CONSUMER CREDIT IN THE EUROPEAN UNION

NURIA DIEZ GUARDIA

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The European Credit Research Institute (ECRI) is a non-profit international association established in March 1999 in partnership with the Centre for European Policy Studies (CEPS) in Brussels. Its principal goal is to promote the study of the various aspects of the retail financial services sector at the EU level. ECRI's activities include the creation of a database on consumer credit in the European Union, research and analysis of developments in retail financial markets and the organisation of seminars on all issues affecting the industry.

This publication is the second in a series of ECRI Research Reports. It was prepared by *Stefanie Kleimeier* (s.kleimeier@berfin.unimaas.nl) of the Universiteit Maastricht – LIFE in the Netherlands and by *Harald Sander* (gh.sander@t-online.de) of the University of Applied Sciences in Cologne.

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European Credit Research Institute
Place du Congrès 1, B-1000 Brussels
Tel: 32(0)2 229.39.11 Fax: 32(0)2 219.41.51
E-mail: info@ecri.be
Website: http://www.ecri.be

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BY

NURIA DIEZ GUARDIA

INTRODUCTION

Economic deregulation in many industrialised countries during the 1980s, the liberalisation of capital movements within the European Union (EU) in 1990, and the establishment of the single market for financial services have radically transformed the regulatory framework of European financial markets. One of the main objectives of the single market programme (1985) was the opening of national markets in order to create a European financial area with the free provision of financial services. Its implementation started in 1993 with the application of the second banking directive.[1] In this context, monetary union is often seen as the accomplishment of the process of European financial integration. The elimination of exchange risk should indeed boost cross-border competition.

The nature and speed of integration differ between wholesale and retail financial markets. Despite the pressure towards convergence stemming from monetary unification, national differences and market segmentation still characterise retail credit markets across EU member states. A first objective of this study is to compare the structure and developments of consumer credit markets in the EU.

Differences in national institutions and practices in the consumer credit sector lie behind the move to a European harmonisation of the laws, regulations and administrative provisions of the member states in this area. In addition to the changes to the legislative and regulatory framework of consumer credit which fall within the scope of national market deregulation – with the lifting of controls on interest rates – and European integration, the Community has adopted directives to protect the consumer. Consumer protection regulation covers different aspects and, as regards consumer credit, the cost of credit and its expression through the annual percentage rate of charge. A directive governing consumer credit was introduced on 22 December 1986, and was subsequently amended and completed by the directives of 22 February 1990 and 16 February 1998. The second objective of this report is to study the effectiveness of such regulation.

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[1] Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of credit institutions and amending directive 77/780/EEC, OJ 1989 L386/1.

This report analyses consumer credit markets and their regulation at European level. After a chapter devoted to definitions and methodology, the second chapter of the report analyses the European consumer credit markets. The third chapter studies the European harmonisation of national provisions concerning consumer credit and focuses on the information regarding the cost of credit.

I. DEFINITIONS AND METHODOLOGICAL PROBLEMS

In a context of international comparisons, the availability of statistical data strongly constrains the analysis. This chapter deals with the conceptual problems of analysing consumer credit in the EU and describes the data used. The statistics collected are obtained from national central banks and statistical offices. The statistical methodologies and the data available differ from one country to another, which complicates a comparative analysis. Indeed, national definitions of credit differ between countries, data on interest rates charged for consumer credit instruments are rarely available, and credit institutions and the definitions of the household sector are not uniform from one country to another.

1. Credit

Credit to the private sector is defined as lending to households and private businesses to carry out transactions in the private sector of the economy. Credit to the household sector includes consumer credit and mortgage credit.

Consumer credit is made up of loans granted for a specific purpose and credit granted for a general use (Balaguy, 1996). The first credit category is characterised by the contractual obligation to use the loan for the purchase of a specific product or service. Consumers use it to buy goods or services most frequently at the point of sale. Credit instruments for general use involve an agreement whereby the borrower obtains funds from the lender, without any commitment as regards the goods or services to be financed. In general, consumer credit is not guaranteed and the tax provisions governing such lending differ from those applying to mortgage credit. Several countries – France, the Netherlands, Italy and the US – allow households to deduct mortgage interest payments. Only the Netherlands allows tax deductibility for consumer credit, subject to a cap. Mortgage credit uses property as collateral. The funds obtained can be used to finance a house purchase or improvement.

Statistical sources distinguish between consumer credit and mortgage credit in total household credit. Consumer credit is defined in the different countries as credit obtained to finance any purchase other than property. In banking statistics, however, the distinction between mortgage credit and consumer credit is not always clear. In several countries, it would seem that consumers arbitrage between the two forms of credit. They obtain an easier or cheaper credit on the mortgage credit market and then use it to finance the purchase of goods or other real or financial assets instead of using it for housing purposes. These developments were observed in the United States in the 1970s and in the United Kingdom in the 1980s (Jappelli and Pagano, 1989). In Germany, it is more and more difficult to distinguish between consumer credit and mortgage credit from national statistical sources.

The use of credit by households is difficult to determine and it is therefore important to consider the aggregate of credit granted to households and its evolution. The Federal Reserve Board distinguishes between lending that is not secured by real estate – whether short-term or medium-term, to be repaid in two or more installments – and mortgages and other home equity loans, whether or not used to finance the purchase of property. The distinction is based on the collateral for the loan rather than on its use. Fiscal advantages partly explain the use of home equity loans since American tax laws often allow borrowers to deduct the interest paid from their taxable income.

Another shortcoming relates to the availability of consumer credit production statistics. Credit can be measured as a stock – total outstanding – or as a flow – gross lending indicating the production of loans during a certain period. Ratios of consumer credit as a percentage of disposable income or consumption should be calculated using gross lending statistics to avoid the stock/flow problem. However, several countries do not publish such data. Nevertheless, due to the relatively short average short-term duration of consumer credit, the total outstanding is not considerably different from the annual flow (Balaguy, 1996). This report uses total outstanding statistics.

Changes of statistical definitions in several countries also make it difficult to analyse developments in consumer credit markets. The March 1993 change in the definition of bank credit to finance property purchases in the United Kingdom had a compensatory effect on consumer credit statistics. Similarly, the changes in the definition of consumer credit in Belgium in 1994 resulted in a break in statistical series, which also distorts comparisons in time.

2. Interest rates

The concept of the level of interest rates is complex. Indeed, national financial instruments are heterogeneous: the products and their maturity vary from one country to another. The short-term level of interest rates is even more difficult to define for a given country than its long-term level (Homer and Sylla, 1998). There are indeed numerous types of short-term instruments, their rates vary considerably and they are often subject to banking regulation. Moreover, differences related to taxation or the structure of markets between countries make it impossible to draw conclusions on relative interest rate levels.

In practice, therefore, interest rate levels are not comparable across countries. Nevertheless, it possible to compare their evolution on the basis of data calculated by national monetary authorities. The best approach for comparing interest rate changes would be to consider the rates for certain specific loans, as well as averages for different consumer credit instruments.

However, statistical series are only available for benchmark rates. Moreover, it is normally difficult to ascertain if the different rates are representative. The information available is inadequate to determine whether the average rates are applied with respect to newly granted loans or with respect to outstanding loans. Within the limits of the information available, relative trends of interest rates of household credit instruments are defined.

3. Lenders

In the institutional classification of credit institutions, published on an annual basis by the European Commission, three groups are distinguished:

- commercial or universal banks, active in all sectors of banking activity, including household credit;
- savings banks and cooperative banks, which have as their principal source of funds the deposits of personal customers; and
- specialised credit institutions which concentrate on certain banking activities. This group includes mortgage banks, building societies and finance companies.

The relative importance of the different lenders in the consumer credit sector varies across countries. Moreover, national statistics do not report the consumer credit granted by all types of lenders.

