University of San Diego
SCHOOL OF LAW

Legal Studies Research Paper Series

Poor Consumer(s) Law: The Case of High-Cost Credit and Payday Loans

Research Paper No. 18-357
2018

Shmuel I. Becher
Yuval Feldman
Orly Lobel

This paper can be downloaded without charge from the
Social Science Research Network Electronic Paper Collection:
http://ssrn.com/abstract = 3235810

Electronic copy available at: https://ssrn.com/abstract=3235810

POOR CONSUMER(S) LAW: THE CASE OF HIGH-COST CREDIT AND PAYDAY LOANS

Shmuel I. Becher, Yuval Feldman, Orly Lobel*

ABSTRACT

Consumers in general, and poor consumers in particular, often make counter-productive financial decisions that undermine their welfare. One key example is that poor people frequently use high-cost credit and loans with onerous interest rates. They are also disproportionally engaged in other types of sub-optimal borrowing, such as rent-to-own transactions and insufficient savings for the future. Although lenders and service providers are obliged to disclose interest rates and other key information in a clear and conspicuous way, disclosures have been at best only partly effective to prevent exploitation and protect consumers.

This chapter seeks to examine how consumer law can, and at times should, respond to this reality. While focusing on borrowing practices, we begin by pointing to the main behavioral patterns that impact financial decision making. We first address biases that are relevant to all consumers: over-optimism, the present bias, and the behavioral economics of information. We then discuss the psychology of poverty and scarcity, which demonstrates that the state of poverty depletes cognitive resources and undermines the consumer's capacity to overcome temptations, choose the uneasy paths and exercise long-term planning.

Against this background, we discuss a variety of policy recommendations. We focus on protections that are better-suited to treat the root causes that lead poor people to make dubious financial decisions. We conclude by succinctly noting some of the challenges entailed in our recommendations and discussing ways to expand our proposed framework.

TABLE OF CONTENTS

* Shmuel I. Becher, Associate Professor, Victoria University of Wellington; LL.M., J.S.D, Yale University.
Yuval Feldman, Mori Lazarof Professor of Legal Research, Bar-Ilan University School of Law; Ph.D., UC Berkeley.
Orly Lobel, Don Weckstein Professor of Law, University of San Diego; LL.M., S.J.D., Harvard University.

Electronic copy available at: https://ssrn.com/abstract=3235810

I. INTRODUCTION

"It's Better to be Wealthy and Healthy than Poor and Ill"[1]

There is a long-standing consensus on the need to fight poverty and eliminate it. Some fifty-five years ago, the American President Lyndon B. Johnson launched a "War on Poverty" in his 1964 State of the Union Address. Nevertheless, poverty is still a striking problem. In the United States, more than 46 million Americans lived in poverty in 2012.[2] Worldwide, billions live on less than eight US dollars a day,[3] and hundreds of millions on less than one dollar a day.[4]

Poverty is a complex, multifaceted and persistent problem.[5] Recently, the Sustainable Development Goals (SDGs), a United Nations strategic plan which came into effect in January 2016, delineated seventeen key goals to be achieved by 2030.[6] The plan, aimed to sustainably improve life, defines "No Poverty" as its first goal. Other goals, such as those that relate to hunger, housing, education and equality, further illustrate that the SDGs put poverty eradication

[1] Alluding to a title of a satiric tragi-comedy movie (1992).
[2] With the rates of state poverty ranging from 10% to 24.2%. *See* POLICIES TO ADDRESS POVERTY IN AMERICA (Melissa S. Kearney & Benjamin H. Harris eds., 2014), pp. 5-6.
[3] *See* GILLIAN K. HADFIELD, RULES FOR A FLAT WORLD: WHY HUMANS INVENTED LAW AND HOW TO REINVENT IT FOR A COMPLEX GLOBAL ECONOMY (2017), p. 281. Hadfield also notes that "more than half of the global population still lives on incomes of less than the equivalent of $3,000 a year"; *id*.
[4] *See, e.g.,* WHO, World Health Statistics 2013 (WHO, Geneva, 2013); World Bank Group, Poverty and Shared Prosperity 2016 – Taking on Inequality, p. 35 ("The global poverty estimate for 2013 is 10.7 percent of the world's population, or 767 million people living on less than US$1.90"). In the United Kingdom, one third of the population "spent at least one year in relative income poverty between 2011 and 2014"; Kizzy Gandy et al., Poverty and Decision Making: How Behavioural Science can Improve Opportunities in the UK, at 7 (October 2016).
[5] *See, e.g.,* PETER H. SCHUCK ONE NATION UNDECIDED: CLEAR THINKING ABOUT FIVE HARD ISSUES THAT DIVIDE US (2017), at 25 (explaining that the chapter that deals with poverty "is the longest chapter in the book, as befits its importance, its complexity, and the enormous amount of social science research devoted to it".)
[6] *See* Sustainable Development Goals, available at http://www.undp.org/content/undp/en/home/sustainable-development-goals.html (last visited 13 July 2018).

Electronic copy available at: https://ssrn.com/abstract=3235810

"at the heart of the 2030 Agenda."[7] Likewise, the World Bank Group's mission is depicted in its slogan "Our Dream is a World Free of Poverty."[8]

Focusing on poverty and aspiring to eliminate it make perfect sense. We have come to realize that poverty may be a significant contributor to some of our most pressing social and policy problems.[9] Poverty is correlated with higher levels of crime and drug addiction, health problems, violence, reduced social mobility, homelessness, lower levels of trust, lack of social cohesion, less attentive parenting, low productivity, lack of opportunities, and counterproductive economic behavior.[10] Poverty is also is often correlated, and compounded, with other markers, such as ethnicity, race, gender, and immigration.[11]

Furthermore, very low levels of income are associated with low life satisfaction. This may be due to an objective lack of financial means, and because low-income earners compare themselves to those who are more fortunate.[12] Low income is also associated with shorter life expectancy.[13] Overall, and in line with Maslow's (contested) hierarchy of needs,[14] the poor are likely to find it hard to experience belonging, be accepted and valued by others, or reach self-actualization.[15]

There is a large body of literature on poverty with experts disagreeing over many aspects. For starters, experts debate the definition of poverty.[16] Moreover, experts contest how to

---

[7] *See id.* (citing UNDP Administrator Achim Steiner who says that "Poverty eradication is at the heart of the 2030 Agenda, and so is the commitment to leave no-one behind").

[8] *See* the World Bank webpages on poverty, available at http://www.worldbank.org/en/topic/poverty/overview.

[9] SCHUCK, *supra* note 5, at 24.

[10] *See, e.g.,* Anandi Mani et al., *Poverty Impedes Poverty Function,* 341 SCI. 976, 976 (2013); Mark M. Kishiyama et al., *Socioeconomic Disparities Affect Prefrontal Function in Children*, 21 J. COGN. NEUROSC. 1106 (2008); Schuck, *supra* note 9, at 24; Policies to Address Poverty in America, *supra* note 2.

[11] See, Hansen, Randall. T*he poverty of postnationalism: citizenship, immigration, and the new Europe*. *Theory and society* 38(1) 1-24 (2009). For an econometric perspective with a critical evaluation of the impact of immigration on low income wages *see* Raphael, Steven, and Eugene Smolensky. "Immigration and poverty in the United States." *American Economic Review* 99, no. 2 (2009): 41-44.

[12] *See, e.g.,* Johannes Haushofer & Ernst Fehr, *On the Psychology of Poverty,* 344 SCI. 862, 864 (2014) (reviewing studies that suggest "causal links between poverty, psychological well-being, and stress levels"); CAROL GRAHAM, HAPPINESS FOR ALL? UNEQUAL HOPES AND LIVES IN PURSUIT OF THE AMERICAN DREAM (2017) (associating poverty in the U.S. with unhappiness, stress, and low levels of hope).

[13] *See, e.g.,* Haushofer & Fehr, *supra* note 12 (noting that "Economic poverty means living in squalor, dying early, and raising children who face similar prospects").

[14] Abraham H. Maslow, *A Theory of Human Motivation,* 50 PSYC. REV. 370 (1943).

[15] For discussing the link between basic need satisfaction and psychological health see Shaun Saunders, Don Munro & Miles Bore, *Maslow's hierarchy of needs and its relationship with psychological health and materialism*, 10 S. PACIFIC J. PSYC. 15 (1998).

