# Consumer Debt and Social Exclusion in Europe

Edited by
Hans-W. Micklitz and
Irina Domurath

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# Contents

# List of Figures and Tables

## Figures



## Tables

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# Acknowledgements

The idea for this book came in the late autumn of 2013, when we organised a conference entitled 'The over-indebtedness of European consumers after the financial crisis' at the European University Institute in Florence. On that occasion, we invited specialists from six European countries to present results of a commissioned study to an audience of academics, policy makers, and interest groups. It became obvious that while European countries are still grappling with the effects of the financial crisis on the macro-level, adverse developments on the micro-level were rather approached with single responsive measures instead of comprehensive plans. Turning indebtedness into over-indebtedness, the financial crisis has had large-scale social effects in terms of social exclusion that follows default on mortgage instalments, eviction and homelessness.

We thank all contributors for their interest, time, and effort involved in conference and the data collection as well as the writing of the contributions. In addition, we thank the Schufa credit bureau in Germany, without which the conference held in November 2013 and the research presented here would not have been possible. The Schufa funding complemented the ERC Grant by Hans-W. Micklitz on 'European Regulatory Private Law'.

Hans-W. Micklitz
Irina Domurath

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# PART I
# The Framework

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# Chapter 1
# Introduction

Irina Domurath and Hans-W. Micklitz

For several years now social inclusion has been at the top of policy agendas for the EU and its Member States. In its Europe 2020 strategy,[1] the EU established the target of lifting at least 20 million people out of poverty and social exclusion by 2020. This target is inherently connected to the EU goal of social cohesion,[2] which is to be achieved by sharing the benefits of growth and jobs. Consumer credit plays a pivotal role for both growth and social inclusion because it enables citizens to foster economic growth by buying goods and services on the internal market and to fulfil their own consumerist desires and achieve the standard of living to which they aspire. In this context, consumer credit has been increasingly expanded into all layers of society by liberalising access to such credit.

However, six years into the global economic and financial crisis social inclusion is not being achieved in many European countries. Many consumers in Europe struggle with high levels of indebtedness and over-indebtedness, being at the risk of default and eviction from their homes as a result of the profound economic, political, and social repercussions European countries have experienced. Governmental and constitutional crises, high levels of public debt, the adoption of austerity measures, unprecedented high levels of unemployment, and increasing poverty have affected many European societies. As a result, the EU has entered into a process of re-examining the structure and design of the banking system within the internal market, with far-reaching political and institutional consequences. New regulatory mechanisms and private law rules are being designed at the supranational and national level. The focus, however, has been on the impact of the crisis on states and on the banks. State default, sovereign debt and bailouts have made the headlines, while the impact of the economic crisis on consumers, as debtors of consumer credit or as mortgage holders, has raised much less concern.

Knowledge of the concrete issues, problems, and tentative solutions tested in the countries most affected by the crisis is crucial in order to have an informed debate about the effects of policy measures on (over-)indebted consumers as well as financial and social inclusion and exclusion. Therefore the major added value of the contributions presented here is twofold: firstly the attempt to deepen our knowledge on the impact of the economic crisis on over-indebtedness of consumers through empirical analysis and secondly to analyse the knowledge that has been gathered and to put it into the wider theoretical and academic debate on over-indebtedness.

The six empirical studies from the three Euro countries (Greece, Spain and Portugal) and three non-Euro countries (Hungary, Romania and Iceland) provide information on the effects of the financial and monetary crisis in six European countries that have been significantly hit by the

1 Communication from the Commission ‘Europe 2020: A strategy for smart, sustainable and inclusive growth’, 3 March 2010, COM (2010) 2020 final.

2 See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions ‘The European Platform against Poverty and Social Exclusion: A European framework for social and territorial cohesion’, 16 December 2010, COM (2010) 758 final.

financial crisis. Consequently, the studies provide insight into the situation of indebted European consumers, the causes of over-indebtedness, and attempts to alleviate debt burdens. What all countries chosen for the case studies have in common is that they have received bailout loans from Eurozone countries and the IMF under the condition of implementing intrusive austerity measures. While the loans were mainly used to improve the financial position of the banks or the economy in general, austerity measures have had an impact on many social issues. For this reason, the country reports focus on the situation of those most affected – namely indebted people with some form of consumer debt or a mortgage on residential property – assessing the effects of a wide range of factors such as the bursting of the housing bubble, the decline in house prices and wages, rising unemployment, and currency depreciation.