Statistics in Greece, Finland, Sweden and Japan only list credit granted by commercial banks. According to the Bank of Greece, banks are the only institution operating in the mortgage credit sector. That was also the case regarding consumer credit up to the middle of the 1990s. Since 1995, a few specialised non-bank institutions have started granting loans to consumers exclusively for the purpose of financing the purchase of a car. Accurate information is not available, but according to the Bank's estimates, the volume of outstanding credit is relatively small. According to the Bank of Sweden, banks grant most loans to consumers in Sweden, with finance companies participating to a lesser extent.

For Spain and the United Kingdom, statistics include practically all lenders. In the Bank of Spain's statistics, for example, the lenders considered are commercial banks, savings banks and cooperative banks. For the United Kingdom, data for the period 1980-83 only cover loans to consumers made by all banks and building societies. Credit granted by other specialised lenders, distributors and insurance companies are only included from 1993 onwards.

Statistics in Germany, France, Italy and the United States cover all lenders. The statistics for Germany include all lenders but only provide a distinction between loans made by banks and non-banks. Statistics for France cover commercial banks, savings banks and finance companies. In Italy, the statistics report loans to consumers granted by banks and finance companies. The United States statistics cover all consumer credit.

4. Households

In addition, the definition of the household sector is not standard in the different countries. The main problem stems from the treatment of individual enterprises and non-profit organisations. These are included in the household sector in Spain, Belgium, Sweden and the United States, whilst in the United Kingdom and Italy separate data are also available. In France[2] and Finland, only individual enterprises are included with households. In Germany, data relative to individual enterprises are reported in the business sector, while non-profit organisations are included in the household sector.

Data relative to the total credit to households are relatively underestimated in Germany as compared with countries where individual enterprises are included in the household sector. Indeed, some borrowing by self-employed persons to finance private consumption is included in credit to the business sector. Mortgage credit for residential purposes is also included in the business sector in Germany, even if such financial transactions consist of property construction or home improvements. From 1999, mortgage credit will be defined as a household sector financial commitment. In this report, mortgage credit is included in household credit. This explains the difference with data from other sources that only take into consideration consumer credit when measuring household indebtedness.[3]

5. Statistical sources

The analysis in this report is based on aggregate data from institutional sources. Statistics on credit to the household sector are principally drawn from the reports of commercial banks, deposit-taking institutions and financial companies. They are published on a regular basis by national central banks. When implementing monetary policy, central banks analyse the effect of interest rate variations on the economy, which depends on the financial balance sheets of the different sectors.

[2] Non-profit organisations have also been included in the household sector in France since March 1999.

[3] The statistics on German households' liabilities published in the OECD Economic Outlook do not include mortgage credit.

National monetary authorities collect households' data in order to ascertain the financial structure of the private sector.

Harmonised statistical data on consumer credit are not available from international sources. Eurostat does not publish data on consumer credit. The OECD publishes statistical data for some EU countries but at irregular intervals that differ from one country to another, which does not allow making comparisons. OECD data[4] come from the same statistical sources as the data used in this report and are not harmonised. The data published by the European Mortgage Federation or by the *Observatoire Européen de l'Endettement* are also drawn from national monetary authorities. The IMF publishes consolidated data on total credit to the private sector, but does not detail the consumer credit category. No international source publishes comparable data on consumer credit.

Consumer credit is analysed with reference to other economic aggregates, such as GDP, disposable personal income or private consumption. General macroeconomic data are drawn from the European Commission and IMF publications. National sources are used for data relative to households' disposable income.

For reasons concerning the availability of statistical data, this report analyses consumer credit in ten EU countries: Belgium (B), Germany (D), Spain (E), Greece (EL), France (F), Italy (I), the Netherlands (NL), Sweden (S), the United Kingdom (UK) and Finland (FIN), and two other countries: the United States (US) and Japan (JP). The data need to be used with caution since they are not harmonised in the EU countries.

II. EUROPEAN CREDIT MARKETS

A common trend in European credit markets since the early 1980s has been the growth in the volume of outstanding consumer credit. But the use of consumer credit varies widely across the countries examined. Economic and Monetary Union should stimulate the demand for credit with the creation of a zone of stable macroeconomic conditions, with low inflation and interest rates (European Central Bank, 1999). Will growth in credit demand be common to all countries? Will the differences in the use of consumer credit between EMU countries be reduced?

Since the beginning of the 1980s, the regulatory framework governing consumer credit has been transformed both at national and at European level. At national level this process has developed differently and at a different pace from one country to another. Financial sector reform includes the liberalisation of international capital flows and the deregulation of domestic financial markets. Regulatory changes, in particular the deregulation of interest rates, the removal of

[4] International Monetary Statistics, Part 2.

credit controls and the reduction of restrictions on bank activities have tended to liberalise the provision of financial services and to increase competition.

During the period 1980-90, regulatory developments at European level have also affected consumer credit. The EU removed restrictions on capital movements, established a harmonised regulatory framework for financial services and adopted the regulation of consumer credit. This chapter examines the trends in European consumer credit markets and the national changes in their regulatory framework that help to explain these developments. The European regulation of consumer credit is studied in the third chapter of the report.

Until the end of the 1970s, the banking activity in European countries was heavily regulated. Controls were established both on interest rates and credit growth, as part of an anti-inflationary policy based on the control of money supply. In the United Kingdom and France, for example, the volume of bank lending was restricted. Towards the end of the 1970s and the start of the 1980s, there was credit rationing in the Scandinavian countries. In Finland and Sweden, the regulation was motivated by the objectives of guaranteeing the stability of the banking system, keeping interest rates low and stable, and channelling subsidised credit to the priority sectors, such as the government or housing. Consumer credit was not part of these priority sectors (Drees and Pazarbasioglu, 1998).

With the financial sector reform in the different European countries and the United States, competition in the financial services industry increased and financial innovation accelerated. The *corset* – the system established to control lending in the United Kingdom – was abolished in 1980. Credit ceilings were lifted in France in 1987. The complete liberalisation of consumer credit by the Bank of Greece is the most recent in the EU and dates from January 1994. Table AA1 in Annex II indicates the dates when interest rates were effectively deregulated in the different countries. In most countries, these changes were accompanied by a rapid growth in outstanding consumer credit.

Consumer credit results from the interaction between household decisions on consumption and savings. There are still huge differences between national retail financial markets today, relative to patterns of household savings and financing of consumption. This chapter documents differences in the level of savings of European households, the growth of consumer credit following financial reform and the diffusion of consumer borrowing across EU countries.

1. Household savings

The differences in economic growth and the borrowing capacity of households, which is linked to imperfections in financial markets, contribute to explaining international differences in household savings rates. Tables A1-A4 in Annex I show average household savings rates, expressed as a percentage of disposable income, for the period 1980-97 as well as for the three sub-periods 1980-85, 1986-91 and 1992-97. Several observations can be made:

- Household savings patterns differ considerably across countries.

- On average, household savings rates have declined since the beginning of the 1980s.

- A comparison of the level of household savings in the different countries indicates that most countries have preserved their relative position since 1980. In comparative terms, households in Portugal, Belgium, Italy and Japan have maintained a relatively high savings rate, whilst in the United States and the Scandinavian countries, savings rates have remained among the lowest.

- In the group of countries with the highest savings rates, some countries, such as Portugal, Italy and Japan, have witnessed an important drop in the household savings rate.

- Until the end of the 1980s, the savings rate in the Anglo-Saxon countries declined, but from 1988 their evolution has been different: the savings rate continues to fall in the United States, whilst in the United Kingdom it has increased and returned to a level comparable with the 1980s.

Financial deregulation has contributed to the fall in household savings, through a reduction in their liquidity constraints. The Scandinavian countries represent an extreme illustration of this trend. In Sweden and Finland, the evolution of household savings since the beginning of the 1980s is characterised by large variations, which can be explained by the deregulation of the banking sector and the macroeconomic context. With the lifting of restrictions on credit and interest rates, households have adjusted their behaviour to the new environment, reducing their savings and increasing their level of indebtedness. Household savings rate became negative during the second half of the 1980s.

