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Where does the buck stop? Community attitudes to over-lending and over-spending

Abstract
This article explores the results of focus groups and a national survey aimed at discovering how ordinary Australians feel about lending and borrowing practices, in the context of high levels of consumer debt. This research, carried out by The Australia Institute in 2007, found a strong community belief that lenders and regulators, rather than individual consumers, were primarily responsible for excessive debt. Many Australians reported feeling uncomfortable about the way that credit is pushed on vulnerable and ill-informed consumers; advertising and marketing were believed to be partly responsible for poor financial decision-making. The authors propose a number of practical policies to improve the environment in which consumers make financial decisions, including a more helpful disclosure regime.

Keywords
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WHERE DOES THE BUCK STOP?

COMMUNITY ATTITUDES TO OVER-LENDING AND OVER-SPENDING

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This article explores the results of focus groups and a national survey aimed at discovering how ordinary Australians feel about lending and borrowing practices, in the context of high levels of consumer debt. This research, carried out by The Australia Institute in 2007, found a strong community belief that lenders and regulators, rather than individual consumers, were primarily responsible for excessive debt. Many Australians reported feeling uncomfortable about the way that credit is pushed on vulnerable and ill-informed consumers; advertising and marketing were believed to be partly responsible for poor financial decision-making. The authors propose a number of practical policies to improve the environment in which consumers make financial decisions, including a more helpful disclosure regime.

Keywords: financial decision making; corporate ethics; lending behaviour; advertising; focus groups.

1. Introduction

Over the course of 2008, Australia's love affair with easy credit turned on itself. In early 2008, the price of credit reached its highest point in 14 years, following 12 successive interest rate rises since 2001 (RBA, 2008a). With the domestic economy overheating, and home buyers feeling the economic pain associated with higher interest rates and inflation (ABC, 2007), consumer debt became the source of mainstream community debate. John Symonds, founder of Aussie Home Loans, has declared that 'we're maxed out as a society' (Denning, 2007). Subsequently, a slowing international economy has led to interest rate cuts and the prospect of rising unemployment.

Even as warnings about the growing debt burden grew louder, Australians continued to borrow. In the year to November 2007, the level of indebtedness to banks rose from $677.4 billion to $762.4 billion, an increase of 12.5 per cent (RBA, 2008b). By comparison, average

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earnings rose just 5 per cent over the same period (ABS, 2008). According to the ANZ Bank, 'the debt-to-income ratio for Australian households has risen from well below international benchmarks for developed economies over the past decade to now being at the higher end of all English-speaking countries' (ANZ, 2005, p. 1). By June 2007 the level of private debt in Australia was 156% of GDP, having passed the 100 per cent mark in 1999, and by current trends is projected to reach 200% by 2015 (Keen, 2007). As much as 16 per cent of consumer demand is now funded through increased debt rather than present wealth (Keen, 2007). One industry study found that a significant proportion of Australians have 'deliberately underestimated expenses and credit commitments, exaggerated their work history and overestimated the value of the assets' on credit applications (Veda Advantage, 2007a).

One of the most troubling aspects of rising debt is how it affects young people. Australia's largest credit information company, Veda Advantage, has expressed concern over the 'increasing appetite' for credit among the younger generation, who often take on debt as a way of fulfilling lifestyle aspirations. Almost a third of credit card applications in 2006 were from 18-27 year olds, and a third of all defaults on credit repayments were from people in the same age range (Veda Advantage, 2007b). Meanwhile, a recent study by the Australian Vice-Chancellors' Committee (AVCC) showed that graduates leaving university at the end of 2006 owed the government an average of $25,000 in HECS and HELP fees alone. As one young woman put it, 'to have such a huge debt behind me without even beginning to work is utterly ridiculous and frightening' (AVCC, 2007, p. 4). Such debts – which essentially amount to a reduction in disposable income until paid off – make it even more enticing for young people to use credit cards.

