Submission to the Senate Economics Committee Inquiring into the nexus between household debt, foreign imports and the Australian current account.

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The majority of consumers see credit as being an extension of their resources. Therefore their perception of the limit of their resources is varied. They will then tend to spend up to that limit. Does this infer that consumers are guilty of excessive use of credit?

No, in my submission excessive use of credit is a myth. The Uniform Consumer Credit Code (UCCC), the national legislative scheme governing consumer credit conduct, requires that credit providers only provide an applicant as much credit as they (the credit provider) assesses the applicant can reasonably be expected to repay. There are significant sanctions for breaching this requirement including forgiveness of the debt created. Therefore consumers cannot use more credit than they are granted and cannot be granted more credit than they are assessed to be able to repay. If consumers are to be found guilty of an excessive use of credit, the corollary must also be true; credit providers must be guilty of excessive provision of credit and therefore liable for sanction under the UCCC.

As there has been no wholesale prosecution of credit providers under the UCCC then it must be assumed that the levels of consumer credit in Australia today are appropriate to the affordability of such levels. The community will therefore spend up to this limit; it is human nature and basic business.

With our spending power now firmly established it is the mix of products on which the spending is exhausted which must surely be the stressor when it comes to the influences on the Current Account. Here is the next logic argument.

Value adding Australian industry is being marginalised by cheaper overseas imports in all areas: food, textiles and manufactured goods. Consumers with tightening household budgets are being forced to choose cheaper imported grocery lines despite a preference for more Australian made products. Why is this?

Despite the availability of credit, domestic budgeting still endeavours to meet staples from cash. However after the cost of taxes, superannuation, accommodation, utilities, health, transport, education, and clothing have been met, there is little cash left for the majority of families today and so buying decisions, even when supplemented by credit, are based in frugality. Government calculations about the real costs of living are quite simply fraudulent and mislead policy development.

So on the one hand consumers at the 'grocery' end of consumption are spending more on imported lines because of economic necessity, this in turn further reduces the viability of domestic value add industry, further reducing the availability of such product for purchase and so on. This is not rocket science.

We are a technological society. We rely on technology not only in our leisure but also as an interaction between business and consumer viz. Internet banking, online shopping and information systems, government service delivery etc. People are being forced to embrace advances technology in the home. But Australia does not produce this technology on shore. A glaring example is the staggering penetration of the mobile phone. Australia has the highest take up rate of this technology per capita in the world. Yet all of these phones let alone peripherals are manufactured offshore.

Again, given that Australians can access a level of resource and are fully expected to expend it on whatever products and services are available to satisfy their respective needs and wants, the nexus to the Australia current account is established but only through the mix of goods and services made available for purchase.

I agree that as we, Australia, seem unable to escape the diluting of domestic consumption by cheaper imports, we should consider reigning in the levels of consumer credit as a means to better managing demand effecting Australia's current account. I do not agree that further regulating credit lending policies is an appropriate or desirable mechanism for achieving this. Such a move is contra to the principles of the free market; it is paternalistic toward consumers and would be in my view economically disastrous. A better way exists.

Credit business is about risk assessment. That is, good credit business is founded on managing and compensating for the risk assumed in agreeing to future payment. At present, credit providers see very little risk associated with advancing funds or credit facilities. They are content in their expectation that their debt will be repaid with interest because they enjoy significant protected under Laws such as Property Law, Contract Law and Insolvency Law. Irrespective of the changing conditions experienced by consumers which might affect their ability to meet their debts, the credit providers are almost certain of recouping their investment.

In my opinion, the protection of the commercial credit provider is neither justifiable equitable or economically sound. Let me explain. Providing credit means both the lender and borrower are gambling that the future conditions will always be such as to enable the borrower to repay the debt. The borrower cannot take credit, it can only be granted by the credit provider. If credit is granted both borrower and lender must be of the mind that the debt can be repaid. To be otherwise would be unlawful per the requirements of the UCCC or fraudulent.

But things do change in people's lives and the impact of *force majeure* i.e. factors or forces over which the consumer has no control, becomes a factor. Such unforseen changes is circumstance can undermine a person's capacity to meet their financial obligations.

The most common manifestations of force majeure include:-

- Bad debt, e.g.
    - The failure of a debtor
    - Being called on to satisfy a guarantee
- Change in personal circumstances e.g.
    - Loss of employment or reduction in income level
    - Ill health preventing income generation
    - Divorce or separation removes assets or creates distraction
- Change in market conditions e.g.
    - Increased competition
    - Decreased demand
    - Obsolescence
- Change in environmental factors e.g.
    - Flood, fire or famine
    - Change in law
    - Changes in overall economic conditions

- Fraud
    - Embezzlement
    - Theft
    - Defrauding

Any and every individual or organization is susceptible to financial problems. By virtue of waking and participating in the real world or opening for business every day, each of us is exposed to the vagaries of circumstance.

The credit providers are largely insulated from these occurrences. Such eventualities mostly work in favour of the lender because interest continues to accrue over a longer period of time. Although some matters may end up in insolvency, the majority of accounts are ultimately paid with considerably more interest being paid than perhaps originally intended. In this environment of protection, credit providers have become complacent and are comfortable writing more and more credit contracts because they feel safe.

If creditors were exposed to the same level of risk as the consumer, I believe that the credit providers would be forced to be more circumspect in their lending and hence this would achieve an overall retardation of the level of consumer credit made available. This is the desirable policy.

This can be achieved easily by amending the existing UCCC to introduce mandatory debt moratoriums in circumstances of financial hardship. This would immediately apportion the cost of 'bad luck' equally to both lender and borrower. The credit provider would also feel the economic cost of defaulted credit. This would cause lenders to more carefully consider the likely impact of *force majeure* and adjust there their risk management accordingly

I propose amending Section 66 of the UCCC to impose an immediate and automatic moratorium on debt repayments and interest accrual upon certain eventualities which represents a material and deleterious change to the circumstances entailed in the original credit or finance application on which the credit was approved. This moratorium would remain in operation until the circumstance have at least returned to the position as at the date on which the original application was approved.

In my view this is likely to lead to more prudent lending and an overall reduction not only in distressed debt but also in the over supply of credit. In short, remove the financial incentive for over supplying consumer credit market. At the same time, such an amendment would be welcomed by Consumer groups and would be fully justifiable on the grounds of equity and fairness.

Of course any retardation in the level of credit to be supplied will have the effect of tightening up household spending. This can surely only lead to increased pressure to purchase cheaper products which then will favour imports over local products. I suspect that it is at this grass roots level of economic reality that the Globalisation theorists fall short of answers.

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About Geoff Munck

Geoff is a former Senior Advisor in Insolvency to the Australian Taxation Office (1980 – 1996); Manager with insolvency and forensic accounting firm Worrells (1996 - 2000)/ and founder and Managing Director of national consumer credit advisory service, Debt Helpline (2000 - present).

Geoff's career credits include task force leader for the ATO in relation to collections and enforcement arising from the Qld Royal Commissions, Fitzgerald and Cooke. He was a convenor for the Australian Society of Certified Practicing Accountants Centre for Excellence in Insolvency and Reconstruction and held board positions with the Australian Institute of Credit Management until 2000.

Geoff is an advocate of equitable commercial dealing with focus on the monetary system and the interaction of creditor and debtor in the human context. He has authored many papers in this field and is a popular speaker and educator.