2. Household credit: a European comparison

Studies on household credit have generally concluded that there is a cultural division between the United States and the United Kingdom, which are historically open to credit and continental European countries (Balaguy, 1996). But the data presented in this report do not allow conclusions on the relevance of this traditional classification. The next sections compare the distribution of credit to the private sector and to households and the use of consumer credit across countries. The analysis of several indicators of household borrowing gives a clearer insight into the wide differences between EU countries.

a. Credit to the private sector

Credit to the private sector includes lending to businesses and households. Lending to the private sector varies according to the country. The ratio of credit to the private sector as a percentage of GDP varies between approximately 50% and 120% in the countries examined. It is the highest in the UK at 124% of GDP, whilst Greece has the lowest figure at less than 30%. The ratio is also comparatively high in Sweden and Germany. For comparison, lending to the private sector is by far the highest in Japan at a ratio of 200% of GDP while the ratio in the US is comparable to that in the UK.

Table 1
Credit to the private sector, as a percentage of GDP

	1980	1985	1990	1995	1997
B	29,3	25,8	36,2	75,6	77,8
D	78,6	87,4	95,2	104,9	113,5
EL	31,4	29,6	18,4	21,7	24,7
E	70,7	59,9	70,0	77,1	84,2
F	75,1	77,6	96,2	88,1	83,7
I	55,5	50,8	52,5	58,1	57,6
NL	66,9	83,1	86,0	98,8	98,8
FIN	48,5	62,8	88,0	64,3	54,5
S	78,4	89,7	133,2	106,7	n.a.
UK	27,5	46,8	116,9	117,8	123,7
EU-10	56,2	61,4	79,3	81,3	71,9
US	77,8	83,4	92,6	103,6	122,7
JP	132,7	152,2	200,6	208,9	201,0

Source: IMF.

Generally speaking, the countries with the highest credit ratios and Belgium have seen the most rapid increases since 1980. Sweden, Finland and France have started to adjust their level of indebtedness during the 1990s and Japan from 1995; this is reflected in the reduction of their credit ratios.

b. Credit to the household sector

The share of credit to the household sector in the total outstanding credit to the private sector is less than 50% in all the countries examined, with the exception of the United Kingdom (59%) and the United States (53%). The share of credit to the household sector is the lowest in Italy, at less than 20%. The weight of household credit is comparatively higher in the Anglo-Saxon countries than in continental Europe countries.[5] The ratio of household credit as a percentage of GDP varies

[5] In this study, the continental European countries refer to Belgium, Germany, Greece, Spain, France, Italy, the Netherlands, Finland and Sweden.

between about 25% and 70% in the countries examined. It is the highest in the United Kingdom and the United States, comparatively high in Sweden and Germany, and the lowest in Italy and Belgium.

Classified according to its use, credit to the household sector can be divided between consumer and mortgage credit. Figures A1-A9 show the distribution of household credit in several countries. Mortgage credit represents the bulk of outstanding credit to households: in all the countries examined, its share varied between 75% and 90% of household credit in 1997 but the trends differ between countries. Since 1990, there has been an increase in outstanding mortgage debt in the countries examined with Spain, Italy and Greece experiencing a more rapid growth (Table A5).

Considerable national differences appear in the total amount of outstanding household credit. Total household financial liabilities as compared to personal disposable income are relatively low in Italy and Belgium. Total household indebtedness is comparatively the highest in Sweden and the United Kingdom, at a similar level as the US (Table A6). It is also comparatively high in Germany and, to a lesser extent, in France and Spain. This indicates the difficulty of generalising the use of credit in the EU.

c. Consumer credit

The analysis of consumer credit and its use shows the specific national characteristics of this sector of household credit. The next sections examine the evolution of outstanding consumer credit and the national differences concerning the weight of consumer borrowing in the economy and the use of credit to finance consumption. These differences may be explained by cultural preferences and by such structural factors as differences in tax, legal and regulatory frameworks.

i. The evolution of outstanding consumer credit

A common trend since 1980 is the increase in outstanding consumer credit measured in nominal terms. The distribution of consumer credit grew very rapidly in the second half of the 1980s, as a result of the deregulation of credit and a favourable macroeconomic climate. The growth in asset prices, with the subsequent wealth effect, and tax considerations, such as the deductibility of interest costs that made after-tax net interest rates negative, have contributed to the expansion of the distribution of credit in Finland and Sweden.

During the 1990s, growth in outstanding consumer credit was slower. The average growth rate of consumer credit is lower in most continental European countries, less than 5%, than in the United States and the United Kingdom, with growth rates around 7%. Growth rates are very high in Greece and Italy, which can be explained by a catching up due to the low initial volume of credit outstanding in the 1980s.

Table 2
Outstanding consumer credit in nominal terms, average growth rate

	1981-85	1986-90	1991-97
B	3,2	12,9	1,9
D	6,1	7,3	5,4
EL	n.a.	n.a.	43,7
E	n.a.	n.a.	4,8
F	17,4	23,2	4,3
I	3,8	21,5	5,3
NL	-2,3	7,1	7,2
FIN	n.a.	n.a.	-2,1
S	4,8	16,1	-5,5
UK	n.a.	15,1	7,9
US	11,3	6	6,8
JP	n.a.	n.a.	-3,1

Variations in outstanding consumer credit reflect economic growth. The strong growth of GDP in European countries during the second half of the 1980s and the slow-down during the first half of the 1990s are reflected in the evolution of outstanding consumer credit. In Sweden, Finland and Japan, the 1990s have been marked by a reduction in the volume of outstanding consumer credit. These changes are linked to specific circumstances. Indeed, after the considerable increase in household borrowing these countries have experienced a period of financial fragility with banking crises following the credit boom. With the economic recession, households started to reduce their level of indebtedness.

ii. The weight of consumer credit in the economy

The weight of consumer credit in the economy differs considerably across countries. Table 3 reports the average of outstanding consumer and mortgage credit, scaled by GDP, for the period 1990-97.

This table indicates that the importance of consumer credit is far higher in the American economy than in the EU countries, with the exception of Sweden. During the period 1990-97, the weight of consumer credit in the economy was the highest in Sweden (14.8%), the United Kingdom (10%) and Germany (11%) among EU countries. In Spain, France and Finland the ratio stood at an intermediate level and it was comparatively the lowest in Greece, Italy and the Netherlands. Table A7 shows the weight of consumer credit in the economy on a yearly basis and indicates the reduction in the weight of outstanding consumer credit in Sweden towards a level comparable to other EU countries. In 1997, the ratio stood at around 11% in Sweden while it reached more than 15% in the US.

Table 3
Credit market, 1990-97
Credit outstanding as a percentage of GDP, average

	Consumer credit	Mortage credit	Total credit
B	5,1	18,3	23,4
D	11,0	34,3	45,3
EL	1,3	4,9	6,2
E	6,9	13,6	20,5
F	5,6	30,2	35,7
I	2,2	6,4	8,6
NL	3,7	47,9	51,6
FIN*	5,7	17,9	23,5
S	14,8	32,1	46,9
UK	9,6	55,5	65,1
US	14,4	48,5	62,9
JP	3,6	9,5	13,1

* 1993-1997.

The ratio is relatively stable in several European countries. It has increased in the UK and has declined in Spain, Finland and Sweden. In the latter country, the ratio had a particularly striking cyclical development compared to the other countries examined, reaching a peak of 24.8% of GDP in 1988. By way of comparison, the ratio in the United States stood at 14.6% at the same date (Table A7).

iii. The share of household consumption financed by credit

Table 4 reports consumer and mortgage credit outstanding as a percentage of private consumption for the period 1990-97. As compared to the ratios calculated by Jappelli and Pagano (1989) for the period 1961-85, the ratios obtained show a moderate increase in Greece and Italy, a more pronounced increase in Spain and the UK and a reduction in Sweden. The ratios are similar for the United States (Table A8).