While concerns were expressed about consumer debt, lenders continue to engage in the hard-selling of credit. A survey by the Finance Sector Union found that nearly 60 per cent of finance and bank workers 'felt pressured to lend people money they could not afford to pay back' (ABC, 2008a). One bank worker reported 'routinely [selling] people loans that they could not afford' (ABC, 2008b). An employee of another bank claimed that managers instruct their staff 'to urge car loans, income protection insurance, household insurance and extended lines of credit on people with an obvious inability to service their debts' (West, 2007). An investigation by the ABC's *4 Corners* program uncovered one case in which a $20,000 car loan was granted to a Sudanese refugee with no English and little financial understanding (ABC, 2008b).

Such examples raise serious doubts about the processes that lenders have in place to assess credit applications. However, Treasurer Wayne Swan downplayed the significance of 'harrowing stories of individuals who have obviously borrowed in circumstances which are less than ideal', arguing that 'as a country [we] do not have the same level of problem that has emerged in the United States through the sub-prime crisis' (ABC, 2008a). While this is true, the debt situation is clearly a concern for the business sector and community members alike.

Whether borrowers or lenders are ultimately responsible for the debt crisis is the subject of much contention. Financial providers argue that individuals must shoulder the consequences of their own choices, and that the best way to protect the public from burdensome debt is through efforts to boost financial understanding across the community (ANZ, 2005). On the other hand, consumer advocates have identified 'evidence of a diminution of appropriate standards in the provision of credit' (Australian Financial Counselling & Credit Reform Association 2008, p. 4).

But what do ordinary Australians think about over-lending and over-borrowing? Do they believe that responsibility lies with consumers, who are too willing to accept offers of credit? Or do they think that lenders, who are in a much better position to understand the nature of financial risk and therefore to determine what constitutes a safe level of credit, are also liable? This report presents the findings of recent empirical research into these issues with ordinary Australians.

2. Research method

In late 2007, the Australia Institute convened a series of six focus groups to explore how ordinary Australians feel about financial decision-making.[2] Shortly thereafter, a nationally representative survey of 1,002 Australians was carried out.[3] This research revealed much about community attitudes to over-lending and over-spending, and these specific findings are the subject of this paper. More general findings from the focus group and survey research are reported in another paper from the Australia Institute, entitled *Choice Overload: Australians Coping with Financial Decisions* (Fear, 2008).

3. Research findings

Attitudes to credit and debt

Survey respondents were asked to indicate whether they agreed or disagreed with a series of attitudinal statements about financial issues, using a scale of 1 (strongly disagree) to 5 (strongly agree). The statements were:

- *It is too easy for banks to lend money to people who can't afford the repayments*;
- *Credit cards are often targeted at people who don't understand what they are signing up for*;
- *Banks are too willing to lend money to people who can't afford the repayments*; and