[16] For one discussion *see* Gandy et al., *supra* note 4, at p.17-18. Shuck, for instance, regards poverty as "a condition of deprivation that causes suffering among those who endue it (and among many of us who observe it), and it is conventionally

Electronic copy available at: https://ssrn.com/abstract=3235810

measure poverty, what its origins are, and what the best way to deal with it is. However, it is generally agreed that poverty has multiple erratic, behavioral, sociological, educational, cultural, historical, and economic causes.[17]

From a psychological perspective, poverty affects people's economic choice patterns and decision-making processes. A growing body of literature suggests that people who face poverty are likely to make ill economic choices.[18] Some of this literature indicates that it is not so much that bad choices lead people to poverty, but rather that poverty can lead people to make bad choices.[19] Suboptimal behavior, in turn, can deepen poverty or perpetuate it. An example of this suboptimal behavior, which sometimes reinforces the poverty cycle, is the use of high-cost credit.[20]

Alleviating poverty requires holistic and innovative policies,[21] and the law has a vital role in this battle. Yet despite the diverse literature on poverty, the legal literature does not systematically address the links between decision making and poverty. Decisions made by individuals can make a significant difference to their poverty status.[22] At the same time, the way we structure choices – i.e., "choice architecture" – using laws and regulation can significantly influence such decisions.[23] In this chapter we examine how consumer law, equipped with behavioral insights, can better serve to alleviate poverty.

Due to its prevalence and importance, this chapter focuses on borrowing practices, with specific emphasis on high-cost credit. In particular, we ask how legal policy should be crafted in

assessed against some measure of well-being"; SCHUCK, *supra* note 9, at 30. We use terms like poor people and poverty more loosely, at times interchangeably.

[17] For instance, Schuck delineates a list of causes which include "bad luck, bad choices, family breakdown, educational deficits, dysfunctional and self-reinforcing cultural patterns, social and neighborhood isolation, immigration, discrimination, mass incarceration, and economic dislocations", while noting that "most of those causes are also its effects". Schuck, *supra* note 9, at 25. For highlighting family structure as an important cause *see* Gandy et al., *supra* note 4, at 19 (in the U.K., single parents are in high risk to experience poverty, amounting to 25% of working age adults).

[18] *See, e.g.,* SENDHIL MULLAINATHAN & ELDAR SHAFIR, SCARCITY: THE NEW SCIENCE OF HAVING LESS AND HOW IT DEFINES OUR LIVES (2013); Haushofer & Ernst Fehr, *supra* note 12; Gandy et al., *supra* note 4.

[19] *See* MULLAINATHAN & SHAFIR, *supra* note 18.

[20] *See, e.g.,* Marcus Banks et al., *'In a Perfect World it would be Great if they didn't Exist': How Australians Experience Payday Loans,* 24 INT'L. J. SOCIAL WELFARE 37 (2015); Allison Daminger et al., *Poverty Interrupted: Applying Behavioral Science to the Context of Chronic Scarcity*, 42 IDEAS (2015), at 18 (explaining that for the poor "payday lenders with usurious interest rates are used to bridge the gap between paychecks but also trap families in debt cycles for months or years"); Anandi Mani et al., *supra* note 10, at 976 (noting that counterproductive behaviors "are… particularly troubling because they can further deepen poverty…. and explaining that "Predatory lenders in poor areas, for example, may create high interest-rate borrowing").

[21] *See, e.g*., Gandy et al., *supra* note 4, at 9, 20 (advocating for not only economic and human capital, but also "environmental capital, social capital, character capital and cognitive capital").

[22] *See, e.g*., Gandy et al., *supra* note 4, at p.16.

[23] *See* RICHARD THALER & CASS SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH WEALTH, AND HAPPINESS (2008).

Electronic copy available at: https://ssrn.com/abstract=3235810

order to inform policy and nudge poor people towards better economic decisions in this context.[24] In answering this question, we take the view that improving people's lives, especially those who are disadvantaged, is a legitimate and desired goal of legal policy.[25]

The remainder of this chapter is organized as follows: Part II introduces behavioral biases that may lead people to over-borrow or use high-cost credit. In the first three Sections of this part we respectively address the following three general biases: the optimism bias, the present bias, and the (behavioral) economics of information. Section 4 then focuses on the psychology of poverty and scarcity. It explains how scarcity affects decision making and thus why poor people are further prone to make erroneous economic choices. Part III is policy oriented. Here we discuss various *ex post* and *ex ante* policies that are better tailored to assist the poor in making financial decisions. Part IV briefly notes some of the challenges for the implementation of our proposals. It also considers how the framework we propose in this chapter can be further implemented in additional contexts.

II. HIGH-COST CREDIT AND BORROWING: KEY BEHAVIORAL CONTRIBUTORS

One would assume that important economic decisions are based on a careful and rational analysis of economic factors. The reality, however, is different. Consumers often make dubious financial decisions.

In one famous study, a bank offered its clients a big loan by sending them a letter, while randomizing a few of its aspects. Some of the letters included photos, varied by race and gender, of bank employees. Some of the letters offered customers a chance to win a cell phone in a lottery, should the client inquire about the loan. The letters also presented the financial information in varying degrees of complexity. Some included a deadline as well. The results indicated that any one of these variants had a significant economic effect. Perhaps most strikingly, a photo of an attractive woman increased men's demand by as much as reducing the interest rate by five points.[26] This, of course, indicates that people deviate from rationality when responding to information and other stimuli.

[24] We use of the term "poor people" to refer to people who experience poverty. "Poor people" constitute dynamic group, since some people may enter and exit poverty in various points in time. *See also* Gandy et al., *supra* note 4, at 19.
[25] For one view of what constitutes an improvement in people's life *see* John Bronsteen, Christopher Buccafusco & Jonathan S. Masur, *Welfare as Happiness,* 98 GEO. L. J. 1583 (2010).
[26] Marianne Bertrand et al., *What's Advertising Content Worth? Evidence from a Consumer Credit Marketing Field Experiment*, 125 QUARTERLY J. ECON. 263 (2010).

Electronic copy available at: https://ssrn.com/abstract=3235810

Many poor people take loans with extremely high-interest rates (payday loans). In the United States, for instance, the typical annual interest rate on such loans is 300-400%. This can lure some consumers into a debt trap.[27] Payday loans do provide credit to poor people who face pressing needs and who typically cannot obtain this money elsewhere. However, access to payday loans can, on average, undermine well-being. Such loans can hurt borrowers by tempting them to over-consume and spend less on life necessities such as housing and food.[28]

The history of the rise of payday lenders and the introduction of credit cards gives some indication of the behavioral aspects of consumer lending. In the mid 1950s, marketers hypothesized that Americans preferred borrowing money from loan sharks and other sketchy institutions at an irrationally high interest rate, rather than from an established bank, because banks were respectable institutions.[29] Consumers therefore viewed the face-to-face interaction with bankers to represent a judgement of a father figure: "Shady lenders were preferred because of their seditious nature. They were closer in kind to those who needed money, and they lacked the moral authority to judge financial failure." Realizing this psychology, marketers made recommendations to banks to reframe loans to overdraft and credit, which removed the moral judgement from taking out a bank loan.

Today, although lenders are subject to mandated disclosure—obliging them to disclose payments, fees, and interest rates—such rules have not removed the high-cost credit market.[30] In fact, the market for payday and other loans is flourishing, and such loans are extremely commonplace. It is estimated that in the United States alone there are more than ten million borrowers annually,[31] with more than 23,000 payday lender branches.[32] According to the Consumer Financial Protection Bureau (CFPB), over eighty-percent of payday loans are rolled over or renewed within fourteen days, and half are in sequences of at least ten loans.[33]

---

[27] For an accessible account of how payday loans turn into a debt trap *see* Michael McCormack, *CFPB Rule Could Protect Low-Income Households from Predatory Short-Term Lending*, THE CENTURY FOUNDATION (October 6, 2016). It should be noted, however, that in spite of these figures there is no consensus on the exact impact of payday loans. For one cautious view *see* Paige Marta Skiba, *Regulation of Payday Loans: Misguided?,* 69 WASH. & LEE L. REV. 1023 (2012). *See also* Neil Bhutta et al., *Payday Loan Choices and Consequences*, 47 J. MONEY, CREDIT & BANKing 223 (2015).