The share of consumption financed by credit allows us to compare the use of consumer credit by European households. As the indicator of the weight of credit in the economy, this indicator shows how consumer borrowing to finance consumption varies across countries.

During the period examined, the share of consumption financed by credit in Belgium, France and Spain stands at approximately 10%, whereas in Germany it amounts to 20%. In Sweden, the share has increased during the second half of the 1980s and peaked in 1988 at 47.2%, more than doubling that of Germany. The reduction in the Swedish households' indebtedness can be observed in the decrease of the share of consumption financed by credit in the second half of the 1990s, which has reached a level comparable to that of Germany. The use of consumer credit is comparatively high in the United Kingdom, with a ratio standing around

15% during the 1990s. Consumer borrowing is the lowest in Italy and in Greece, amounting to less than 4% of private consumption (Table A9). The analysis of Guiso, Jappelli and Terlizzese (1994) finds constraints on the borrowing capacity of consumers in the Italian credit market, which are due to market imperfections. This also explains the comparatively high savings rate in Italy. For comparison, consumer borrowing in the United States has varied between 20 and 23% of private consumption during the period considered and stands at a close level from Germany and Sweden.

Table 4
Credit market, 1990-97
Credit outstanding as a percentage of private consumption, average

	Consumer credit	Mortgage credit	Total credit
B	8,0	28,8	36,8
D	19,2	60,2	79,4
EL	1,7	6,6	8,3
E	11,0	21,8	32,8
F	9,3	50,3	59,6
I	3,5	10,2	13,7
NL	5,7	79,9	85,7
FIN*	6,7	32,6	39,3
S	27,9	60,3	88,2
UK	15,1	87,0	102,0
US	21,3	71,6	92,9
JP	6,1	16,1	22,2

* 1993-1997.

iv. The ratio of consumer indebtedness

The ratio of consumer indebtedness expresses the volume of outstanding consumer credit relative to households’ disposable income. Table A10 displays the ratios of the different countries. During the period 1989-93, the ratio is stable in all the countries and several groups can be distinguished. In Belgium, France, Spain and the United Kingdom, the ratio stands at around 10%. It is the highest in Germany at around 17% and the lowest in Greece and Italy at less than 4%. Starting from 1993, consumer indebtedness rose rapidly in the United Kingdom, with the ratio reaching a level comparable to that of Germany.

The indebtedness of Swedish households reveals the very wide use of consumer credit during the 1980s and the first half of the 1990s: the ratio varied around 40% of disposable income and went up to 50% in 1988. Since 1994, the indicator shows a drop in the use of consumer credit in Sweden, where the situation is drawing closer to that of the United States, with consumers borrowing more for financing consumption than in the other EU countries.

v. Consumer credit: distribution by origin

Classified according to its origin, a distinction can be made between consumer credit granted by banks and non-bank institutions. The share of credit granted by banks differs between the EU countries and the United States. Indeed, banks grant the bulk of consumer credit in the EU. Bank credit has been preponderant in Germany since 1980: its share in total outstanding consumer credit stood at 93% in 1997. In the United Kingdom the share of bank lending has decreased since the beginning of the 1990s but it stood at 74% in 1997 (Table A11). In Italy, bank credit amounted to 50% of consumer credit in 1997. However, specialised lenders change of legal status has to be noted. Many non-banks are indeed licensed by the banking authorities, while lending to households remains their core business.

The situation in the United States contrasts markedly with that in the EU. The share of consumer credit granted by commercial banks has dropped since 1990 and it is much lower than in the EU: it represented 40.5% in 1997. The share of savings banks amounts to less than 4% of outstanding credit.

A fundamental difference between the European and American financial systems explains the higher share of consumer credit granted by banks in the EU. In the European financial system, banks play a preponderant role, whereas the US financial system has been fragmented since the separation between investment banks and commercial banks introduced by the Glass Steagall Act (1933). This has also encouraged American banks to securitise assets, including consumer credit assets. Between 1989 and 1997, the share of pools of securitised assets increased very rapidly in the United States, standing at 25% of outstanding loans in 1997. An expected implication of the introduction of the euro for capital markets is an increase in the securitisation of assets. In France, the share of pools of securitised assets stood at less than 5% of outstanding loans in 1997, thus partially indicating that the securitisation of assets is less developed in the EU.

vi. Consumer credit: distribution by category

The various consumer credit instruments have developed differently. Historically, consumer credit granted for a specific purpose was the most widely used instrument but its share of total consumer credit has decreased. Credit instruments that are not granted for a specific purpose have tended to replace it. These include personal loans, revolving credit and deferred payments linked to the use of payment cards. Revolving credit is a contract whereby a credit institution grants a customer a credit line that can be used once or several times. The amount of the credit line reverts to the original level as and when repayments are made.

The most significant trend in consumer credit markets over the last decade is the increase in the share of credit instruments associated with payment cards in total consumer credit. Statistics on the use of revolving credit were published by the

Banque de France for the first time in 1991. Its share has increased from 14% of the total outstanding consumer credit to 25% in 1992 and has remained stable since. In the UK, the share of credit cards stood at 15% of the total outstanding consumer credit in 1987 and rose to 21% in 1997. In Belgium, the share of revolving credit amounted to 20% of the total outstanding consumer credit in 1997. In Germany, the share of revolving credit has fallen slightly since 1980 and it accounted for 11% of total consumer credit in 1997. The evolution of this form of credit in Germany differs with the trend in the other countries examined (Tables A12-A17).

In the United States, the increase in the use of revolving credit is far more striking than in the European countries considered. Revolving credit is the largest source of consumer (non-mortgage) indebtedness. Its share of total consumer credit reached 44% in 1997 and has been rapidly growing since 1980, when it accounted for 16.5% of outstanding consumer credit. The deregulation of interest rates charged by lenders has increased the availability of credit instruments, in particular credit lines such as credit cards for general use: Visa, MasterCard, Discover. Following a ruling of the Supreme Court in 1978, several American states have abolished the limits on interest rates and have allowed card issuers to fix several different rates, in order to adapt interest rates to the different categories of borrowers and the relative risk attached to each category.

vii. Segmentation of European credit markets

National differences in the size and developments of consumer credit markets are deep. Moreover, data on cross-border credit indicate that European markets integration remains limited, although cross-border banking penetration has increased between 1996 and 1997. In 1997, less than 10% of loans granted by financial institutions to non-bank agents in the EU countries considered were cross-border loans (table 5). These loans were made to non-banks, thus including the business sector. This suggests that cross-border consumer loans are very limited. The market share of branches and subsidiaries has exceeded 10% only in five EU countries, in descending order: Luxembourg, Ireland, the UK, Belgium and Greece (ECB, 1999).

The convergence in the price of financial services that the single market was expected to bring about has not happened yet. According to the Cecchini Report (1988), price differences in the EU for the same service were as high as 200%. A postal survey carried out among 115 EU banks as part of a European Commission study on the effectiveness of the single market (European Commission, 1997a) broadly concluded that there was no real convergence so far in the prices of the services covered by the Cecchini Report. On the contrary, price differences had increased in some cases. The costs of some services had fallen, for example the price of credit cards, but price differences across countries for consumer loans or the cross-border transfer of funds remained substantial. In principle, it could have been expected that the single market legislation would have led to the functioning of a single consumer credit market with the integration of different national markets through effective cross-border competition or as a result of the threat of such competition. In practice, however, the integration of consumer credit markets is still very limited.