The country reports demonstrate that, despite initial signs of cautious macro-economic recovery in 2013,[3] recovery at the micro-economic level remains tentative. This is especially so for consumers with mortgages who are still facing increasing levels of (over-)indebtedness and are struggling with the effects of the crisis, both in financial and social terms. The country reports show a convergence in all countries with regard to the problems and causes of over-indebtedness, especially with regard to the adverse impact of macro-economic 'external shocks', such as the bursting of a housing bubble, unprecedented high levels of unemployment, or the devaluation of the currency, but also provide evidence of divergence concerning the governmental and administrative responses to over-indebtedness with regard to aim, design, and effectiveness. In the three non-Euro countries some specific issues have perhaps aggravated the problems consumers face. For instance, Iceland (participating in the EU internal market framework through the EEA Agreement) was the first country to experience the resignation of a government and new elections in 2009. In Iceland, Hungary, and Romania the vast majority of the loans to private households were connected to foreign currencies with the benefits of lower interest rates and longer maturities but the risk of depreciation of the local currency and subsequent inability of the borrower to repay their foreign currency loans.[4]

All these factors have influenced contractual relations and have brought to the fore the importance of private law and private law litigation, before the highest courts in the countries and the European courts. The *Aziz* decision of the CJEU[5] has had an immense impact both on Spanish procedural law and on the legal orders of other European states with regards to the interpretation

3 Recent developments since 2013, cautiously interpreted as the first signs of economic recovery, have been identified on both sides of the Atlantic, see for example in the United States: http://www.economist.com/node/21550256; Portugal: http://www.economist.com/news/europe/21584346-few-crumbs-cheer-count-welcome-good-news-between-bail-outs; Spain: http://www.ft.com/cms/s/0/4a56f51c-2b60–11e3-bfe2–00144feab7de.html#axzz2suJHGJzv, http://www.economist.com/news/europe/21587811-mariano-rajoy-predicts-economic-joy-spain-still-has-long-way-go-worst-may-be-over; and Greece: http://www.economist.com/news/finance-and-economics/21577076-back-source-euro-zone-crisis-daring-hope-fearing-fail.

4 We have to distinguish between foreign-currency loans (loans denominated in foreign currencies), FX-indexed loans (loans indexed to foreign currencies and thus dependent on the exchange rate), and CPI-indexed loans (loans indexed to the consumer price index thus dependent on inflation). See further on the issue P. Yesin, 'Foreign currency loans and systemic risk in Europe', Federal Reserve Bank of St. Louis Review, May/June 2013, 95(3), pp. 219–35, available at http://research.stlouisfed.org/publications/review/13/03/219–236Yesin.pdf.

5 *Mohamed Aziz v. Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa)*, C-145/11 (14/3/2013); note H.-W. Micklitz, Unfair Contract Terms – Public Interest Litigation before European Courts Case C-415/11 Mohamed Aziz, in V. Colaert and E. Terryn (eds) Landmark Cases of EU Consumer Law – in Honour of Jules Stuyck, Intersentia, 2013, 615–34.

of unfair contractual terms in mortgage agreements. It can be regarded as a turning point for over-indebted consumers in Europe, as it not only triggered a number of follow-up requests for preliminary rulings from Spanish courts to clarify certain issues but also led to requests from other countries within[6] and outside the EU (albeit after initial reluctance). The Icelandic Supreme Court has declared FX-indexed loans illegal and sought an advisory opinion from the EFTA-Court on the legality of CPI-indexed mortgage loans. Private law is considered to be of utmost importance as a means of last resort for solving over-indebtedness issues resulting from mortgage agreements. Whether and to what extent private litigation contributes to the search for broader political solutions remains to be seen.

The country reports also highlight the shortcomings of EU consumer policy, which is largely based on the image of the reasonably circumspect consumer who is empowered, predominantly through the provision of information and competition in the internal market with the information asymmetry to be addressed by credit registries and credit bureaus. In this regard, the EU suffers from a clear market bias that promotes and requires easy access to consumer and mortgage credit,[7] in line with the Anglo-American vision of ‘cheap money’ as a means of achieving financial and social inclusion. The 2008 crisis, however, provoked over-indebtedness yielding financial and social exclusion without there being a European policy to counteract such effects.