[28] *See* Christine Dobridge, *For Better and for Worse? Effects of Access to High-Cost Consumer Credit,* FEDS Working Paper (2016), available at https://ssrn.com/abstract=2810054.

[29] ORLY LOBEL, YOU DON'T OWN ME (2017).

[30] For a general critique of information disclosures *See, e.g.,* CARL E. SCHNEIDER & OMRI BEN SHAHAR, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATES DISCLOSURES (2014). We return to this issue in more detail below.

[31] John Caskey, Payday Lending: New Research and the Big Question (2010).

[32] MULLAINATHAN & SHAFIR, *supra* note 18, at 107.

[33] Kathleen Burke et al., CFPB Data Point: Payday Lending (CFPB Office of Research, 2014).

Electronic copy available at: https://ssrn.com/abstract=3235810

Overborrowing is often also reflected in late utility payment or credit card debt, for those consumers who can afford credit cards.[34] For many others, rent-to-own transactions are another source of expensive purchases and financial hardship.[35] The same is true with respect to lottery tickets, which poor people tend to purchase disproportionally.[36] These behaviors often come at the expense of saving more for the future and consuming in a way that is more aligned with long-term aspirations and preferences.[37]

This Part presents behavioral biases that may lead people to over-borrow and conduct their financial affairs in ways that undermine their own preferences and welfare. In the following sections we first discuss three general behavioral phenomena: the optimism bias, the present bias, and the behavioral economics of information. We then address the psychology of the poor in particular. Understanding the dynamics that influence the mind of the poor when making financial decisions will make crafting policies that tackle the problem efficiently more likely.

Before addressing particular behavioral biases, the concept of dual reasoning – which is a central notion that stands at the heart of our analysis – should be introduced. Dual reasoning reflects the idea that individuals depart from rational decision-making models in systematic and predictable ways.[38] The behavioral literature differentiates between two thinking processes.[39] One is fast, automatic, intuitive, effortless and mostly unconscious process – dubbed System 1. The other is a controlled, attentive, voluntary and deliberative process, labeled System 2.[40] While System 2 represents long-term planning, calculating, analytical thinking, and self-control,

[34] *See, e.g.,* MULLAINATHAN & SHAFIR, *supra* note 18, chapter 5 (discussing deferral of utility bills); YVETTE HARTFREE & SHARON COLLARD, POVERTY, DEBT AND CREDIT: AN EXPERT-LED REVIEW, pp. 18-31 (2014) (discussing credit and poverty relationship in the UK).

[35] *See, e.g.,* Paul Ali et al., *Consumer Leases and Indigenous Consumers*, 20 AUSTRALIAN INDIGENOUS L. REV. (forthcoming) (noting that "recent studies illustrate that the price ultimately paid to hire goods under a consumer lease contract will generally exceed the retail value of the goods hired and that it is the most expensive form of finance available" and that this reality "forces … [consumers] into even greater financial distress").

[36] *See, e.g.,* Emily Haisley, Romel Mustafa & George Loewenstein, *Subjective Relative Income and Lottery Ticket Purchases*, 21 J. BEHAV. DEC. MAKING. 283, 287 (2008) (poor people spend more on lottery tickets); Andrew Weinbach, Rodney Paul, *Running the Numbers on Lotteries and the Poor: An Empirical Analysis of Transfer Payment Distribution and Subsequent Lottery Sales*, 36 ATL. ECON. J. 333, 343 (2008), (lottery spending increases soon after welfare payments are made).

[37] *See, e.g.,* Daminger et al., *supra* note 20, at 20 (explaining that "a payday loan may be a plainly bad financial choice in the long run, but the immediate tradeoff of no electricity or food can trump that long-term loss").

[38] DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2001). *See also*, Orly Lobel & On Amir, *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy,* 108 COLUM. L. REV. (2009).

[39] For an important review *see* Jonathan St. B T. Evans, *Dual-Processing Accounts of Reasoning, Judgement, and Social Cognition,* 59 ANN. REV. PSY. 255 (2008).

[40] Kahneman, *supra* note 38, at 13. Kahneman notes that "[t]he distinction between fast and slow thinking has been explored by many psychologists over the last twenty-five years." *Id. See also* Amir & Lobel, *supra* note 38, at XX.

Electronic copy available at: https://ssrn.com/abstract=3235810

System 1 represents automatic and sometimes hasty behavior, focused on present needs and desires.[41]

This concept regarding the role of automaticity in decision-making now lies at the heart of much research in behavioral law and economics.[42] As we demonstrate below, some borrowers are liable to use – and lenders are likely to target – System 1, hence bypassing System 2. The traps of System 1, which can too often lead people astray, are often dubbed "behavioral biases".

As Hanson and Kyser note, policymakers should also be aware of "the possibility that other actors will take advantage of ... [psychological phenomena] to influence individual preferences for their own gain."[43] Indeed, firms are liable to "respond to market incentives by manipulating consumer perceptions in whatever manner maximizes profits."[44] Furthermore, competitive markets can lead to a reality where firms "*must* exploit consumers' imperfect rationality.... [thus, firms] that do not take advantage of consumer biases... would not succeed in the marketplace."[45] In the subsequent sections we provide a few concrete examples relevant to our context.

1. The Optimism Bias

The optimism bias is one of the most robust findings in the behavioral literature.[46] The literature demonstrates that people display unrealistic optimism in various ways. People are overly optimistic about their future, underestimating their risks and overestimating their chances to experience positive life events.[47] For instance, the majority of people believe they are

---

[41] There is an enormous body of literature discussing the dual reasoning model, documenting the variation in controllability, malleability and awareness. *See, e.g.*, IN TWO MINDS: DUAL PROCESSES AND BEYOND (Jonathan Evans & Keith Frankish eds., 2009); Jonathan Evans, *Dual Processes, Evolution and Rationality*, 10 THINKING & REASONING 405, 405 (2004). *See also,* Gerd Gigerenzer & Daniel G. Goldstein, *Reasoning the Fast and Frugal Way: Models of Bounded Rationality*, 103 PSY. REV. 650 (1996). However, the paradigm of intuitive versus deliberate processes has also been debated and criticized. *See, e.g.,* Arie W. Kruglanski & Gerd Gigerenzer, *Theoretical Note: Intuitive and Deliberate Judgments Are Based on Common Principles,* 118 PSY. REV. 97 (2011).

[42] Plentiful papers have been published in this tradition with many collective works. For a recent collection *see* EYAL ZAMIR & DORON TEICHMAN BEHAVIORAL LAW & ECONOMICS (Oxford University Press, 2018).

[43] Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation,* 112 HARV. L. REV. 1420, 1426 (1999).

[44] Jon D. Hanson, & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 743 (1999).

[45] This is so since consumers would fail to appreciate the value of the products and services that are being offered by those firms that do not exploit consumers' biases. *See* OREN BAR-GILL SEDUCTION BY CONTRACT (2012), at p.54.

[46] *See, e.g.,* Neil D. Weinstein, *Unrealistic Optimism about Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806 (1980); Ola Svenson, *Are We All Less Risky and More Skillful than Our Fellow Drivers?*, 47 ACTA PSYCHOLOGICA 143 (1981).

[47] *See, e.g.*, Neil Weinstein, *Optimistic Biases About Personal Risks*, 246 SCI. 1232 (1989); Lynn A. Baker & Robert E. Emery, *When Every Relationship Is Above Average: Perceptions and Expectations of Divorce at the Time of Marriage*, 17 LAW &

Electronic copy available at: https://ssrn.com/abstract=3235810

less likely than others to face accidents, health problem and diseases.[48] Kids, teens, adults and the elderly all display over-optimism, and over-optimism is represented in a vast majority of the population.[49]

Being unrealistically optimistic can lead people to take risks based on a mistaken perception regarding their relative immunity from harm. In our context, a consumer who contemplates a loan may exhibit over-optimism by erroneously over-estimating the likelihood of enjoying a stable income. Consumers also under-estimate the risks of facing economic crises that would make repayments difficult or impossible. Therefore, consumers may fail to correctly predict their chances to experience an inability to repay the loan on time.[50]

Such behavioral patterns have been observed in a variety of contexts. In one study, students demonstrated over-optimism by underestimating the time that paying off their loan will take while overestimating their future income.[51] In another study, more optimistic consumers tended to choose credit cards which were sub-optimal for their actual borrowing behavior.[52] Data (from the UK) also shows that consumers with more optimistic financial expectations incur more debt.[53] As Bar-gill points out, over-optimism can be a significant driver of excessive borrowing in sub-optimal conditions.[54] This may be further exacerbated given the possibly that some people in poverty may actually choose high-cost loans "as a way of imposing discipline on themselves to pay it back faster."[55] Given the high rates of payday loans rollover,[56] this may result in rather serious financial problems.