Table 5
Cross-border loans to non-banks as a percentage of domestic credit

	1996	1997
B	7,7	7,9
D	3,9	5,3
E	2,7	3,1
F	4,5	5,5
I	3,3	3,0
NL	6,8	7,2
UK	15,1	14,9
average	6,3	9,4

viii. Interest rate trends

Interest rates on mortgage credit are below those applying to most types of consumer credit with a relatively shorter maturity. This apparently has been the case for several centuries in the US. The risk of short-term consumer loans is higher than that of long-term loans guaranteed by a mortgage. However, the reason why interest rates are higher is not principally linked to the higher risk of consumer loans, but rather because the administrative costs involved in granting a large number of small short-term loans is very high (Homer and Sylla, 1998).

The narrowing of inter-bank money market rates stemming from the introduction of the euro points to a convergence of the short-term refinancing costs of financial institutions. Consumer credit rates are higher and also more stable than money market rates. An important part of the explanation lies in the fact that consumer credit rates contain cost factors that do not vary a great deal, even when there are important fluctuations in money market rates.

ix. Conclusions

Several conclusions can be drawn from this analysis of consumer credit statistics. First, there has been a general trend towards the expansion in outstanding consumer credit measured in nominal terms since the 1980s, both in the EU and the United States. On the supply side, a liberalisation of the financial sector has increased the availability of credit products. The increase in credit demand can be explained by different macroeconomic factors. Since the beginning of the 1990s, the growth in outstanding consumer credit has been slower in continental Europe than in the Anglo-Saxon countries. Outstanding consumer credit has dropped in

Sweden, where it had reached a very high level when measured as a percentage of disposable income.

An Anglo-Saxon consumer credit model cannot be identified from these statistical data. The weight of household credit in the economy is comparatively higher in the Anglo-Saxon countries than in the continental European countries, whether calculated as a percentage of lending to the private sector or as a percentage of GDP. But the indicators of the use of consumer credit in the UK are closer to those of Germany than to those of the United States. Moreover, the weight of loans made by banks is smaller in the United States than in the EU countries examined. Finally, the share of revolving credit in total outstanding consumer credit is greater in the United States than in the European countries.

Nor is it possible, on account of the large differences in the use of consumer credit observed across EU countries, to identify a European model. Consumer credit is very widely used in Sweden, whereas its use is relatively limited in Greece, Italy and the Netherlands. The use of consumer credit reaches comparatively high levels in Germany and the UK and an intermediate level in France and Spain. Consumer borrowing in the UK and Spain were comparable during the period 1989-93 and since 1993, the faster growth of outstanding consumer credit in the UK has resulted in a wider diffusion of consumer borrowing.

III. CONSUMER CREDIT REGULATION

The preparation of a specific Community regulation in the field of consumer credit has been a long process. The Commission started preparing working papers on the rules concerning installment credit sales in 1965. After the first drafts of the UK Consumer Credit Bill became available, the Commission issued a working paper for discussion outside the Community institutions in 1974: 'Draft articles proposed for discussion as the basis of a proposal for a Directive relating to consumer credit' (Latham, 1978). Work was pursued during the next years by different Directorate-Generals – following reorganisations of the Commission – until a final proposal was presented to the Council in February 1979. A directive was adopted in 1986, only after a drawn-out process of reflection and discussion between the member states and the European Commission.

European harmonisation of national measures concerning consumer credit is being pursued in order to enhance the protection of consumer economic interests. Although a single consumer credit market was seen as desirable, the directives on consumer credit are not part of the programme to complete the single market in financial services before 1 January 1993. But consumer credit is covered by EC legislation affecting financial services' providers. The European Community has aimed to establish a regulatory framework that should create a common market in consumer credit and provide adequate protection for consumers. Consumer credit is at the articulation between EC policies for financial services and for the protection of consumer economic interests. The next sections analyse in turn EU policy affecting financial services, the objective of consumer protection and the harmonisation achieved by the directives on consumer credit – with a focus on the provisions relative to the total cost of credit.

1. Financial services policy

As part of the single market programme, the European Community aimed to remove restrictions on the provision of financial services between member states. The second banking directive and the related directives were adopted with a view to enhancing cross-border competition in the financial services sector. Consumer credit is included in the list of activities covered by the single authorisation and the principle of home country control, which appears in an annex to the second banking directive.

The principles for establishing a single market in financial services include the mutual recognition of national laws and the responsibility of the regulatory authorities in the home country for the activities of credit institutions in the EU. Mutual recognition includes two elements: the harmonisation of essential provisions and, where harmonisation has not occurred or has occurred only in general terms, the respect of the principle of home country control. Harmonisation mainly relates to prudential supervision with the definition of prudential standards, which must be satisfied by all credit institutions. Lenders can operate in all the member states on the basis of a licence granted by the home country. The free provision of financial services by the establishment of a subsidiary or on a cross-border basis is included.

Nevertheless, a credit institution operating in another member state must satisfy certain provisions adopted by the host country. The second banking directive provides indeed that the general interest of the host country must be respected (general good clause). With the application of the host country rules, the discrimination between national and foreign credit institutions is in principle avoided but non-discriminatory obstacles, resulting from differences in national rules, can remain. The European Commission has published an official interpretation of the general good clause to avoid its use becoming an obstacle to the free provision of services (European Commission, 1997b).

General good provisions for the financial services area relate mainly to consumer protection. Consumer protection is at the same time a justification for restrictions on the free provision of services and an area of Community regulation. European financial regulation is principally directed at financial institutions and less at financial products. However, a specific consumer credit regulation has been developed. By way of the harmonisation of contracts, its aim is to ensure, in particular, that the consumer receives correct and adequate information as regards the total cost of credit.

2. Consumer protection policy

Two main concerns underlie the regulation to ensure adequate consumer protection. First, the difference in the size and resources between sellers and buyers suggests that they are not in an equal footing in terms of negotiating power: buyers would be obliged to accept the contracts drawn up and decided by sellers.[6] But this argument fails to take into account the limits on the negotiating power of sellers due to the effect of competition from other sellers. Secondly, sellers could take advantage of informational asymmetries. The differences in the negotiating power and the imbalance in terms of information between buyers and sellers could lead to problematic transactions for consumers (Hadfield et al., 1998). Consumer protection policy aims principally to correct the informational imbalance between consumers and sellers by regulating the information provided. In particular, it attempts to ensure that the consumer receives information that is easy to understand and readily comparable. The underlying idea is that consumers could protect themselves against problematic transactions if they receive adequate information. It appears that information is the fundamental principle of consumer protection regulation.

Community regulation of consumer credit must be seen against this background. The approach of Hadfield et al. (1998) is based on the modern theory of information and warns against the paradox of using costly information procedures to solve informational asymmetries. These are indeed created by the cost of becoming informed. Moreover, the costs of such regulation need to be taken into account. Several issues provide a basis for orientating consumer policy in markets with specific characteristics. First, the market problem must be identified. Its origin can be related to competition or to information. Then, the necessity and feasibility of regulation must be assessed, by examining the costs and benefits of the forms of intervention and the alternatives. The third question concerns the choice of the regulatory instruments, for instance the obligation to provide information or to comply with minimum standards or the centralisation of information databases.

The objective of consumer protection seems to be gaining in importance in Community action. The specific objective of a ‘contribution to the reinforcement of consumer protection’ was included in the Maastricht Treaty. Furthermore, the new Article 129A inserted in the Treaty provides that the Union should contribute to the objective of consumer protection and aims in particular to protect the economic interests of consumers and to provide them with adequate information. Article 153.2 of the Treaty of Amsterdam provides for the integration of consumer policy into the other Community policies and actions. In its 1999-2001 Action Plan for Consumer Policy, the European Commission plans to focus, as regards the

[6] Theories of inequality of bargaining power originating from differences in size and resources were developed at the time when consumer protection laws were being enacted or prepared, during the 1960s and 1970s (Hadfield et al., 1998).

protection of the economic interests of consumers, on consumer credit, over-indebtedness and electronic payment systems.