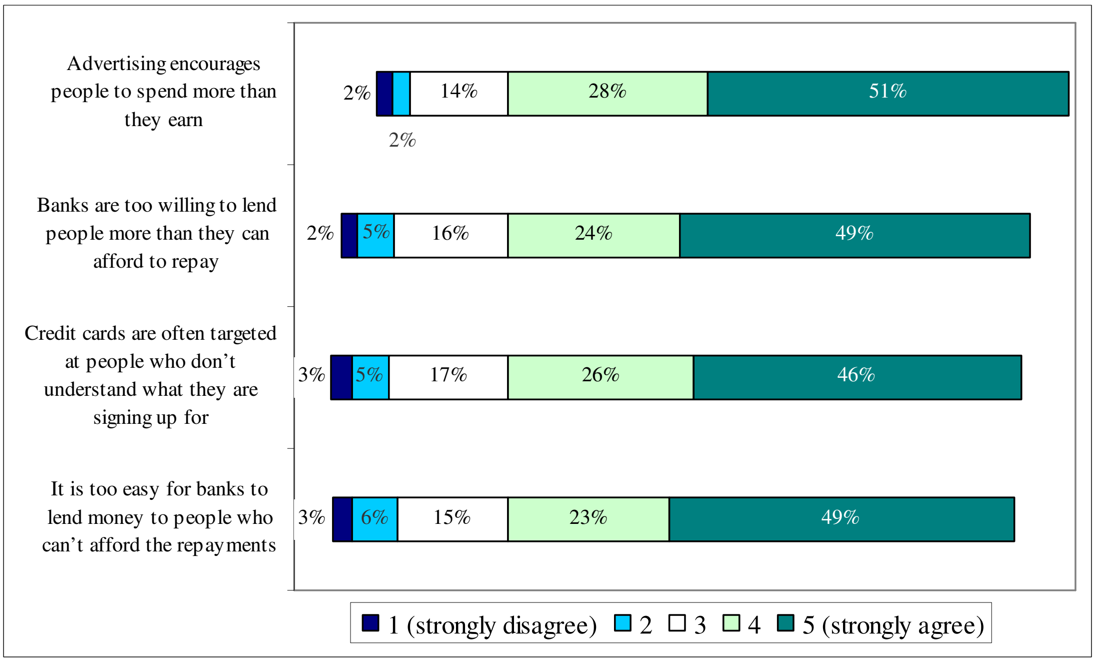
[2] Each focus group included between seven and nine participants, selected by an independent professional recruitment firm. The groups were held in Wollongong, Canberra and Adelaide, and ran for 90 minutes each. In order to represent a broad cross-section of society, the six groups were comprised of between seven and nine participants in specific age and income categories, with each group including a mix of genders. Two groups were held with people 18-29, 30-49, and 50-70 respectively. Within in each age range, one group was with people of below-average incomes, while the second group was with people of above-average incomes.
[3] The survey sample was drawn from a panel of online 'pre-recruited' respondents, and was designed to be nationally representative by gender, age, income and state/territory. Online sampling is increasingly being used by market and social researchers as an alternative to telephone sampling, as landline penetration declines and household internet access rates rise. The growth in popularity of online survey techniques means that there are now a number of high quality panel providers operating in Australia. The panel used to source respondents for this survey was the Valued Opinions panel, which is owned and managed by the Australian arm of Research Now. It is a research-only panel (i.e. panel lists are not used to carry out any non-research activities, such as marketing) recruited from a wide variety of sources, to avoid any bias associated with limited-source recruitment. The incentive for participation was $1.50 per respondent.

- *Advertising encourages people to spend more than they earn.*

Their responses to these statements are summarised in Figure 1 (below).

Seventy-two per cent of survey respondents agreed that *it is too easy for banks to lend money to people who can't afford the repayments*, while only nine per cent disagreed. Among focus group participants, there was a common view that many Australians have in recent years taken on more debt than they can handle, both through excessive reliance on credit cards and via mortgages that are out of proportion to income. When asked about the factors contributing to this situation, most people agreed that lax regulation has allowed financial institutions to lend too much.

Figure 1 Attitudes to lending practices and corporate social responsibility



* Base=1,002. Mean scores presented are calculated from responses on a scale of 1 to 5, where 1 is 'strongly disagree' and 5 is 'strongly agree'.

There was considerable debate about the extent to which ultimate responsibility for excessive debt should rest with the borrower or the lender. Some people argued that individuals should take responsibility for their own actions, while others pointed out that many people are not fully aware of how their decision might affect their future situation, and are not given independent advice about the implications of taking on debt before they do so.

> *It's easy to blame governments or banks for whenever we're not getting exactly what we want. But we need to accept that this is our income, and we need to live within our means. So many people want it now or yesterday, or they're no bloody good.*

> *People have to take responsibility for their own actions. But they probably shouldn't have been granted credit in the first place.*
>
> *You have to strike a balance between people taking responsibility for themselves and state-imposed regulation. It's a difficult one to answer, but at the moment I wouldn't mind seeing some regulation about easy credit.*
>
> *It's too easy to get money nowadays.*
>
> *In the past, there weren't that many institutions that would lend big. So you would see that you were trying to borrow too much. Now that's the exception.*

According to some older focus group participants, changes in attitudes toward credit and debt have contributed to excessive borrowing. These people referred to the higher expectations of today's young people, who are prepared to go into debt to fund their 'lifestyle'. This cultural shift was generally attributed to the influence of advertising and the media, which have convinced many young people that constant consumption and luxury goods are the norm.