2. *The Present Bias*

HUM. BEHAV. 439 (1993); Neil D. Weinstein & William M. Klein*, Unrealistic Optimism: Present and Future,* 15 J. SOC. & CLINICAL PSYC. 1 (1996).

[48] *See, e.g.*, Weinstein, *supra* note 47. People are also overly optimistic regarding their general abilities, skills and success. *See,* Baker & Emery, *supra* note 47.

[49] This is estimated that about 80% of the population exhibit over optimism. *See, e.g.,* TALI SHAROT, THE OPTIMISM BIAS: A TOUR OF THE IRRATIONALLY POSITIVE BRAIN (2011) 59.

[50] Brigitte C. Madrian et al., *Behaviorally Informed Policies for Household Financial Decisionmaking*, 3 BEHAVIORAL SCI. & POL. 27, 32 (2017).

[51] *See* Hamish G. W. & Simon Kemp, *Optimism Bias and Student Debt,* 29 NEW ZEALAND J. PSYC. 17 (2000).

[52] *See* Sha Yang, Livia Markoczy & Min Qi, *Unrealistic Optimism in Consumer Credit Card Adoption*, 28 J. ECON. PSYC. 170 (2007).

[53] Sarah Brown et al., *Debt and Financial Expectations: An Individual-and Household-Level Analysis*, 43 ECON. INQUIRY 100 (2005).

[54] BAR-GILL, *supra* note 45. Yet, this is not to say that all borrowers are overly optimistic in all respect. *See* Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers,* 21 SUP. COURT ECON. REV. 105 (2013) (finding that 60% of payday loan borrowers were able to accurately predict the length of repayment).

[55] Gandy et al., *supra* note 4, at 27 (referring to Murdoch, 2009).

[56] As noted below, more than 80 percent of payday loans in the US are rolled over within a month.

Electronic copy available at: https://ssrn.com/abstract=3235810

The present bias reflects the general tendency to overvalue present, relatively small rewards and prefer them over larger future rewards for self-regulation and cognitive mechanisms. From a cognitive perspective, immediate benefits or costs loom larger and disproportionately outweigh future ones. Therefore, people will also prefer immediate benefits even if these benefits will come at a greater cost in the future.[57] The terms "myopia" and "time/hyperbolic discounting" also describe this kind of behavior.[58] Put simply, myopic consumers "care more about the present and not enough about the future".[59] This effect is also related to people's limited will power where people's limited ability to delay their need to for immediate satisfaction is causing them to make repeated mistakes with regard to their economic choices.[60] In the following paragraphs, when we speak on the present bias we refer to both types of effects.

The bias towards the present can lead to suboptimal and counterproductive behaviors. Such behaviors may include, for instance, drinking soft drinks rather than water; spending more money at present rather than saving for the future; not flossing teeth; watching a movie at home rather than going to the gym; procrastinating when facing a task that requires work. True, delaying gratification and avoiding temptation is not easy. People tend to surrender to the demands of the "present self" at the expense of the "future self."

While the present bias is a universal phenomenon, young, poor and less educated consumers are most likely to suffer from it.[61] Poor people must face immediate and pressing needs – such as paying rent or utilities – which forces them to focus on the present. Studies have also demonstrated that when processing resources are limited, people are more liable to prefer the alternative that is more momentarily pleasurable over the one that is cognitively superior (e.g., cake over fruit).[62] In our context, as will be further elaborated below, chronic scarcity

---

[57] Ted O'Donoghue & Matthew Rabin, *Doing it Now or Later,* 89 AM. ECON. REV. 103 (1999).
[58] *See, e.g.,* Ted O'Donoghue et al., *Time Discounting and Time Preference: A Critical Review*, 40 J. ECON. LIT. 351 (2002); David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 QUAR. J. ECON. 443 (1997); Robert H Strotz, *Myopia and Inconsistency in Dynamic Utility Maximization*, 23 REV. ECON. STUD. 165 (1955).
[59] BAR-GILL, *supra* note 45, at 21.
[60] There is a rich literature in developmental psychology, on how poverty, especially in childhood affects people's ability to regulate their self and cope with the need to delay gratification. Evans, Gary W., and Pilyoung Kim. "Childhood poverty, chronic stress, self-regulation, and coping." *Child development perspectives* 7, no. 1 (2013): 43-48. Interestingly these effects could also be manipulated in the lab Liu, Lei, Tingyong Feng, Tao Suo, Kang Lee, and Hong Li. "Adapting to the destitute situations: Poverty cues lead to short-term choice." *PloS one* 7, no. 4 (2012): e33950.
[61] Joseph G. Eisenhauer & Luigi Ventura, *The Prevalence of Hyperbolic Discounting: Some European Evidence*, 28 APPLIED ECON. 1223 (2006).
[62] Baba Shiv & Alexander Fedorikhin, *Heart and mind in Conflict: The Interplay of Affect and Cognition in Consumer Decision Making*, 26 J. CONS. RES. 278 (1999). At the same time, enjoying a high income may give people a stronger sense of control

Electronic copy available at: https://ssrn.com/abstract=3235810

makes it harder for poor people to plan for the future. This may lead to counterproductive financial decisions, such as using a payday loan to alleviate pressing needs at the expense of future welfare.[63]

At this point it is important to note that poor families are not disinterested in planning for the future. It is also not the typical case that they lack the necessary information for planning ahead. Instead, the urgent needs of the present cause a "decision fatigue." In other words, our present needs undermine our mental ability.[64] We return to this notion in more detail in Section 4 below, where we discuss scarcity and the psychology of the poor.

3. (Behavioral) Economics of Information

Standard economics posits that people are rational agents who base their beliefs, actions, and preferences on information. Information, therefore, can valuably enhance decision making and is essential for people to make well-informed choices. According to this line of reasoning, imperfect or asymmetric information can lead to market failures. As Akerlof famously pointed out nearly 50 years ago, asymmetric information can lead to a market for "lemons," where only low-quality products are offered (for low prices).[65]

However, behavioral findings suggest that people approach information in a different way, and it is definitely not as a matter of rule that "the more, the better."[66] For starters, too much information can cause "information overload."[67] The term "information overload" is used to recognize that people exhibit limited processing capacity and can become overwhelmed by a deluge of information or choice. Information overload can sometimes result in suboptimal decisions, where subjects ignore (at least part of) the information at hand.

While information overload stems from limited cognition, other informational biases come from a belief-based utility. For instance, confirmation bias causes people to look for, and over-value, information that supports their existing beliefs or desires. As its name implies,

---

over the future (and therefore be less liable to the present bias); Gandy et al., *supra* note 4, at 27 (referring to Joshi & Fast, 2013).

[63] MULLAINATHAN & SHAFIR, *supra* note 18, at 108-110.

[64] *See, e.g.,* Banks et al., *supra* note 20, at 20.

[65] George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

[66] *See, e.g.*, Charles E. Davis & Elizabeth B. Davis, *Information Load and Consistency of Decisions*, 79 PSYCHOL. REP. 279, 279 (1996) ("While there may be a belief that 'more is better,' decision-makers often complain of 'information overload' or an inability to respond to the abundance of information available.").

[67] Naresh K. Malhotra, *Reflections on the Information Overload Paradigm in Consumer Decision Making*, 10 J. CONS. RES. 436 (1984).

Electronic copy available at: https://ssrn.com/abstract=3235810

confirmation bias leads individuals who, in forming an opinion, search for data that confirms their existing opinion, rather than information that may challenge or contradict it.[68] Therefore, if a consumer has reached a decision to take a specific course of action – such as using high-cost credit – she is more likely to search for reinforcing indications to buttress her decision.

