws such as those in the Credit Contracts and Consumer Finance Act. These efforts have been rewarded with token efforts by Government in introducing such things as a 'responsible lending code' and vague conditions around unreasonable fees, even vaguer definitions around oppressive actions and virtually unenforceable provisions around the burden of proof on the part of lenders. Put simply The Salvation Army believes that New Zealand's consumer credit laws remain unfairly weighted in the interests of lenders and have little regard for the often huge power imbalance between lenders and borrowers.

Aside from largely voluntary codes designed by the finance industry and some belated regulation of lenders under the Financial Markets Authority Act, the Government's best shot to curb the problems of usury and moneylenders preying on the poor is financial literacy.

As an aside and somewhat ironically much of the regulatory efforts of the Government in and around financial services are to do with controls in the way finance companies borrow money off middle class lenders. Such efforts are to avoid a repeat of the debacle of 2008 through to 2010 where finance companies collapsed owing lenders and debenture holders hundreds of millions of dollars. It seems that as a society we need to make extra effort to protect the relatively well off from the folly of their own greed while we pay scant regard to the way some businesses engage in predatory lending to the poor.

But back to financial literacy. Financial literacy as you know has become the new orthodoxy of budgeting agencies and of Government's response to problems of excessive indebtedness and insufficient incomes. Despite this orthodoxy financial literacy has not been put under the spotlight to examine its ideological content, its efficacy or its relevance to addressing the problems it sets out to address. This absence of scrutiny I suggest is partly because financial literacy has some intuitive appeal and perhaps it already resonates with many people working in budgeting agencies.

While I do not plan to offer this spotlight analysis here I believe that it is important to begin to shine some light onto the basic idea that poverty and chronic indebtedness is caused by peoples' ignorance and stupidity. To put it more plainly I am suggesting that the prescription of financial literacy is not only patronising and paternalistic but it based on the core notion that the poor are dumb and stupid and that they need the good example of those who can manage their finances in order to lift themselves out of debt and poverty.

By now I am probably annoying some in the audience who I have no doubt can offer anecdotes of some people's atrocious behaviour with money and stories of how budgeting has turned their lives around. I am sure there are such examples and I don't wish to pour scorn on your practice by criticising one of your main tools as budgeters. However as the story goes 'if all you have is a hammer then everything starts to look like a nail'. In other words we might define our problems or rather the problems of those we work with by the tools we have to deal with them – or perhaps more accurately, by the tools we are funded in our contracts to use.

Financial literacy is straight out of economic rationalism with its belief in the efficiency and sanctity of markets. Economic rationalism would have us believe that markets are almost always the best way for a society to allocate resources and that any limitations to markets are caused either by information failures or poorly defined property rights. Thus, the reason some people get hopelessly into debt is because they make poorly informed decisions around borrowing. The answer quite simply is to provide people with the right information and then they can live the rest of their lives as happy rational consumers.

I suggest to you that the reason for many peoples' chronic indebtedness is rather more complex than it just being an information problem. There are problems of power imbalances, people's cognitive behaviour and the plainly predatory practices of many moneylenders. Not to mention poverty and inadequate income.

Power imbalances come in at least two forms. Firstly, there is the basic imbalance in broadly defined literacy and familiarity with credit contracts. Moneylenders have lawyers to draw up standard loan agreements which are barely understandable even for people with a reasonable level

of education. Naturally these contracts are slanted in favour of the lender although they must of course comply with the law. Any level of compliance and the reasonableness of contract is seldom if ever tested in courts either because the value of the contracts do not warrant an expensive judicial process or because debtors do not have the confidence and resources to contest such things in court. In addition the ability of would be borrowers to argue for changes in a credit contract is quite limited when they have few if any choices over where they will get the credit from. Furthermore, a borrower is hardly familiar with the process of settling credit contracts while those working for a credit company or loan shark do such things every day.

The second form of power imbalance comes about through lack of choice. Those people borrowing from second or third tier lenders are doing so because they have little or no chance of getting credit from middle class sources such as trading banks and credit card companies. This lack of choice of course disempowers them but on top of this might be the urgency with which they require credit. Many fringe lenders make it a marketing point that they have quick approval processes for relatively small loans – 'thanks instant finance'. This urgency might arise through lack of planning and foresight in which case a financial literacy programme might help. But often people in these circumstances are literally 'robbing Peter to pay Paul' so are borrowing to pay off other debts or to pay regular bills which are left unpaid because much of their income is going to service existing debts – sound familiar? Often too these people lead generally chaotic lives which might be caused by alcohol drug and even gambling addictions or by homelessness or by health problems – or all of these. While financial literacy might help them to get their lives a bit more together there deeper problems here which probably need to be addressed before someone can set some financial goals.

A core idea of economic rationalism is the notion that people are rational utility maximising individuals – the so-called Homo-economicus. It is however doubtful that Homo-economicus is now extinct but more likely that he (or she if women want to take credit for such a bad idea) never existed. It is not new news that people are not rational but make deeply flawed decisions repeatedly – we are creatures of habit –we sometime demonstrate a herd instinct and we often overlook our poor decisions and put them down to bad luck. Such ideas have recently been popularised by an imminent behavioural psychologist Richard Thaler titled 'Misbehaving'.