Since 1985, the Community has adopted several directives relative to the harmonisation of contracts as part of its consumer policy. In particular, directives have been adopted concerning consumer protection with regard to contracts negotiated away from business premises[7], unfair terms in contracts concluded with consumers[8] or distance contracts[9]. Consumer financial services, including consumer credit, fall within the scope of these directives. However, consumer credit is the only specific financial product for which national provisions are subject to harmonisation in the framework of consumer policy. European consumer credit regulation is designed to guarantee equilibrium between the parties to the contract and to establish a common market in consumer credit. To attain these objectives, dispositions are established to ensure that the consumer receives adequate information, in particular relative to the total cost of credit.

3. Regulating interest rates

Interest rate regulation aims at protecting consumers and comprises two distinct aspects: rate disclosure and rate control. The first aspect concerns the information given to the consumer on the cost of credit that should enable him, on the one hand, to know the costs of credit and, on the other hand, to compare the conditions applied by different institutions. The second aspect concerns the control of interest rates. Controls on usury may sanction interest rates that are considered too high. Whereas controls on usury are determined at national level, the national provisions concerning the disclosure of the cost of credit fall within the scope of European harmonisation. These two aspects are analysed in the next sections.

The 1986 consumer credit directive[10] was the first step towards the harmonisation of the legal and financial conditions applying to consumer credit. The directive was amended and completed by the 1990[11] and 1998[12] consumer credit directives. The successive amendments illustrate the difficulties in finding a compromise that is acceptable for all the Member states.

[7] Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, OJ L 372 31/12/85.

[8] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 095 , 21/04/93.

[9] Amended proposal for a European Parliament and Council Directive concerning the distance marketing of consumer financial services and amending Directives 97/7/EC and 98/27/EC, COM (1999) 385 final.

[10] Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, OJ L 42 12/2/87.

[11] European Parliament and Council Directive 90/88/EEC of 22 February 1990, OJ L 61 10/03/90.

[12] European Parliament and Council Directive 98/7/EC of 16 February 1998, OJ L 101 01/04/98.

a. Consumer information on the cost of credit

i. The 1986 consumer credit directive

There are several approaches to eliminating non-discriminatory obstacles that originate from national rules and may affect the functioning of the single market. The complete harmonisation approach was tried for the products sector, but without success. For the provision of financial services, whether on a cross-border basis or through branches, the European Community has relied on an approach based on mutual recognition and home country control. The approach used for consumer credit is different. Indeed, the Community has tried to achieve total harmonisation of certain aspects of credit agreements relative to consumer protection.

The directive tackles the non-discriminatory obstacles that have their origin in differences in national legislation governing consumer credit. These differences could lead to competitive distortions between lenders and thus restrict opportunities for consumers to obtain credit in other member states. The volume and the nature of the credit sought as well as the purchase of goods and services could then be affected and, by extension, the functioning of the single market.

The aim of the directive on consumer credit is two-fold: protecting consumers against unfair credit terms and promoting cross-border credit and the free movement of goods and services financed by credit, by means of the harmonisation of the information to be provided to the consumer.

The directive applies to credit agreements for amounts between 200 and 20,000 ecu. The scope of the directive is limited as regards credit to households since it does not apply to mortgage credit, but it is extended to all consumer credit instruments including credit card accounts. The directive does not cover credit granted in the form of advances on a current account however.

The fundamental consumer protection elements of the directive fall in two general categories: dispositions to guarantee a fair contractual balance between the parties and the provisions related to consumer information. Dispositions to ensure a contractual equilibrium between the parties concern credit granted to finance the acquisition of goods. The directive requires that the repossession of goods does not entail any unjustified enrichment for the lender. It also provides that consumers have the right to make early repayment of credit and are entitled to an equitable reduction in the total cost of the credit.

Regarding consumer information, the directive aims to ensure that the consumer receives correct and complete information about credit conditions, in particular on the cost of credit, both in advertisements and in the written agreement. When calculating the cost of credit, fixed costs are generally distinguished from variable charges. Whereas fixed costs are made up of costs and charges, variable costs correspond to the interest and depend on credit maturity.

The total cost of consumer credit consists of all the costs that the consumer has to pay and includes interest and any other charges. The total cost of credit must be expressed in terms of the annual percentage rate of charge (APR). Regulation providing rate disclosure concerns the mathematical calculation of the rate and the elements to be included in the calculation. The APR is defined as 'the total cost of credit to the consumer, expressed as an annual percentage of the amount of the credit granted and calculated in accordance with the methods existing in the Member States'. The APR is intended to provide consumers with a means of comparing all forms of credit across the member States. Its method of calculation is not obligatory and the determination of the method used is also left to national legislation. The directive provides for the adoption of one or more Community methods for calculating the APR but leaves this for a subsequent directive. The elements to be included in the calculation are to be determined by national legislation. As regards the other essential contractual conditions listed in the annex to the directive, it is for the member states to decide whether or not their inclusion should be compulsory. Member states are also authorised to retain or introduce more stringent national provisions.

The harmonisation achieved by the directive is very limited. Indeed, only certain aspects concerning the protection of consumers are harmonised. Of these, on the one hand the directive establishes general definitions but the practices decided by the Member States are maintained. On the other hand, the minimal clause leaves the Member States with a certain leeway, as they are allowed to maintain or adopt more stringent provisions to protect consumers.

In addition, although the directive harmonises certain aspects of credit agreements, other international differences remain in the field of consumer protection. Elements of the cost of credit that are linked to the legal protection of the consumer vary according to national measures. In particular, measures concerning the cooling-off period – which allows consumers to withdraw from a credit agreement – the provisions concerning the early repayment or the debt recovery vary across countries.

Moreover, the European Community considers that the establishment of a single consumer credit market would be beneficial. Yet, the directive aims essentially at the harmonisation of information. In reality, other aspects are just as important to the possibility of obtaining a cross-border credit, such as the cost of cross-border payments or the tax provisions that affect EU financial institutions incentives to provide cross-border services in another member state. In particular, withholding tax in the country of the borrower imposed on interest paid to third parties reduces the lender's profit margin. Withholding tax applied to interest paid to a domestic lender is fully set off against the corporation tax on its profit margin. In the case of a foreign lender, however, withholding tax is a final, non-refundable tax (Dassesse, 1993). A withholding tax levied in the country of the borrower thus hampers the granting of a cross-border credit and may constitute an obstacle to the creation of a single consumer credit market.

ii. The report on the operation of the 1986 consumer credit directive

Considerable use was made by the member states of the minimum clause, which allows the introduction of more stringent provisions than those of the directive (European Commission, 1995). A central objective of the Commission was to develop a common approach for calculating the cost of credit and to require the disclosure of such information to the borrower. The difficulties in the negotiations were such that the elaboration of a mathematical method for the calculation was left for a later directive. The 1986 directive therefore had a modest impact on the harmonisation of consumer protection measures.

Moreover, given the time elapsed between the proposal and its adoption, the directive is better adapted to traditional forms of consumer credit rather than to modern credit instruments, in particular those linked to credit cards. The Commission noted the difficulties relative to the calculation of the APR for advances on a current account, since the duration of the credit and its use are not known.

According to the Commission report, cross-border credit has developed more through cooperation between financial operators than through direct dealings between lenders and borrowers. The volume of credit transactions between consumers and lenders based in different member states does not seem to have increased. In addition, the Commission points out the lack of complete statistical data on consumer credit in Europe and the difficulty in obtaining comparable data across Member States.

iii. The 1990 consumer credit directive

The 1990 directive aims at harmonising the financial aspects relative to the cost of credit that had not been addressed by the 1986 directive: the mathematical aspect of the calculation and the determination of the elements to be included in the APR. A method for calculating the APR is introduced.[13] First, a mathematical formula is

[13] APR is defined, as expressed in the 1990 directive, as the 'total cost of the credit to the consumer expressed as an annual percentage of the amount of the credit granted (…)'. It expresses the equivalence, on an annual basis, of the current value of all existing or future commitments (loans, repayments and charges), entered into by the lender and the consumer and is calculated in accordance with the mathematical formula set out in Annex II of the 1990 directive, i.e. in accordance with the equivalent actuarial method and not the proportional actuarial method.

defined. Secondly, the elements that must not be taken into account for calculating the APR are listed.