The confirmation bias can explain why those consumers who do read disclosures and loan information are not likely to evaluate their content rationally. According to the confirmation bias, people process information in a way that strengthens their already existing viewpoints.[69] Hence, even if consumers read information regarding their loans, they should not be expected to always evaluate such information objectively.[70] As a result, a poor consumer who believes that expensive credit will end up improving her long-term financial situation is likely to over-value information that supports her desire/belief. At the same time, she is likely to ignore or discredit contradicting information or evidence that could have served as warning queues.

Assuming that most consumers do not expect to find positive signals (to further denote that the transaction they are about to enter is a favorable one) integrated in disclosure materials, behavioral biases might prevent them from reading such disclosures in the first place. This is related to "active information avoidance," which is yet another form of biased information processing and information interpretation.[71] Information avoidance leads people to not obtain relevant information, even when they know that such information is available and free. This behavior is closely related to the "ostrich effect/problem,"[72] and its incentive is rooted in hedonic preferences. The motivation for this behaviour is self-preservation by evading psychological pain or suffering.[73] People prefer not feeling bad, and avoiding information may allow subjects to stay optimistic, reduce anxiety, prevent dissonance, and not experiencing regret. Alternatively, people may avoid information to prevent having to behave contrary to their current

---

[68] *See, e.g.*, SCOTT PLOUS, THE PSYCHOLOGY OF JUDGMENT AND DECISION MAKING 233 (1993) ("[The confirmation bias] usually refers to a preference for information that is consistent with a hypothesis rather than information that opposes it.").

[69] *See* ARTHUR S. REBER, THE PENGUIN DICTIONARY OF PSYCHOLOGY 151 (2d ed. 1995) (defining confirmation bias as "the tendency to seek and interpret information that confirms existing beliefs").

[70] Hillman and Rachlinski use the term "motivated reasoning" to illustrate this idea in the context of consumer form contracts. *See* Robert A. Hillman & Jeffery J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 453 (2002) ("Because consumers usually encounter standard terms *after* they have decided to purchase the good or service, they will process the terms in the boilerplate in a way that supports their desire to complete the transaction.").

[71] Russell Golman et al., *Information Avoidance,* 55 J. ECON. LIT. 96 (2017).

[72] Webb, T. L. et al., *'The Ostrich Problem': Motivated Avoidance or Rejection of Information about Goal Progress*, 7 SOC. PERS. PSYCHOL. COMPASS 794 (2013).

[73] Golman et al., *supra* note 71.

Electronic copy available at: https://ssrn.com/abstract=3235810

preferences.[74] People who exhibit active information avoidance may be willing to pay to avoid unfavorable information they do not wish to learn.[75]

As an interesting example, empirical data shows that investors are less likely to seek information regarding their investment portfolios when the stock market declines.[76] Information avoidance, when applied to our context, entails that some people who face a decision to take an expensive loan are unlikely to actively seek information relating to the loan if this information is likely to be difficult to handle. Likewise, they are not liable to pay proper attention to disclosures and warnings. Moreover, those who do come across negative information might be more likely to forget this information.[77]

At times, financial information concerning debt is likely to threaten one's beliefs and emotions, as well as require unattractive courses of action.[78] Avoiding financial information is, therefore, a "common, pathological and detrimental approach that people adopt in relation to their finances and debt."[79] This entrenched behavior, which is difficult to overcome, deprives people of potentially valuable information.[80] Naturally, such information can sometimes be imperative for good decision making and improving future behaviors.

4. *The Psychology of Poverty and Scarcity*

"[o]ne cannot take a vacation from poverty".[81]

The biases discussed in the previous sections are universal, and as such, they are generally relevant to all consumers. Nonetheless, poor people are more likely than others to make ill economic choices. As noted, poor people frequently take loans with very high-interest rates and are frequently engaged in other types of sub-optimal borrowing and spending (such as rent-to-own transactions and credit cards debt). In this Part, we examine some unique causes that may lead poor people to bad financial decision making. As we demonstrate below, this also may

[74] Ben Harkin, *Improving Financial Management via Contemplation: Novel Interventions and Findings in Laboratory and Applied Settings*", 8 FRONT. PSYCHOL. 327 (2017).
[75] Anada Ganguly & Joshua Tasoff, *Fantasy and Dread: The Demand for Information and the Consumption Utility of the Future*, 63 MANAG. SCI. 4037 (2016).
[76] *See* Nachum Sicherman et al., *Financial Attention*, 29 REV. FINANCIAL STUD. 863 (2016).
[77] Golman et al., *supra* note 71, at 103.
[78] Harkin, supra note 74 (Summary).
[79] Harkin, *id*.
[80] Harkin, *id*.
[81] MULLAINATHAN & SHAFIR, *supra* note 18, at 148.

Electronic copy available at: https://ssrn.com/abstract=3235810

explain why poor people make counterproductive choices in other domains, such as the consumption of unhealthy foods and other products.

Most importantly, the psychology of scarcity teaches us that poor people suffer from an additional distinct problem, one that interacts with the above-mentioned behavioral patterns and, at times, exacerbates them. The problem, in essence, is that poor people often make bad decisions merely because they are poor.[82] Impulsive financial behavior and poor decision-making may, in fact, be the products of a persistent sense of scarcity. Marketers may recognize this reality and pray on the poor for certain services and products.

The state of poverty reduces the capacity to overcome temptations and exercise planning.[83] Scarcity is likely to make people myopic: it directs people to further focus on present needs and overvalue immediate gains.[84] Scarcity means that the mind is clouded and more prone to error.[85] Let us delineate this imperative idea in some more detail.

System 2 thinking requires cognitive bandwidth in the form of mental processing capacity. Our attention, self-control and long-term planning abilities are bounded.[86] Poverty means less cognitive bandwidth. The multiple disadvantages of poverty – including financial worries, time pressure, negative stereotypes, and emotional distress – tax cognitive capacities. This, in turn, can negatively affect the quality of judgements and decisions.[87]

People on low income often have fewer opportunities to refill or rest their cognitive resources.[88] As Mullainathan & Shafir put it, "[o]ne cannot take a vacation from poverty."[89] Low socioeconomic status typically involves the disadvantages that come with a noisy urban environment without green spaces, which result in enhanced mental fatigue;[90] coping with negative feelings associated with job loss and stigma; and the need to make many critical decisions, such as complying with the conditions of welfare payments and coordinating irregular

[82] MULLAINATHAN & SHAFIR, *supra* note 18, chapter 5.
[83] Haushofer & Fehr, *supra* note 12, at 862 ("poverty appears to affect decision-making by rendering people susceptible to the willpower and self-control depleting effects of decision-making").
[84] MULLAINATHAN & SHAFIR, *supra* note 18, pp. 52-60.
[85] Interestingly, scarcity may also improve decision making, since it forces people to focus on pressing needs and recognizing the trade-off they face. *See* Anuj K. Shah et al., Scarcity *Frames Value, 26* PSYC. SCI. 402 (2015). However, additional research is needed to identify whether scarcity can potentially protect poor consumers against various biases; *id.*
[86] Frank Schilbach et al., *The Psychological Life of the Poor,* 106 AM. ECON. REV. 435 (2016).
[87] MULLAINATHAN & SHAFIR, *supra* note 18, Chapter 7.
[88] Schilbach et al., *supra* note 86, at 439.
[89] MULLAINATHAN & SHAFIR, *supra* note 18, at 148.
[90] Frances E. Kuo, *Coping with Poverty: Impacts of Environment and Attention in the Inner City,* 33 ENV. & BEHAV 5 (2001).

