



OXFORD ECONOMIC RESEARCH ASSOCIATES

APACS/BBA/FLA/CML

**ASSESSMENT OF THE ECONOMIC
IMPACT OF THE PROPOSED EC
CONSUMER CREDIT DIRECTIVE:
EXECUTIVE SUMMARY**

Blue Boar Court
Alfred Street
Oxford OX1 4EH
Tel: +44 (0) 1865 253000
Fax: +44 (0) 1865 251172
Email: Enquiries@oxera.co.uk

1. OXERA has been commissioned by the Association for Payment Clearing Services, the British Bankers' Association, the Finance & Leasing Association, and the Council of Mortgage Lenders to assess the impact of the new (draft) EC Consumer Credit Directive (CCD)¹ on credit for consumers and, more broadly, the UK economy. The study consists of three elements:
 - a qualitative cost–benefit analysis of the Directive;
 - a quantitative impact assessment of changes in the usage and costs of credit on the UK economy;
 - a quantification of additional net welfare effects.
2. The second element was subcontracted to Oxford Economic Forecasting.

Key findings

3. A number of scenarios of increases in the costs of credit and reduction in the availability of credit were designed in order to model the impact of the Directive on consumer spending and GDP in the UK. The scenarios show that within two years of the implementation of the Directive:
 - consumer spending could fall by around 0.6% (or around £4 billion/€5.8 billion);
 - overall GDP could fall by around 0.2% (or around £2 billion/€2.9 billion);
 - the welfare loss to consumers could be as high as £950m/€1,400m, with at least 2m consumers finding it difficult or impossible to obtain credit.

Background

4. The study was commissioned in light of the omission on the part of the European Commission to undertake a rigorous impact assessment of the Directive. In the time available it has only been possible to model the impact on the UK economy. However, the market for consumer credit in the UK is the largest in the EU, accounting for around one-third of the total European market for consumer credit. The consumer credit market in the UK is well developed, with a wide range of credit products, a high proportion of revolving credit, constant product innovation and a large number of credit providers.

¹ Commission of the European Communities (2002), 'Proposal for a Directive of the European Parliament and of the Council of the EU on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers', COM 2002/443 dated 11 September 2002

Impact on credit users

5. The Directive, if implemented, would result in a serious impact on users of credit. This would arise through three main effects:

- a direct increase in the cost of providing credit. In particular, the enforced duty to advise and the requirement for credit providers to ensure that their customers re-sign their credit agreements would add directly to the costs of providing credit. Overall, there would be similar impacts across the product range. For example, by abolishing the present exemption of overdrafts from the scope of the Directive, the draft Directive would pose a real threat to the current flexibility enjoyed by users of overdraft arrangements. The costs imposed by the Directive would tend to be fixed per agreement, and so would impact most significantly on those credit agreements where the amount of credit drawn was smallest;
- a reduction in the availability of credit, particularly to those with low credit ratings. The responsible lending provisions are likely to increase the risk to credit providers of lending to this group of consumers. This would have the most serious impact on those with low and irregular incomes and those in the sub-prime market;²
- a series of ‘hassle factors’, which would add indirectly to the cost of providing credit and may even preclude the provision of common forms of credit. These include, in particular, the obligations placed upon providers of overdrafts and the provision for a cooling-off period for credit arrangements agreed on retailers’ premises. Other measures could reduce competition, potentially leading to higher prices for consumers in the long term.

Impact on the UK economy

6. The effects of the Directive would not be limited to the users or potential users of consumer credit, but would affect the whole UK economy. An increase in the cost of credit faced by consumers, and a reduction in the availability of credit to those with low credit ratings, would reduce the use of consumer credit, leading to lower consumer spending and a reduction in GDP.

7. A number of scenarios of increases in the costs of credit and a reduction in the availability of credit were designed in order to model the impact of the Directive on consumer spending and GDP in the UK. The scenarios show that consumer spending could fall by around 0.6% (or around £4

² Defined as the part of the market made up of those borrowers who have been refused credit more than once.

billion/€5.8 billion) and overall GDP by around 0.2% (or around £2 billion/€2.9 billion) within two years of the implementation of the Directive.³

8. Because the Directive would result in a higher cost of credit and a restriction in the availability of credit, there would be a significant welfare loss to consumers. All users of credit would end up paying a higher rate of interest in order to cover the costs that would result from the Directive. Also, a significant proportion of consumers could be affected by a reduction in the amount of credit that lenders would be prepared to make available to them—a conservative estimate indicates that at least 2 million UK consumers could be affected. This welfare loss could be as high as £900m/€1.3 billion.

Meeting its objectives

9. One of the objectives of the Directive is to increase consumer protection and to address the problem of overindebtedness. The effect of these provisions is likely to be a reduction in the availability of consumer credit to those with low credit ratings. However, studies show that the main causes of overindebtedness are unforeseeable and would not be avoided systematically by provisions such as responsible lending and duty to advise. The blunt measures in the Directive are unlikely to have an impact on the rate of overindebtedness, but would have a significant impact on the ability of those with low or irregular income and consumers in the sub-prime market to obtain access to credit. The end result could be to exacerbate the existing problems of financial exclusion.
10. Moreover, a reduction in the availability of credit to consumers in the sub-prime market may lead to an increase in the use of credit from sources willing to operate outside of legal and regulatory regimes.

Conclusion

11. The analysis in this study shows that the Directive is unlikely to achieve its objectives. The economic and welfare-related effects of the Directive may be significantly larger than envisaged by the Commission; by contrast, its benefits are likely to be small.

³ This is based on the medium scenario consisting of an increase in the cost of unsecured consumer credit of 0.7 percentage points; a restriction in availability of unsecured consumer credit of 2.5%; an increase in the cost of secured credit that would be covered by the Directive, of 0.05 percentage points; and a restriction in the availability of secured credit that would be covered by the Directive, of 3%. In this scenario, it is assumed that 50% of secured credit would be covered by the Directive.