The rapporteurs were: Georgios Mentis and Ekaterini Pantazatou for Greece, Mónika Józon for Hungary, M. Elvira Méndez Pinedo and Irina Domurath for Iceland, Catarina Frade and Mariana Pinheiro Almeido for Portugal, Beatrice Andresan-Grigoriu and Madalina Moraru for Romania, and Pablo Gutiérrez de Cabiedes Hidalgo and Marta Cantero Gamito for Spain. The country reports are based on a cross-country study collecting information against a factual background of empirical data relating to over-indebtedness. The rapporteurs were required to answer a broad questionnaire with the help of different sources: statistics and empirical sources, legal sources, policy documents and secondary academic sources amongst others. Whenever data collection proved insufficient the rapporteurs were encouraged to collect primary data themselves through interviews with affected parties. Most rapporteurs conducted semi-structured interviews with different parties such as consumers, bank employees or representatives from consumer organisations. Obviously, there are limits to such an approach: comprehensive data collection proved difficult, not least due to the lack of consistent statistics, common parameters for the measurement of concepts or the limited preparedness of the targeted groups to be available for interviews. Despite these limits, the country reports provide an extremely useful basis for analysis.[8]

The book is structured in the following way: Guido Comparato (Chapter 2) opens the larger debate with a deeper analysis of financial and social inclusion. He elaborates on the dichotomy between the promotion of financial inclusion with a view to achieving social inclusion and the actual result of financial exclusion not only through the social repercussions of over-indebtedness

6 The Hungarian Supreme Court raised questions relating to unilateral changes to loan contracts by banks as well as exchange rate margins *Árpád Kásler, Hajnalka Káslerné Rábai v. OTP Jelzálogbank Zrt*, C-26/13, Judgment of 30 April 2014.

7 See OECD Discussion Paper on Information Sharing ‘Facilitating Access to Finance’, available at http://www.oecd.org/investment/psd/45370071.pdf.

8 The contributions in the book provide for a condensed analysis of the findings only. The complete country reports are accesible via the internet for those who are interested in using the data. Further information on the setup of the research can be found therein, see I. Domurath, G. Comparato and H-W. Micklitz, ‘The Over-Indebtedness of European Consumers – a View from Six Countries’, EUI Working Paper LAW 2014/10, pp. 15–18.

but also through the regulatory responses that put emphasis on financial stability. He also elicits the role and politics of private law against the background of the inclusion–exclusion dichotomy.

The six country reports form Part II of the book (Chapters 3 to 8), starting with the report from the Euro countries (Greece, Portugal and Spain) and concluding with the non-Euro countries (Hungary, Iceland and Romania). Against this empirical background, the other contributions in this volume analyse the inclusion–exclusion and the over-indebtedness paradigms, both from an *ex ante* viewpoint, concerned with the causes and prevention of over-indebtedness and social exclusion, and from an *ex post* viewpoint, focussing on the measures taken after over-indebtedness has occurred in order to remedy its negative effects.

In Part III, Elaine Kempson (Chapter 9) starts her analysis by painting a broad picture of how the crisis has affected European consumers, ranging from the causes of over-indebtedness to the characteristics of debt. She contends that there are different structural conditions in the countries that have influenced over-indebtedness levels in the European countries: the nature of a country's economy as the economic downturn hit, the state of household finances at that point in time, and the policy measures adopted in the aftermath of the crisis. She arrives at this conclusion drawing from comparative statistics for individual countries as well as information contained in the six country reports.

The prevention of over-indebtedness is the focus of two contributions by Irina Domurath and Akos Rona-Tas. Irina Domurath (Chapter 10) deals with consumer contract law, analysing the tools available in the EU legal framework on consumer credit and mortgage contracts for the prevention of over-indebtedness. She examines the conceptualisation of *responsible lending* and *responsible borrowing*, claiming that the EU legal order starts from a much too narrow understanding too much engrained by the responsible consumer rhetoric. She concludes by suggesting complementary private law tools to strengthen the current framework, especially tools that address 'external shocks' and the increased access to credit. Akos Rona-Tas (Chapter 11) elicits the role of credit bureaus in the contractual design of credit agreements in modern globalised economies. Even though credit bureaus are intended to reduce the risk of over-indebtedness and protect lenders from defaulting borrowers by solving the information asymmetry problem, Akos Rona-Tas calls into question the fulfilment of that purpose based on the contention that credit bureaus have the 'perverse effects' of extending credit to 'worse' borrowers; that their data is socially constructed and, hence, of diminished quality; that they are built on the false assumption that payment depends solely on the debtor who intends to exploit his information advantage, neglecting the relational nature of credit; and that credit scoring can even make it unnecessarily hard for individuals to obtain credit if the information submitted to credit bureaus is too broad.