Electronic copy available at: https://ssrn.com/abstract=3235810

shift-work with childcare.[91] On top of that, experiencing low self-esteem can lead to a stronger desire to acquire high-status goods.[92] In other words, status purchases are sometimes a compensatory behavior, meant to quiet an injured ego.[93] This may become more acute where income and health inequalities are large and conspicuous, which is likely to be the case in materialistic societies.[94]

Overall, there is no evidence of significant difference in cognitive abilities of people with high and low incomes. However, if people were prompted to think about money worries before taking a fluid intelligence test, the subsequent scores of the low-income subjects dropped dramatically.[95] These results were repeated in a real-world setting: Indian sugarcane farmers' effective IQ scores correlated with fluctuation in their financial situation, which was dependent on the planting cycle. Before a harvest, when they were poor, their scores were 9-10 points lower than after the harvest, when they were relatively well off. This constitutes a dramatic difference.[96]

In short, Scarcity has been shown to dramatically reduce bandwidth and thus have implications for other cognitive activity.[97] This helps to explain why people in disadvantaged circumstances may make poorer decisions that at times seem irrational and counter-productive.[98] In particular, it suggests that for poor people who experience scarcity "borrowing is an obvious feature."[99] Furthermore, a "feedback loop in which poverty reinforces itself through exerting an influence on psychological outcomes . . . may prolong the climb out of poverty for poor individuals."[100] Therefore, interventions that impose additional cognitive costs on low-income groups are problematic.

---

[91] Allison Daminger et al., *supra* note 20.

[92] See, e.g., Niro Sivanathan & Nathan C. Pettit, *Protecting the Self Through Consumption: Status Goods as Affirmational Commodities,* 46 J. EXP. SOC. PSYCOL. 564 (2010).

[93] *Id.*; *see also* Derek D. Rucker & Adam D. Galinsky, *Desire to Acquire: Powerlessness and Compensatory Consumption,* 35 J. CONS. RES. 257 (2008).

[94] Income inequality in the United States is among the highest. *See* Income Inequality (indicator), OECD (2018) available at https://data.oecd.org/inequality/income-inequality.htm#indicator-chart. Poverty rates in the United States are also among the highest. *See* Poverty rate (indicator), OECD (2018), available at https://data.oecd.org/inequality/poverty-rate.htm#indicator-chart.

[95] Mani et al., *supra* note 10.

[96] The equivalent of going from a borderline intellectually challenged to average. MULLAINATHAN & SHAFIR, *supra* note 18, at 161.

[97] Mani et al., *supra* note 10.

[98] *See, e.g.,* Schilbach et al., *supra* note 86, at 439 (noting that "when you are poor, economic challenges are more than just economic, they are also cognitive").

[99] MULLAINATHAN & SHAFIR, *supra* note 18, at 148.

[100] Haushofer & Fehr, *supra* note 12, at 866.

Electronic copy available at: https://ssrn.com/abstract=3235810

Interestingly, this is in line with recent neuroscience studies which indicate that modern experiences may cause a cognitive divide between the haves and the have-nots.[101] Low income and levels of wealth can negatively impact brain dynamics. More generally, part of the problem may have deep roots that date back to childhood. Remarkably, child poverty has adverse effects on the development of the brain because it sets it on a particular path. Children who are born into poverty will hear thirty million fewer words by the time they turn four. While the number is staggering, the difference in exposure is significant for both quantity and quality.

More generally, the first three years of childhood are crucial for the development of the brain.[102] Along these lines, research shows that the prefrontal cortex, the part of the brain that is critical for attention and problem solving, is negatively altered in children of low socioeconomic status.[103] Living in poverty impacts one's identity and leads to feelings such as shame, self-blame and abnormality.[104] All this entails that the approach of placing the burden solely on poor consumers to improve their decision-making processes is problematic. Hence, policy-makers should give special attention to preventing exploitative marketing strategies and aiding poor consumers in their endeavor to make good economic choices. We turn to this next.

III. THE ROLE OF LAW AND POLICY

"Anyone who has ever struggled with poverty knows how extremely expensive it is to be poor."[105]

It may be tempting for people who are financially stable to look down on those with low income or living in poverty. Our culture often contains the messages of merit and logic to social and economic status and downplays the role of luck and history.[106] Social capital undermines people's willingness to help others.[107] It may as well be hard to fully understand the

[101] For an interesting discussion *see* All in The Mind: Brain diversity and modernization, available at https://overcast.fm/+CYGCMMq8.
[102] DANA SUSKIND, 30 MILLION WORDS: BUILDING A CHILD'S BRAIN (2015).
[103] *See, e.g.*, Mark M. Kishiyama et al., *supra* note 10. The study found that brain measures of attention were reduced in low socio-economic status children in a way that resembled patients with brain damage.
[104] *See, e.g.,* Matt Helmer, How Poverty and Cognitive Biases Can Impact Decisions and Actions (2015).
[105] Attributed to novelist and essayist James Baldwin.
[106] As noted above, race, gender and ethnicity may impact one's wealth and opportunities. Minorities and women are disproportionately among the poor, and their social mobility is rather limited.
[107] Lene Aarøe & Michael Band Petersen, *Crowding Out Culture: Scandinavians and Americans Agree on Social Welfare in the Face of Deservingness Cues*, 76 J. POLITICS 684 (2014).

Electronic copy available at: https://ssrn.com/abstract=3235810

circumstances and hardships that scarcity and poverty entail. Wealth leads to more independence, which in turn decreases empathy emotions and prosocial behavior.[108] Furthermore, brain scans reveal that pictures of people in poverty can activate the brain part that is associated with feelings of disgust, therefore denying poor people humanity.[109] But as the previous Part illustrates, it would be erroneous to put the blame on the poor. It would also be unwise to assume that poor people can easily and simply learn from their mistakes and improve their decision-making processes.

Furthermore, firms often tailor their tactics and marketing efforts to their target audience. Some firms have specialized in targeting and luring poor or vulnerable consumers; offering services and products such as payday loans, rent-to-own transactions and uninvited sales. It is thus unsurprising to find a positive correlation between the number of payday lenders and the percentage of youngsters, minorities, and the poverty rate.[110] If anything, with the aid of big data and sophisticated algorithms, this trend is likely to become even more persistent.

To be sure, poverty has not been left unnoticed. Thoughtful, expensive, and expansive social programs have been designed to assist poor people. Legal rules and regulations have been implemented. However, such rules and programs are often not tailored to the problem and do not address its origins. Although such interventions sometimes fall short,[111] policymakers tend not to engage in a consistent and long-term examination of the effects of such intervention programs.[112] Therefore, it is of little surprise that current tools can be not only unhelpful but also counter-productive. Such tools may provide the poor with a false sense of protection, which makes them ever more tempted and comfortable to make bad decisions.

In this Part, we propose three types of policy recommendations. First, we focus on general policies and large-scale policy measures that may alleviate scarcity mindset or enhance alternatives to payday loans. Second, we look at borrowers. Here, we discuss some behavioral best practices that may debias consumers and improve their decision-making process. We

---

[108] Paul K. Piff et al, *Having Less, Giving More: The Influence of Social Class on Prosocial Behavior*, 99 J. PERS. SOC. PSYC. 771 (2010).

[109] Susan T. Fiske, *From Dehumanization and Objectification, to Rehumanization: Neuroimaging Studies on the Building Blocks of Empathy,* 1167 ANNALS NEW YORK ACADEMY SCI. 31 (2009).

[110] As well as negative correlation to income and education level. *See* James R. Barth et al., *Banks and Payday Lenders: Friends or Foes*? 21 INT'L ADVANCES ECON. RES. 139 (2015).

[111] *See, e.g.,* Paul Ali et al., *supra* note 35 (arguing that "despite regulatory reforms and enforcement actions, Indigenous communities continue to be vulnerable consumers").

[112] *See generally* Shmuel I. Becher, *Unintended Consequences and the Design of Consumer Protection Legislation*, TULANE L. REV. (forthcoming, 2018), III.B-III.C.

Electronic copy available at: https://ssrn.com/abstract=3235810

further examine how consumers' heterogeneity may impact legal policy, proposing a more personalized approach to legal intervention. Third, we look at lenders and inquire how legal regulation may enhance responsible lending. While some of our suggestions may help consumers in general, others are more specifically tailored to poor consumers and payday loan borrowers.

1. General Policy and Ex Ante Fixes

People over-value treatment but under-value prevention. However, prevention is often preferable. In our context, prevention might be achieved in two main ways: (1) encouraging alternative lending mechanisms and (2) preventing the negative consequences of scarcity by changing macroeconomic policies.