> *Years ago when you bought your first home you used hand-me-down furniture for years, and you might not even have carpet on the floor. But kids these days have much higher aspirations.*
>
> *They've grown up thinking thy can have everything now.*
>
> *Kids today want it now. It's an instant gratification society.*
>
> *Advertising plays a very important part in our self-image.*

In line with such comments, almost four in five survey respondents (79 per cent) agreed that *advertising encourages people to spend more than they earn*, with fully one half (50 per cent) agreeing strongly (and only 5 per cent disagreeing). Despite strong views about the negative influence of advertising, there was uncertainty from most focus group participants about what exactly could be done to restrict the harm associated with such commercial messages, with most people reluctant to tamper with what they saw as 'free speech'.

Three out of four survey respondents (74 per cent) agreed that *banks are too willing to lend money to people who can't afford the repayments*, while only seven per cent disagreed. Focus group participants concurred that the banking sector seems to have lost the element of social responsibility that tempered lending practices in the past, with many people citing examples of predatory or manipulative practices on the part of financial institutions. The loss of corporate social responsibility was said to stem from the deregulation of the banking sector and the entrance of new corporate players with a focus on short-term profit.

> *In the past the banks were nicer. They were caretakers. Now it seems like it's just cut-throat.*
>
> *We used to have banks that had a vested interest in making sure that their customers' kids banked with them, that people could meet their interest payments, that everyone benefited. Then we have deregulation and outside banks came in,*

> *which were out to make a quick profit. The existing banks ramp up their activity, and you end up with this situation.*

Focus group participants had strong feedback about credit card debt. Many denounced the practice of soliciting large increases in credit card limits, and regarded such activity as unethical.

> *When I was 18, I didn't understand interest rates properly and kept racking up a debt on my credit card. But the bank wanted to give me even more credit. They give you huge loans even when you don't earn much.*
>
> *It's a bit immoral. It's very easy for young people to get credit cards and get a credit card debt. You're on a small wage, and they say, 'Why don't you take a $20,000 limit and max it out?' And then they rake in the interest payments. They're targeting everyone and trying to get as many people as they can.*

Most participants agreed that not enough has been done to ensure that people make informed decisions before taking on debt. They expressed particular concern for people who are more susceptible to the dangers associated with consumer credit, such as young people, the elderly and people less familiar with financial concepts. 'They're open to exploitation', said one person. In keeping with such comments, three in four survey respondents (73 per cent) agreed that *credit cards are often targeted at people who don't understand what they are signing up for*, while just eight per cent disagreed.