Iain Ramsay (Chapter 12) looks into the *ex post* measures taken in order to alleviate over-indebtedness. After explaining the responses taken against the background of policy ideas, actors and institutional settings, he goes on to describe the separation of consumer credit as belonging to the economic establishment of the internal market and personal insolvency regulation as part of the social problem of over-indebtedness. He sheds light on the influence of economics on household deleveraging in different countries around the globe, which regards the latter as an economic problem that hampers economic growth, and analyses the emerging EU narrative of promoting entrepreneurialism through personal insolvency. He concludes by remarking that the 'responsibilisation' of personal insolvency becomes a means of addressing financial and social exclusion from the market, while the balance between personal responsibility and the facilitation of re-entry to the market still needs to be found.

In the final remarks Hans-W. Micklitz (Chapter 13) positions the debate on consumer over-indebtedness in the broader framework on financialisation and the possible impact it might have on the future development of a consumer credit law. His main argument is that the *micro* level of over-indebtedness mirrored in the individual harm of consumers has to be linked to the *macro* level of household over-indebtedness. Such a perspective requires deeper investigations into the role and function that private law, and more specifically contract law, might have as a new mode of governance that reaches beyond the privity of contract.

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## Chapter 2

# The Design of Consumer and Mortgage Credit Law in the European System

Guido Comparato

Over the course of the first decade of the 21st century the general level of household indebtedness, including mortgage and consumer credit loans, has generally increased in Europe.[1] The level of indebtedness became a considerable social problem for many individuals in various European countries after the outbreak of the 2007–2008 financial crisis, which had serious ramifications for Europe. These simple observations should be placed in the specific political, economic and social context which has characterised Western societies in recent years in which it is possible to observe an increase in the level of consumption and household debt. It should be noted that the increase in levels of household debt was not solely a casual development rooted in the changing consumption habits of a more and more individualistic society. Rather, this increase was most notably the result of specific economic and political choices which informed the overall economic and legal architecture of several Western countries. Focusing specifically on Europe, the increase in household debt, which was moderate in some states and significant in others in the mid-2000s, can be directly linked to the macroeconomic situation in those countries as well as to other structural factors.[2] In other words, whilst from a purely private law perspective credit is simply the result of a bilateral transaction, in a broader sense the recourse that individuals make to private debt cannot be considered a purely private matter. On the contrary credit is strongly dependent on more general factors which must also be taken into account in any legal analysis. Admitting that a link between increased consumer credit and macroeconomic figures exists,[3] it becomes obvious that the economic crisis would necessarily affect contractual relations, exposing some consumers on the front line to the detrimental effects of poor macroeconomic figures.

When the financial crisis hit Europe a large number of citizens proved to be unable to continue to make payments on their loans which in numerous instances resulted in home repossessions, similar to what thousands of citizens experienced in the United States just a few years earlier. Such developments increased levels of social exclusion, in direct contrast with the initial promise of financial inclusion for an ever-increasing number of citizens. The fact that this development was not limited to the default of a few debtors and the failure of a limited number of contractual agreements, but rather became an extensive social phenomenon, suggests that the reasons behind the crisis are systemic in nature. Levels of over-indebtedness, considering the variations in different European Member States, can therefore be explained also on the basis of general economic factors.[4] In particular, those countries that witnessed a considerable rise in household debt are

1 Chmelar, 2013, 13, 3.

2 Chmelar, 2013, 3.

3 On the need to consider the interaction between macroeconomics and contract law in this context, *see* Köndgen, 2011, 43.

4 In particular, Elaine Kempson, Chapter 9, this volume, identifies three factors: ‘the nature of a country’s economy as the economic downturn hit, the state of household finances as the economic downturn

now experiencing over-indebtedness and adverse social effects to such an extent that leads one to wonder not only what occurred in the economy but also – and perhaps more relevant for legal analysts – in the contractual design and legal governance of mortgage and consumer credit. It is suggested that some Member States were made more vulnerable to the economic downturn by a failure to regulate mortgage and consumer credit markets.[5]

The specific focus in this chapter lies in the role and the politics of private law in this context against the background of the inclusion/exclusion dichotomy. It will highlight the role of private law in the more general socio-economic context and the changes that are being made as a result of the economic crisis. At the same time, in a multi-level governance context such as Europe where different measures can be taken for different motives by diverse lawmakers and regulators, the description of the design of consumer law in Europe cannot avoid the question of the distribution of competences between the national and the supranational levels, a topic which also appears to be decisive in this area. This chapter therefore attempts to examine the design of the consumer credit system in the multi-level system of the European Union in a broad sense both before and during the crisis. Subsequently, this chapter will consider how the design of this system relates to the idea of financial and social inclusion. In doing so the chapter firstly examines the political and economic considerations which were aimed at extending the market and promoting financial inclusion, which underpin the legal and institutional framework for mortgage and consumer credit in Europe. It then illustrates the way in which the financial crisis altered that idea by leading to the introduction of new regulatory responses which appear to be aimed at ensuring the stability of the economic system as well as possibly preventing social exclusion in the long term.