There are a few alternative services with lower costs, which can substantially mitigate consumers' need to use payday loans and high-costs credit. For starters, banks and credit unions already offer competitive financial products at a lower cost.[113] Another emerging alternative is employer-based loans and payday advances. It has been reported that an increasing number of "U.S. employers are teaming up with financial institutions.... to offer small personal loans to their workers."[114] This may not only be a humane and a socially responsible move, but also a beneficial one. This is because such loans may increase employees' work satisfaction and improve retention rates.[115] A further option to consider is modern Postal Banking, which exists in many countries, but not currently in the United States. The idea, in essence, is that local post offices – building on their financial, democratic and human infrastructure – will offer microloans and other fundamental financial services.[116] Subprime credit cards may provide yet another superior alternative to payday loans.[117]

Moreover, governments offer significant support programs to poor consumers.[118] These may include, for example, job training, tax benefits, food/nutrition aid, security income, and

[113] Madrian et al., *supra* note 50, at 33.
[114] Yuka Hayashi, *New Workplace Perk: Loans for Low-Income Employees*, THE WALL STREET JOURNAL (November 2, 2017).
[115] *Id*. (citing a chief executive stating that "If you could help an employee whose car breaks down or water heater is broken, you are going to have an employee come to work in better shape" and referring to his observation that "the loan program helped the company boost its employee retention rate").
[116] *See* MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY (Harvard University Press, 2015), Ch. 7 (Postal Banking).
[117] Mike Calhoun, *Think There's no Good Alternative to Payday Loans? Think Again,* THE WASHINGTON POST (June 29, 2016).
[118] *See, e.g.,* SHUCK, *supra* note 9, at 64-86 (discussing anti-poverty programs in the US).

Electronic copy available at: https://ssrn.com/abstract=3235810

temporary assistance programs. However, many eligible poor households do not take advantage of these programs,[119] which leads to two unfortunate and interrelated results. First, households lack financial resources, therefore turning more to payday loans. Second, the lack of financial support bolsters the problematic aspects of scarcity. In effect, a vicious cycle is in place.

Therefore, policymakers should take more proactive steps to increase awareness of these programs among poor consumers.[120] The current approach – trigerring warning only when consumers attempt to take out a loan – may be too late to aid planning financial behavior. To begin with, advertising the other alternatives (such as bank services) and their benefits will lead fewer consumers to take out payday loans.[121] Policymakers should also make sure that such alternatives are easily accessible,[122] simplifying and standardizing related procedures and enrollments.[123] Simplicity and coherence can help the poor make better decisions,[124] freeing cognitive bandwidth and thus elevating "helpful programs into transformative ones."[125]

Additionally, third parties can have an essential role in mitigating some of the challenges that poor people face. For starters, aid organizations would be wise to offer poor consumers accessible assistance with procedures and the filing process. More broadly, objective third parties could also produce a voluntary 'Fair Trade' standard or stamp of approval, which will be awarded to lenders that employ fair practices.[126] This may serve to mitigate the negative consequences of the payday loans marketing.

---

[119] Madrian et al., *supra* note 50, at 34.
[120] This issue brings to mind the question of how credit, aid programs and payday loans advertisements should be regulated. We briefly touch upon this issue below.
[121] Firms are far more likely to engage in aggressive marketing campaigns, while far less advertising is done for plans and programs which can assist poor people. *See* Marianne Bertrand et al., *Behavioral Economics and Marketing in Aid of Decision Making Among the Poor*, 25 J. PUB. POL. & MARKETING 8 (2006).
[122] Madrian et al., *supra* note 50, at 35 (suggesting the implementation of "a universal portal through which claimants can both verify eligibility for and complete enrollment in a range of programs").
[123] *See, e.g.,* RUTGER BREGMAN, UTOPIA FOR REALISTS – AND HOW WE CAN GET THERE (2017), p. 96 (arguing that social services and aid plans require "claimants to demonstrate their shortcoming…. Otherwise your benefits are cut. Forms, interviews, checks, appeals, assessments, consultations, and then still more forms – every application for assistance has its own debasing, money-guzzling protocol... This isn't a war on poverty; it's a war on the poor"); Madrian et al., *supra* note 50, at 35.
[124] *Cf*. Hadfiled, supra note 3, at 290-291 (discussing the argument that complexity and high demands prevent poor people in poor countries from using the formal infrastructure and legal institutions). Numerous field studies demonstrate that one of the main mechanisms to increase cooperation of individuals, is to make things, as simple as possible. This is naturally more likely to be needed for people are less educated on average.
[125] Colleen Briggs, *How Boosting Cognitive Bandwidth Can Fight Poverty* (Aug. 17, 2017), available at https://www.jpmorganchase.com/corporate/news/insights/cbriggs-kdavis-boosting-cognitive-bandwidth.htm.
[126] For a thorough discussion of this idea in the general context of consumer standard form contracts *see* Shmuel I. Becher, *A "Fair Contracts" Approval Mechanism: Reconciling Consumer Contracts and Conventional Contract Law,* 42 U. MICH. J. L. REFORM 747 (2009).

Electronic copy available at: https://ssrn.com/abstract=3235810

Moreover, third parties can also offer – and be encouraged to offer – valuable microfinance programs.[127] In short, microfinance is often regarded as a cutting-edge financial innovation that may alleviate poverty and empower poor consumers, especially women.[128] However, research on the impact of microfinance is at times conflicting and still partial in scope, hence its potential should be examined carefully.[129]

People rarely consider more than one option at a time – a behavior called "cognitive rigidity." Cognitive rigidity "gets amplified when we feel threatened by time pressure, negative emotions, exhaustion, and other stressors."[130] But having a few options in mind is likely to yield a better decision. Keeping options open should be especially valuable to borrowers who experience scarcity and consider payday loans. Accordingly, other possible strategies include informing single-program users of the existence of other programs.[131] A further possibility is automatically enrolling eligible individuals into some programs.[132] Promotion of these programs, or verifying that consumers indeed use them, can also be a prerequisite for the execution of a payday loan.[133]

2. Improving Consumers' Financial Decision Making

Many consumer markets are characterized by market failures that prevent market forces from maximizing welfare. However, we cannot simply replace failed market forces by regulation. First, it is highly doubtful that the legislature is equipped with the expertise, knowledge, resources, and information necessary to determine optimal products and contracts. Furthermore, consumer heterogeneity makes it harder on legislatures to set optimal regulation,

[127] *See, e.g.,* the Grameen America initiative, http://www.grameenamerica.org; Elmira Bayrasli, *Microfinance in America?* FORBES (March 26, 2012).
[128] *See, e.g.,* Hadfield, *supra* note 3, at pp. 311-318.
[129] For a careful and nuanced attitude *see, e.g.*, Frithjof Arp et al., *Microfinance for Poverty Alleviation: Do Transnational Initiatives Overlook Fundamental Questions of Competition, Informal Microcredit and Intermediation?*, 24 TRANSNATIONAL CORPORATIONS 103 (2017). *See also* Abhijit Banerjee et al, *The Miracle of Microfinance? Evidence from a Randomized Evaluation*, 7 AM. ECON. J.: APPLIED ECON. 22 (2015).
[130] *See, e.g.,* Jack B. Soll et al., *Outsmart Your Own Biases,* HARV. BUS. REV. (May 2015).
[131] This can be done, for instance, by linking application procedures and eligibility prerequisites across various support programs.
[132] Madrian et al., *supra* note 50, at 34. In light of the status quo bias and the power of inertia this has been done with success in other domains. For one famous example *see* Richard H. Thaler & Shlomo Benartzi, Save more Tomorrow™: *Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164 (2004).
[133] While these alternatives address lending institutions, there are more ambitious yet highly contested proposals that focus on broad (macroeconomic) policy measures. One alternative is to increase minimum wages. Another is to promote Universal Basic Income (UBI). Both options, which are beyond the scope of this chapter, may improve mental health and reduce financial stress, thus making poor people less inclined to make counterproductive financial decisions.