Teaching everyone financial literacy can overcome some of these failing although it is doubtful that will make much of a difference overall as suggested by American journalist Helaine Olen in a recent book titled 'Pound Foolish: Exposing the Dark Side of the Financial Services Industry'. One reason Ms Olen gives for such an impossibility is the chronic imbalances in the US economy. In a 2013 op-ed published in the Guardian she said

'Cutting back on minor expenses won't save you much in a country where luxuries are cheap and necessities expensive. It's not our daily latte that is driving us to the poorhouse. It's our Lipitor … and our houses, our families and other necessities of life'[i]*.*

Lipitor is a medication to treat high cholesterol which of course in the US is not subsidised so like other medication is quite expensive for those who need it. But aside from this difference, how true is this observation of New Zealand too? Luxuries are comparatively cheap while necessities are increasingly expensive. For the middle class this is not much of a problem because they have the incomes to pay for the necessities so then get to benefit also from the cheap luxuries. For those on

low incomes paying for the necessities is a real challenge and then it is sometimes the case they get sucked into buying relatively inexpensive luxuries – often on credit, which they cannot afford. In a classic blame the victim scenario such purchases of luxuries like flat screen TV's or unnecessary mobile phones are seen as the cause of their problems. We all know that it is the cost of the necessities and especially housing which is crippling people with impossible debt.

But it is the example of people on low incomes buying unnecessary luxuries which draws attention to their poorly informed decisions and some would say their foolishness. Such decisions may be as much about circumstance as they are about choice. Sure we should almost always grant people agency and accept and expect them to make reasonably sound choices for themselves and their families. However, sometimes the circumstances impact significantly on the choices available and how these choices are presented and perceived. This is where the predatory practices of some lenders need to be raised.

It is always easier to get someone to do something when they are vulnerable. There are certain well-known psychological processes or effects which make such manipulation possible. Examples of these include the links between immediate or delayed gratification and person's state of mind and our different abilities to self-regulate our behaviour when we alone or with supportive friends. Predatory sales practices rely on such connections as shown amply with the way clothing trucks operate or the way unsolicited debt is offered to people around Christmas time.

The intention here is often quite clear – to ensnare people in more debt regardless of whether or not it is really manageable for them. These practices are always self-serving and often malicious. Yet those selling debt and selling stuff through access to debt are protected by laws which just suggest vague and unenforceable standards of behaviour on one hand and on the other hand offer efficient and often punitive remedies when debtors fall over.

In many ways predatory lenders can be likened to drug dealers. Both sell products with malicious regard for the people they are selling to and both products have the potential to trap people in a cycle of dependence, which severely limits their life choices. It is because of the often predatory way in which debt is peddled and the way that it can ensnare people which leads The Salvation Army to present debt as a social hazard.

Presently the idea of debt as a social hazard might appear somewhat odd to most New Zealanders. Perhaps this is because we have not had a sovereign debt crisis as in Greece, Ireland and Iceland or a sub-prime mortgage crisis as in many states in the US. The reality is that New Zealanders across the income spectrum and the country itself have a love affair with debt and we don't see this as a problem.

For example household debt in New Zealand has risen 45% in inflation adjusted terms over the last decade[ii]. Over the same timeframe the current account deficit – that is the difference between what we earn from the rest of the world and what we spend has totalled $88 billion[iii]. We worry about foreigners coming and buying up our assets but this only made possible by the way we are racking up debts on cheap Chinese imports.

Debt is effectively a charge on the future. Where households have heavy debt burdens and negative net wealth, their futures are effectively mortgaged in a form of debt bondage. From all accounts

things are getting worse rather than better although we have no reliable data of just how indebted low income household are. Such a future cannot be good for the tens and perhaps hundreds of thousands of New Zealand households who virtually have nothing but a pile of debt.

The Salvation Army believes that the way debt is currently framed is misleading and that we need to reframe it in order to more accurately identify the problems and challenges we face. Instead of talking about credit we should be talking about debt and where the terms of this debt are onerous and unfair we should be saying so.

For The Salvation Army the current consumer debt law remains woefully inadequate and unfair despite the Government's efforts at tinkering with it minimally. The Army believes that the following changes are urgently required

1. That lenders be governed by a statutory code of conduct not a voluntary industry decided one
2. That a maximum interest rate should be set for any debt contract. This rate should be no more than 50% including all the add-ons, penalties, fees, charges and commissions which moneylenders are good at extracting. As well, any effective interest rates above this maximum should be effectively illegal and unable to be enforced by the lender.
3. That more specific conditions be set around terms and conditions in debt contracts rather than the vague requirements to be reasonable. Furthermore, these conditions should be based on the statutory code of conduct.
4. That debt contracts are not enforceable if they are deemed by the courts to be unjust or unlawful.

While the prohibitions on usury and of charging interest are relics of the distant past, the idea that debt and debt contracts should be administered fairly and honourably is a relevant today as it was 800 years ago. The notion of usury and of the unjust exploitation of our most vulnerable people remains an idea worth holding onto. As individuals concerned for the interests of our most vulnerable we owe it to them to be unashamedly in favour of the Biblical idea that lenders should be reasonable and fair. Only a radical change in our debt laws will achieve this.

THANKYOU

Endnotes

[i] http://helaineolen.com/2013/08/13/giving-up-coffee-to-balance-the-books-how-many-lattes-to-financial-freedom/

[ii] This data comes from the Reserve Bank data which is available at http://www.rbnz.govt.nz/statistics/tables/c21/

[iii] Source: Statistics New Zealand's balance of payments dataset