The directive does not define all the elements to include in the calculation of the cost of credit. Rather, a list of the elements that must not be taken into account is provided (reproduced in Annex II). This indirect list is not conceptually coherent. Indeed, elements to be included in the calculation of the total cost do figure in the list. Charges for the transfer of funds and for keeping an account to receive payments for the reimbursement of the credit are listed under point iii) and certain costs relating to insurance or guarantees imposed by lenders as a condition for granting the credit figure under point v).

National definitions of the APR use similar wordings as the directive. However, the use of a negative list has granted some leeway to member states in the determination of the elements that may be excluded from the calculation of the cost. The treatment of insurance and guarantee costs differs considerably across countries. In the UK, all premiums for life insurance may be excluded from the calculation of the cost. The other countries often distinguish between mandatory insurance – whose cost is to be included – and non-mandatory insurance – whose cost may be excluded from the calculation. The treatment of non-mandatory insurance also differs between countries (Table AA3).

The member states whose legislation prior to 1 March 1990 allowed the use of a different mathematical formula are authorised not to apply the formula adopted in the directive during a transitional period. Following a new report from the Commission, the Council should have decided on 1 January 1996 on the establishment of a single mathematical formula.

iv. The report on the operation of the 1990 consumer credit directive

According to the Commission report (1996), the 1990 directive was transposed into law in the majority of member states and the mathematical formula is used in all the member states with the exception of Germany, France and Finland. The elements used to calculate the APR differ between member states and the differences of interpretation might generate differences in the APR calculated for identical products.

The effects of the second attempt to harmonise the method of calculating the cost of credit are also limited. The indirect definition of the elements to be used for calculating the cost allows variations between the member states and the mathematical formula defined in the directive is not used by three of the member states.

v. The 1998 consumer credit directive

The directive of the European Parliament and of the Council of 16 February 1998 requires the application of a single mathematical formula. Member states must comply with this directive no later than two years after its entry into force, which is to say by 20 April 2000. The Commission considers it appropriate to study whether further harmonisation of the elements used to calculate the cost of credit is necessary.

b. The harmonisation accomplished

The policy goal of consumer protection is relatively recent, both at European and national level. Early legislation on consumer credit concerned credit granted for the sale of goods (or the provision of services). With the development of credit instruments granted for a general use, the scope of regulations was extended to cover all forms of consumer credit, with certain exceptions however. Most of the legislation in the member states was aimed at specific consumer credit instruments, such as instalment credit. The first legislation covering all forms of credit was enacted in the UK – with the adoption of the Consumer Protection Act in 1974 – and European regulation has been inspired by that approach.

In the long run, the directives on consumer credit issued have influenced the legal orders of the member states. Indeed, European consumer credit regulation has given an impetus for the development of national legislation, which has been elaborated or amended in line with the directives adopted. National laws on consumer credit in the member states date from different periods and the implementation of the directives has been carried out differently from one country to another. In several member states, consumer credit legislation was adopted or substantially reformed as a result of the adoption of the 1986 directive, such as Belgium, Germany, Greece, Spain or Italy.

European harmonisation of the legal and financial conditions relative to consumer credit has been under way since 1986. The 1986 directive provided for the introduction of one or more methods of calculating the annual percentage rate of charge. The 1990 directive introduced a single mathematical formula for calculating the APR, but allowed the member states applying a different formula to maintain it for a transitional period. The 1998 directive required the application of the single method and introduced the possibility of further harmonisation of the elements included in the calculation of the APR.

The directive also argues that differences in national legislation had led to distortions in competition and also prevented consumers from enjoying the same level of protection in all the member states. In comparison with the objective pursued, the harmonisation accomplished remains incomplete. This can be explained not only by the extensive use of the minimal harmonisation clause by the member states, but also by the harmonisation approach used.

The 1986 directive has had a limited harmonisation effect because national provisions determine the information on the total cost of the credit. The 1990 directive covers this aspect. A single method for calculating the APR is defined, although not all the Member States are obliged to apply it. The approach adopted is a general definition of the total cost of credit and the determination of the elements that must not be included in the definition. Consequently, the elements used to calculate the total cost of credit are not defined precisely and can vary between Member States.

Member States have used the leeway that they enjoy under the directive in different ways. Most of the charges excluded from the calculation by the 1990 directive are also excluded from the calculation under national laws. The exclusion of insurance or guarantee costs is interpreted differently in national legislation, which can lead to differences in the calculation of the APR for identical products.

The differences in national laws underlie the consumer credit directive. If the European harmonisation of laws governing consumer credit is used to encourage consumer cross-border shopping for credit, then there is no limit to the harmonisation of national provisions. This approach has already been abandoned in the field of products.

European harmonisation of legislation governing consumer credit has not eased the cross-border provision of credit. After more than a decade of regulating consumer credit, national differences in the use of consumer credit are deep and the cross-border provision of consumer credit remains limited. A single consumer credit market is thus far from being accomplished. The possibilities for consumers to obtain a credit in another member state depend indeed on numerous factors, such as the cost of cross-border payments or the tax obstacles to the cross-border provision of consumer credit. The EU has undertaken to address the information issue but there has not been enough attention paid to the possibilities to obtain cross-border consumer credit.

Finally, the regulatory instruments chosen are rigid. They require the disclosure of information and impose the application of a harmonised method to calculate the cost of credit. The lack of statistical information on the sector highlighted by the Commission (1996) does also apply to the cost of the different credit instruments in the member states. A centralisation of such data could enable consumers and lenders to be better informed. This raises fundamental questions for regulators.

c. Controls on usury practices

A fundamental concern of Community regulation in the field of consumer credit is the introduction of a harmonised method to express the total cost of credit through a rate. The control of maximum rates is the second aspect of regulating rates and is addressed at national level.

From a legal point of view, the usury rate is an abnormally high rate in relation either to a maximum rate set by the legislator or to certain principles, such as law and order, accepted standards of good behaviour, or fair business practices (European Commission, 1995). The issue of usurious rates can be tackled by setting objective controls: rates cannot exceed a maximum rate established by the competent authorities. The usury rate can either be determined by the subjective decision of courts, on a case by case basis, whether a rate is usurious.

Most member states control usury practices *a posteriori* by jurisprudence. However, Belgium, France, the Netherlands and Italy have an objective control system for usury (Table AA2). Such regulatory differences have an influence on the behaviour of consumers and lenders. A rate considered usurious in countries with an objective control may be socially accepted in countries where the courts exercise control *a posteriori*.

According to the Commission, imperfections in the functioning of the credit markets sometimes lead to extremely high interest rates and, if regulations on usury are necessary, they must probably be adopted at Community level in the context of the single currency. From an economic point of view, this reasoning fails to take into account the effects of competition between lenders. The objectives of introducing controls on the markets can be achieved more effectively by the functioning of a competitive market. The aim of the single market programme is to guarantee effective competition in order to limit the possibilities of domestic institutions taking advantage of their market power and to allow the institutions with the best-quality and best-priced financial products to operate throughout the single market.

IV. CONCLUSIONS

During the period 1980-90, a rapid increase in outstanding consumer credit characterised both the EU and US consumer credit markets. Since the beginning of the 1990s, the growth in the volume of credit is faster in the Anglo-Saxon countries than in Continental Europe. The case of Sweden is special, with a reduction in outstanding consumer credit as a result of the 1990s banking crises and the subsequent reduction of households' indebtedness.

Consumer credit markets reveal striking differences between the EU countries covered in this report and the United States. The weight of household credit is comparatively higher in the Anglo-Saxon countries than in continental European countries, but UK consumer borrowing is closer to the level of Germany than to the United States level. In the United States, banks grant comparatively less consumer credit, securitisation of consumer credit assets is more developed and outstanding revolving credit has reached a higher share of consumer credit than in the EU.