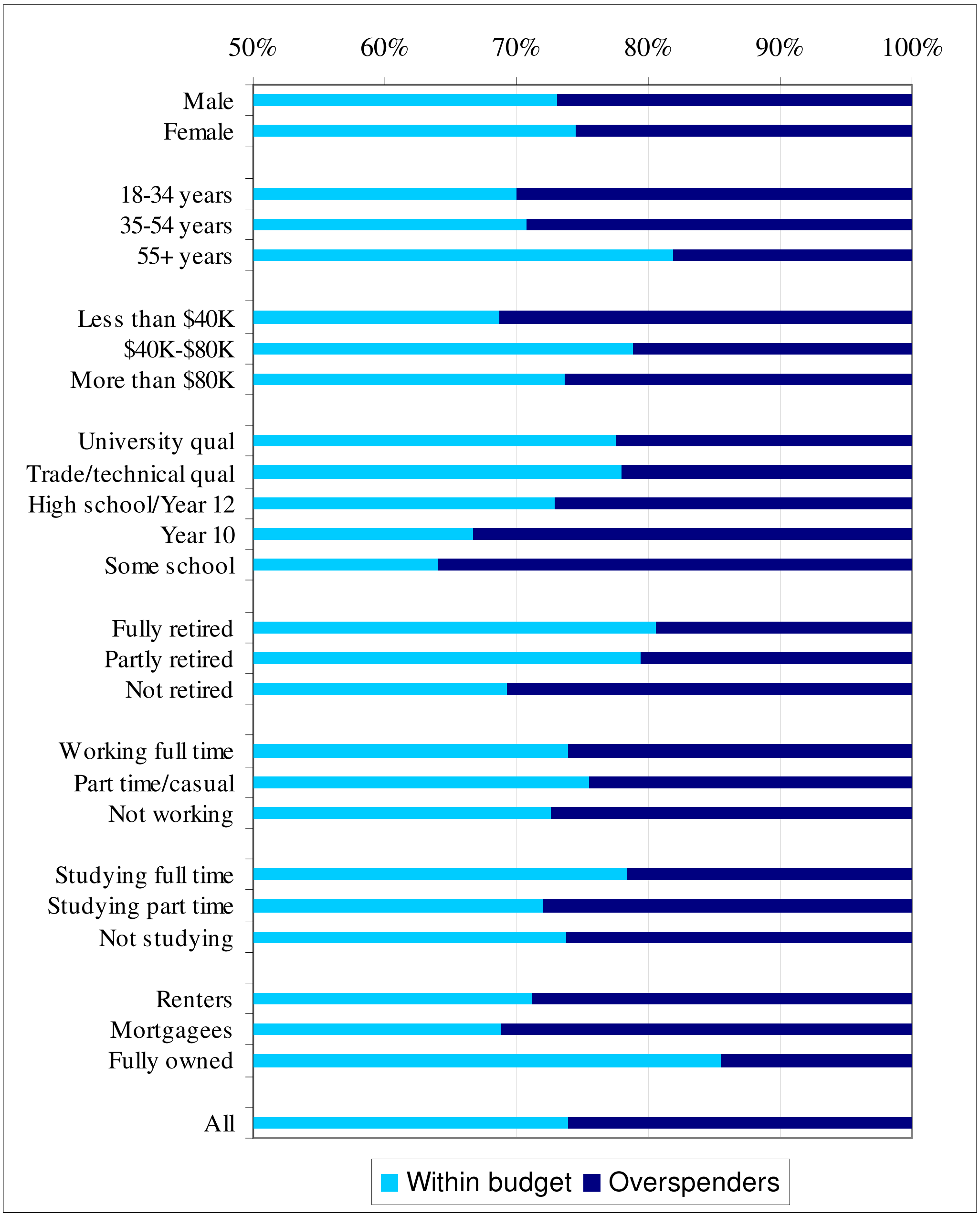
Spending habits

Survey respondents were asked whether, over the past year, they had spent more than their income, less than their income, or about the same as their income. Around one in five (22 per cent) had spent more than their income, while 39 per cent had spent less than their income. Another third (35 per cent) had spent about the same as their income, while four per cent were not sure.

For the purposes of analysis, this question has been used to divide the survey sample into those who were *within budget* over the previous 12 months (i.e. respondents who reported spending about the same or less than their income) and *over-spenders* (those who reported spending more than their income, plus those who were unsure). In total, 74 per cent of respondents were within budget (as defined), while 26 per cent were over-spenders.

Figure 2 (below) shows the breakdown of spending habits by a range of respondent characteristics. The clearest differences in spending habits relate to levels of formal education: people with a university, trade or technical qualification were much more likely to report staying within budget than people with no post-school education, while people older than 55 were more likely to stay within their means than younger people. Notably, people living in middle-income households ($40,000-$80,000 per annum) were more likely to be within budget than lower-income households (less than $40,000) or higher-income households (more than $80,000). People who owned their home outright reported staying within budget more than either renters or mortgagees – presumably because their discretionary incomes are generally higher than those with significant housing costs.

Figure 2 Spending *versus* income in the previous year*



* Base=1,002. Respondents 'within budget' are those who reported spending less than or about the same as their income in the previous year, while 'overspenders' are those who reported spending more than their income or were unsure how their spending compared to their income.

