TITLE: **Credit reform needs to go back to basics**

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Earlier this week the Rudd Government released its green paper on financial services and credit reform. While the nature of the changes are yet to be established, strong Commonwealth action in this area is long overdue.

Public sentiment has already turned against financial providers. Recent research by the Australia Institute reveals the extent of community mistrust of the financial sector. Indeed, a large majority of adult Australians hold banks and other financial institutions responsible for the current debt crisis.

Although many people believe that personal responsibility in financial decision making is important, there is broad consensus that the banking sector has lost the element of social responsibility that tempered lending practices in the past. Around three in four respondents to a nationwide survey agreed that "banks are too willing to lend money to people who can't afford the repayments".

Pushy marketing

Many Australians are also 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 is regarded by many as unethical.

In 2007, households in the United States received 5.3 billion offers for credit in the post. Comparable data for Australia are hard to find, but policy-makers should endeavour to gather it. Objective evidence on the marketing pressures being brought to bear on consumers would allow unconscionable forms of marketing and promotion in this area to be prohibited.

Of course, there are other factors that have contributed to the debt situation. Four in five survey respondents agreed 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.

'Free speech'

Despite strong views about the negative influence of advertising, there is uncertainty about what exactly can be done about it. Many people are reluctant to tamper with what they see as 'free speech'. This is a surprising take on the notion of free speech, one which attests to how successful the corporate sector has been in promoting its own interests at the expense of community welfare.

One way to redress the power imbalance between consumers and corporations is to introduce new rules covering what information needs to be displayed prominently on monthly credit card statements. 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.

While consumers can find such information if they look hard enough, it is by no means readily available. Anyone who has looked into their options for private health insurance, superannuation or even a home mortgage knows that it can be very difficult to cut through the clutter that surrounds the relevant facts.

OECD statistics on functional literacy show that at least one in five Australians is not able to properly interpret financial and other documentation. Even more worryingly, there is a considerable body of research showing that many people act in irrational ways in their financial affairs. Examples from the Australia Institute's research include failing to plan for the future, relying too much on advertising for information, making "stab in the dark" decisions, and not seeking out objective information.

Less is more

Extensive choice is usually regarded as a positive thing for consumers, and it often is. Yet there are circumstances where more choice is actually detrimental to consumer wellbeing. In the realm of personal finances, people are often presented with choices that they would prefer not to make, or prefer someone to make on their behalf.

Our research findings back this up. Fully 42 per cent of respondents agreed that "when I need to make a financial decision, I often find there is too much choice". Only 18 per cent disagreed.

The standard policy response to poor financial decision making, both in Australia and overseas, has been to address the 'information asymmetry' problem by providing financial information and education to consumers.

Such an approach places the onus of responsibility for dealing with a changing financial environment squarely on consumers, and neglects the fundamental responsibilities that governments and financial institutions have to present people with choices that they understand and value.

Reform to consumer credit that simplifies decision-making, and makes relevant information easier to find, will help to ease the disquiet that many people feel about the way financial providers manipulate their customers.

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