But European consumer credit markets also differ deeply. Consumer credit is very widely used in Sweden and its use is very limited in Greece, Italy and the Netherlands than in the other EU countries. Consumer borrowing stands at comparatively high levels in Germany and the UK, and at an intermediate level in France and Spain. Between 1989 and 1993, the use of consumer credit in the UK was comparable to that of Spain. Outstanding consumer credit then grew comparatively faster in the UK. Restrictions on household credit in Italy help to explain the comparatively high level of household savings and the limited use of credit to finance consumption. To these differences across countries adds considerable market segmentation. The cross-border provision of credit to private individuals is indeed very limited. As far as consumer credit markets are concerned, a single market is not yet functioning.

Following the development of new credit instruments linked to credit cards, the approach to regulating consumer credit was modified after the 1970s, in order to cover all consumer credit products. European regulation has led to changes in national legislation – the scope of which was previously limited to certain consumer credit instruments – or to the adoption of a specific regulation of consumer credit.

The objectives of the European regulation were two-fold: protecting consumers against unfair credit terms and promoting cross-border credit and the free movement of goods and services financed by credit, by means of the harmonisation of the information to be provided to the consumer. The provisions relative to consumer protection attempt to ensure that a certain information is provided to the consumer, in particular regarding the cost of credit.

The harmonisation of national legislation accomplished is limited however. The aim of ensuring that the consumer receives information about the cost of credit and, in particular, about the APR dates from the very early work of the Commission on consumer credit. The 1986 directive leaves to the member states the definition of the APR. The 1990 directive defines the elements to include in the calculation of the APR – but leaving some leeway to the member states regarding the costs that may be excluded – and authorises three member states, Germany, France and Finland, to use their own methods of calculating the total cost of credit. Finally, the 1998 directive requires the adoption of the single method for calculating the APR.

The directive also aims at promoting the cross-border provision of credit. It considers that the creation of a single consumer credit market would be desirable, in particular for consumers. However, lending to consumers is mainly carried out through subsidiaries and the development of cross-border credit is very limited. EU directives on consumer credit have required political efforts to define harmonised measures for the protection of the consumer through a long regulatory process. Preparations for the consumer credit regulation started when the weight of that sector in the economies of European countries was small, in comparison, for example, with that of mortgage credit. Despite the regulation, a single consumer credit market is not yet functioning and markets have developed within borders during the period between the preparation and adoption of successive directives.

The directives' scope is limited to addressing the information issue but other aspects may impede cross-border shopping for credit. Not enough importance seems to be attached to the objective of enabling consumers to benefit from the best credit offers in other member states. In fact, factors other than the divergence of laws governing consumer credit contracts are important. With the harmonisation of the calculation of the total cost of credit, the objective is to enable consumers to compare the different credit offers. Ensuring sufficient information to consumers is important for the functioning of the single market but not sufficient if consumers do not have a real possibility to obtain credit on a cross-border basis. Tax provisions, which affect lenders providing cross-border services in another member state, and inefficiencies in the field of cross-border retail payments constitute obstacles to the creation of a single consumer credit market.

The instruments used to regulate consumer credit are technical directives, which impose changes in national legislation with a view to harmonisation. The approach followed is rigid, with the harmonisation of contracts. Only certain elements essential to contracts are involved, however, such as the method of calculating the cost of credits or the right to early repayment. If the concept of the functioning of the single market does not simply relate to the free movement of services and capital, but does also involve the concept of consumers shopping around, then there is no limit on the harmonisation of contracts.

The approach to regulating consumer credit is specific among other consumer financial services. European regulation is primarily focused on credit institutions and, in certain cases, on financial products. The development of new technologies facilitating distance selling and electronic commerce extends the range of credit instruments available in a given jurisdiction, which makes it even more difficult to regulate a specific product.

It is necessary to determine whether the problems are structural (to be addressed by competition policy or economic regulation) or information-related. The need to take into account the costs of regulation and the benefits to be obtained from regulation is now widely recognised. The regulatory process for ensuring certain information to the consumer on the credit agreement has been long, the harmonisation accomplished is limited and cross-border provision of credit has not been eased. Experience in other financial markets teaches that their integration is slow. The integration of national retail financial markets is even slower, despite its special relevance for consumers.

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Annex I. Statistical Annex

Annex II. Regulatory Annex

Table AA 1
Interest rate deregulation

Country	**Date**
B	March 1990
D	1981
DK	October 1988
E	December1992
EL	March 1993
F	June 1990
I	June 1990
IRL	January 1993
L	March 1990
NL	1981
P	December 1992
UK	October 1979

	Following the jurisprudence, an instalment credit contract may be considered null and void because it affects morality if, taking into account all circumstances, there exists a patent deviation between contractual and market interests rates. In particular, if the rate is more than double the market rate. Courts refer to the average interest rate published by the National Bank.	
F	There is a legal definition of an usurious rate. Is usurious any loan granted at a global percentage rate which exceeds, when granted, by more than one third the the average global rate applied by credit institutions the preceding quarter, for similar operations involving analogous risks. Usury is subject to penal and civil sanctions.	Objective control
I	There is a legal definition of an usurious rate. Interest rates are usurious when they exceed by more than half the average APR applied by banks and financial intermediaries published quarterly in the Gazzeta ufficiale and classified according to their nature, object, amount, duration, risk and guarantee. Usury is subject to penal and civil sanctions.	Objective control
UK	The assessment of usury is left to the Courts. The Courts may sanction manifest excessive rates. The assessment is function of the market rate and the borrower characteristics.	Subjective control

Source: National laws, European Commission

Charges that may be excluded from the calculation of the "Total cost of credit to the consumer" as defined by Directive 90/88/CEE in Article 1 (2) (d)

i) charges payable by the borrower for non-compliance with any of his commitments laid down in the credit agreement;

ii) charges other than the purchase price which, in purchases of goods or services, the consumer is obliged to pay whether the transaction is paid in cash or by credit;

iii) charges for the transfer of funds and charges for keeping an account intended to receive payments towards the reimbursement of the credit the payment of interest and other charges except where the consumer does not have reasonable freedom of choice in the matter and where such charges are abnormally high; this provision shall not, however, apply to charges for collection of such reimbursements or payments, whether made in cash or otherwise;

iv) membership subscriptions to associations or groups and arising from agreements separate from the credit agreement, even though such subscriptions have an effect on the credit terms;

v) charges for insurance or guarantees; included are, however, those designed to ensure payment to the creditor, in the event of the death, invalidity, illness or unemployment of the consumer, of a sum equal to or less than the total amount of the credit together with relevant interest and other charges which have to be imposed by the creditor as a condition for credit being granted.

Table AA3
International comparison of the elements of cost in the calculation of the Annual Percentage Rate

	Elements of cost to be included	Elements of cost that may be excluded
B	All the costs which, in a credit contract, are imposed to the consumer by the lender or intermediary.	
	A list is defined.	A similar list than in the directive.
	Insurance costs, guarantees and personal securities are included when mandatory.	Insurance costs, guarantees and personal securities may be excluded if the consumer has a reasonable freedom of choice.
D		Similar wording as the directive but it is assumed that life-insurance is never mandatory.
E	All the costs including interests and other charges, which the consumer has to pay for the credit.	
	Insurance covering repayment in case of death, injury, disease or unemployment of the holder, are included if requested by the creditor.	Non-mandatory insurance is not mentioned as allowed to be excluded.
F	All charges are included in the rate, including payments to intermediaries.	
I	Interest and all other charges to be paid by the consumer in relation to the credit.	A list follows closely the wording of the directive.
	Any insurance or guarantee costs concerning forms of insurance or guarantees required by the creditor.	Insurance and guarantee costs other than those included (i.e. non-mandatory)

Source: ECRI, European Commission

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