4. Discussion

The findings of this research indicate a strong community belief that lenders and regulators, rather than individual consumers, are responsible for the debt situation in Australia. Around three in four respondents agreed that *it is too easy for banks to lend money to people who can't afford the repayments* and that *banks are too willing to lend money to people who can't afford the repayments*. This situation was attributed to both the deregulation of the financial sector and to a loss of corporate social responsibility generally – although many people still emphasise the need for people to be accountable for their own actions.

A large majority of Australians are uneasy about the way that credit has been pushed on vulnerable consumers. Three-quarters of survey respondents agreed that *credit cards are often targeted at people who don't understand what they're signing up for*. The common practice of soliciting increases in credit limits on an almost routine basis was regarded as unethical by most research participants.

Many Australians believe that there are broad cultural factors influencing the proclivity to take on debt, with four in five survey respondents agreeing that *advertising encourages people to spend more than they earn*. Older people are particularly concerned about the ability of the younger generation to resist the temptation to buy now and pay later.

There is a common perception that Australians take on debt as a way to fund their 'lifestyle' or to enjoy things today that they would otherwise be unable to afford. Our research shows that this applies to around one in five Australians (or 22 per cent) – the proportion of survey respondents that reported spending more than their income over the previous 12 months. Over-spending tends to be more common among younger adults, people with less formal education, and people living in either low-income or high-income households. Middle-income households, by contrast, tended to report more prudent spending behaviour.

5. Policy implications

The corporate sector has tended to blame individuals for taking on more debt than they can handle, drawing on the doctrine of 'personal responsibility' to absolve itself of any culpability in the debt crisis. From the business perspective, the solution to excessive borrowing is to encourage greater financial literacy.

By contrast, this research suggests that many ordinary Australians hold the corporate sector responsible for the debt problem, and believe that financial institutions have acted unethically in promoting the easy availability of credit. From the consumer perspective, corporations need to rebuild their moral credentials if they are to be trusted to make decisions which affect the livelihoods of their customers.

In July 2008, the Council of Australian Governments resolved to transfer responsibility for consumer credit regulation from the states and territories to the Commonwealth. The first step in the process is to enact the Uniform Consumer Credit Code (UCCC) as Commonwealth law, along with increasing the role of the Australian Securities and Investments Commission in monitoring credit practices. The second phase of reform is planned for mid-2010, and will involve additional measures to address unfavourable lending practice, such as credit card limit extension offers. However, few details on the this aspect of the reform process have yet been released (Australian Government 2008).

Once the UCCC becomes Commonwealth law, it will not necessarily overcome the current shortcomings in consumer protections against unscrupulous lending. For example, the UCCC contains 'no clear provision … that a lender should consider a borrower's ability to repay a loan and no penalty for failing to do so' (Consumer Credit Legal Centre 2007, p. 67). Integrating such provisions into the existing regulatory framework is an area of clear priority for policy-makers. A systematic examination of the processes that credit providers currently use to make lending decisions would also help in designing policies to discourage undesirable lending practices.

Households in the United States received approximately 5.3 billion offers for new credit cards during 2007 (Synovate 2007). Comparable figures for Australia are not (publicly) available, but focus group feedback gathered for this research indicates that many Australians are concerned about the number of solicitations they receive, both for new credit cards or for increases in credit limits. Government agencies should therefore endeavour to collect data on the number and type of credit solicitations being made to Australian consumers by post, online and face-to-face. This would allow policy to be informed by objective evidence on the marketing pressures being brought to bear on consumers – with a view to eliminating unconscionable forms of marketing and promotion.

In 2001, reforms to the financial services sector made it compulsory for lenders to make information on their products available in the form of Financial Services Guides, Product Disclosure Statements and Statements of Advice. Despite the extraordinary amount of information that consumers are now given, certain important facts can still be quite difficult to ascertain. New rules covering monthly credit card statements should therefore be introduced, setting out what information is to be displayed prominently. This could include how much interest the customer has paid over the past 12 months, how long it will take to pay off the debt if only the minimum repayment is made, and how much interest they are expected to pay over that period.

At a time when our debt is catching up with us, these policy ideas go some way towards alleviating community concerns about over-lending and over-spending.

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