In order to highlight the private law dimension in particular, this chapter will also consider a number of topics and their legal regulation that recur throughout the book as a whole, such as the causes of (over-)indebtedness,[6] the concepts of responsible lending and responsible borrowing,[7] the role of credit reference agencies,[8] and the mechanisms for dealing *ex-post facto* with over-indebtedness.[9]

## From the United States to Europe

Since the outburst of the financial crisis in 2007–2008 it has become clear that an overextended inclusion of vulnerable consumers in the financial market might be eventually detrimental both to consumers and the financial market itself. For several decades the idea that social inclusion would naturally follow from financial inclusion had been advocated on both sides of the Atlantic. In political terms it was initially in the United States that the consumer became the main focus of an ideology which strived for an egalitarian class-less society in which citizens could purchase more products and services.[10] It is observed in sociological literature that debt has a tendency to disrupt conventional understandings of social class.[11] In economic terms, a mature economic system cannot focus exclusively on supply if this is not supported by constant and growing demand. Especially

hit, how countries dealt with or were forced to deal with the economic downturn'.

5 Chapter 9, this volume.

6 *See* Chapter 9, this volume.

7 *See* Chapter 10, this volume.

8 *See* Chapter 11, this volume.

9 *See* Chapter 12, this volume.

10 Whitman, 2007.

11 Sullivan, 2013, 37.

in the United States the economic system started immediately developing new ways to expand the market in order to foster demand, encouraging internal consumption through consumer credit.[12]

According to broadly Keynesian views this effect could be achieved by means of a more proactive role for the state through government spending. However, the task of enabling consumers to consume more, and by implication to become pivotal economic actors, fell mostly on the private sector. This model started developing in the United States in the 1920s when (industry-financed) research showed that 'consumptive credit', far from being morally irresponsible as it had been generally considered up until that time, instead had a potentially productive function inasmuch as it fostered the purchase of goods and services.[13] Even the consumer who purchases goods and services is a 'productive' economic actor as a result of the fact that they expand the market for the supplier with their demand for new products and services. Providing consumers with the means to purchase everyday products slowly became an industry in the 1930s.[14] By the same token, the policy goals which normally lie behind public policy, and which can include social considerations, shifted to the private sector. Consumer credit was not just a matter of business but it could also offer citizens resources to improve their own welfare. However, in the 1980s such policies achieved their full potential as a result of a wave of deregulation and diminished state control which led to a kind of 'privatized Keynesianism'[15] in which the private sector played the role of the public sector. In this era the role of the state as a 'competitor' to the private sector in providing for services decreased and, at the same time, deregulation facilitated financial innovation. In this context, a possible coincidence of purposes between social and financial inclusion emerged.

It was only later that this view was exported to Europe.[16] Traditionally, European states instead developed welfare systems which fostered internal demand through providing benefits to the citizens. In simple terms: in Europe public indebtedness ideally prevailed over private indebtedness. The spread of consumer credit in Europe can therefore also be historically seen as correlating with waves of deregulation which favoured private instead of public indebtedness. Taking the European Union as a whole, however, the ideology of easy access to credit which emerged in the United States was not completely faithfully replicated on this side of the Atlantic. Rather, the regulation of consumer credit became associated with internal-market goals as laid down in the European treaties. When the EU started drafting rules on the issue, its main objective was to create an internal market of credit within which different actors in different Member States could contract and compete. The expansion of household debt was therefore facilitated by the creation of a common credit market as well as by the later introduction of the common currency, which also led to a convergence and therefore an initial (in some cases significant) lowering of interest rates in some countries.[17]

While the interventions of the EU in relation to consumer credit were therefore expressly mostly aimed at establishing an internal market, considerations related to the possible social function of credit lay in the background of those measures. As the state began to retreat from the provision of certain services to its citizens, reflecting a shift from a welfare state to a new 'market state' model,[18] private debt also began to assume such functions. This development is not limited to consumer credit but also applies to financial services more generally as they began to be more

12 Marron, 2009.
13 Seligman, 1927.
14 Clark, 1931.
15 Crouch, 2008, 476–487; Crouch, 2011.
16 In this context, with a focus on the inclusion/exclusion dimension, *see* Micklitz, 2013, 47–75.
17 For instance for Greece, *see* Pasiouras, 2012, 101; and Chapter 3, this volume.
18 Micklitz and Patterson, 2012.