Electronic copy available at: https://ssrn.com/abstract=3235810

and having this flexibility is generally one of the advantages of the market. Second, it is not at all clear that the legislature's purpose is indeed maximization of consumer or social welfare. Often the legislature is influenced by pressure applied by corporations (political capture) that push forward legislation that maximizes the firms' profits at the expense of the consumers' interest.[134]

Keeping that in mind, behavioral economics proposes soft paternalistic approaches. "Asymmetric paternalism" and "libertarian paternalism" are examples of more subtle approaches, which take consumer heterogeneity into account. Asymmetric paternalism calls for rules that advance the welfare of the less shrewd consumers while not significantly hurting the more sophisticated ones.[135] For instance, disclosing (in our context, financial) information can be very beneficial for those consumers who lack this information, yet it does not impose an excessive cost on sophisticated consumers who can gather this information elsewhere. Along similar lines, libertarian paternalism seeks to advance protections that preserve the individual's ability to choose what they would choose absent legal intervention.[136] For example, default rules that encourage saving (e.g., social deductions from wages) can still allow those who are not interested in this arrangement to opt out.[137] Whenever possible, we recommend considering protections that follow this logic.

As illustrated above, multiple biases and challenges may lead people to make imprudent financial decisions. One can think of two types of interventions that may improve consumers' financial behavior. The first is to utilize System 1 nudges. The other is priming consumers to make more use of System 2.

i. <u>System 1 Nudges</u>

Defaults. Defaults are known to have a strong impact on people's behavior. In payday loans, it is worth considering the introduction of defaults of full repayments, where consumers do not roll over their loans. If full payment cannot be made and the consumer needs to deviate

---

134 For a basic public choice theory account *see* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: CRITICAL INTRODUCTION 12–37 (1991).

135 For a development of the idea *see* Colin Camerer et al., *Behavioral Economics and the Case of "Asymmetric Paternalism"*, 151 U. PA. L. REV. 1211 (2003).

136 *See* Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003); Richard H. Thaler & Cass R. Sunstein, *Libertarian Paternalism*, 93 AM. ECON. REV. 175 (2003). For a more extensive discussion see RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008).

137 A default rule like this utilizes the fact that many tend, by inertia, to stay with the status quo. This does not prevent others' from choosing a different alternative.

Electronic copy available at: https://ssrn.com/abstract=3235810

from said default, perhaps there should be another default of a significant partial repayment. A warning should also be displayed as borrowers opt out of desirable defaults.

Reminders and Kind Messages. Let us illustrate the idea of reminders by referring to nudge banking – a new concept aimed at helping consumers in achieving their long-term financial goals. In one instance, customers were given a Nudge app, which includes 38 types of short messages.[138] Using this app, customers received, among other things, notices regarding their spending. The app could detect increased spending or inform users how much they would save by changing their behavior (e.g., eating at home instead of dining out). It could also tell consumers when their spending is not in line with the way other, similar consumers behave.

A similar application, which can utilize behavior insights that may nudge people to better decisions, could be used in respect to payday loans (for those borrowers who own a smartphone). Such an application can send payment reminders, be used to pay loans and can provide borrowers with comparative information regarding other borrowers' payments.[139] Downloading and using such an application can even be a mandatory (or a default) pre-requisite for loan issuance. This application may as well serve as a platform that will exploit human biases to increase savings among low income earners.[140] Such savings can buffer against the need to use a high-cost credit/loan.

Information Presentation. Information presentation should be in line with current findings as to how people process information. To begin with, information should be presented in an accessible and easy way, which should also account for borrowers' levels of education and language proficiency. For example, empirical studies that examined the readability of payday loans in general and arbitration clauses in particular found that these were not in line with consumers' (let alone poor consumers!) levels of literacy.[141]

---

[138] *See Banking Innovations Here and Around the World - from the Blog: Would you Like to Experience the Benefits of "Nudge" Banking?*, UNICREDIT BULBANK (26 January, 2016), available at https://www.unicreditbulbank.bg/en/about-us/news/banking-innovations-here-and-around-the-world-from/.

[139] *See* Cara Feinberg, *The Science of Scarcity – A Behavioral Economist Fresh Perspective on Poverty,* HARVARD MAGAZINE (May-June 2015) (noting "a 20 percent improvement in timely rent payment simply by sending postcard reminders and creating a monthly raffle for tenants who paid on time").

[140] A somewhat similar move has been successfully taken by Walmart. *See* Rob Walker, *How to Trick People into Saving Money,* THE ATLANTIC (May 2017).

[141] CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS (2015), at pp. 27-29; Brenna A. Sheffield, *Pre-Dispute Mandatory Arbitration Clauses in Consumer Financial Products: The CFPB' s Proposed Regulation and Its Consistency with the Arbitration Study,* 20 North Carolina Banking Institute 219, 242, 251 (2016).

Electronic copy available at: https://ssrn.com/abstract=3235810

Moreover, information presentations can use visual cues – such as font, size, color and frames – to enhance their effectiveness. Since people are strongly influenced by comparisons and loss aversion, showing the actual price in fees of a payday loan compared with the price of other existing alternatives may make payday loans seem less attractive.[142] Framing and word choice may also play a role, as people respond differently to "dollars owned" than to interest percentages.[143]

ii. Priming System 2

Promoting a deliberative environment around high-cost credit transactions can be very beneficial. Interestingly, "[e]asy convenient process/little paperwork" is cited as a key motivation that leads borrowers to use payday loans.[144] Since the psychology of scarcity induces people to take the easier path involving minimal effort, this makes perfect sense. Hence, regulation should ensure that payday loans paperwork is not too simplified; i.e. – simplified in a way that conceals important information and gives the borrowers a false sense of a mundane and trivial decision.

People need some degree of stress to behave optimally when making decisions. Therefore, a moderate amount of stress can be constructive for efficient decision making.[145] We can further increase the likelihood of borrowers using System 2 by asking them to assume they cannot have a payday loan and then requiring them to think of the other alternatives to a payday loan.[146]

Moderate levels of stress can yield another benefit: reducing the optimism bias. Therefore, it is worthwhile to make sure that the lending environment is structured in a way that will not overly reduce – and perhaps even increase – levels of stress. For starters, lenders should be required to conspicuously disclose and highlight the likelihood of having a future rollover. To make these disclosures more powerful and prevent potential mistakes, individualized use-

[142] Gandy et al., *supra* note 4, at 28.
[143] Feinberg, *supra* note 139.
[144] Elliehausen Gregory, *An Analysis of Consumers' Use of Payday Loans*, Financial Services Research Program Monograph No. 41, Board of Governors of the Federal Reserve System (2009).
[145] *See generally* IRVING LAW JANIS & LEON MANN, DECISION MAKING: A PSYCHOLOGICAL ANALYSIS OF CONFLICT, CHOICE, AND COMMITMENT 62 (1977) (specifying conditions for vigilant decision making). *See also* Gloria Phillips-Wren & Monica Adya, *Risky Decisions And Decision Support: Does Stress Make A Difference?*, 9 PROCEEDINGS OF JAIS THEORY DEVELOPMENT WORKSHOP. SPROUTS: WORKING PAPERS ON INFORMATION SYSTEMS (2009); MULLAINATHAN & SHAFIR, *supra* note 18, at pp. 142-143. For a more reserved view and for suggesting that this issue merits additional research *see* Haushofer & Fehr, *supra* note 12, at 866.
[146] This is known as "the vanishing options test", *see* CHIP HEATH & DAN HEATH, DECISIVE: HOW TO MAKE BETTER CHOICES IN LIFE AND WORK (2013).

Electronic copy available at: https://ssrn.com/abstract=3235810

pattern information should be mandated.[147] Where such information does not exist, lenders should disclose use-pattern of consumers with similar traits.

Research has demonstrated that relatively simple interventions in the setting of decision making can improve financial mismanagement for consumers "with complex and negative financial histories."[148] For example, asking people to think about reasons for avoiding debt-related information is likely to reduce the likelihood of information avoidance.[149] Additionally, long-term planning can be encouraged by employing questionnaires and videos. Such questionnaires and videos can ask people to contemplate information avoidance and explain its origins and negative consequences. Videos may prove to be a powerful tool since they can present information in a more intuitive and entertaining way. Such videos can be produced by governmental entities (like the CFPB) or pro-consumer organizations. They can then become a mandatory and integral component of loan issuance.

Also, it may be beneficial to include a worksheet in the loan process that will help consumers make a concrete plan for loan repayment. First, this will induce a more serious environment and make payday loans less hassle free and therefore less misleadingly attractive. Second, including a worksheet has been proven to be a successful intervention that reduces the problem of underestimating expenditure.[150] Third, channeling consumers' attention to future repayments may make the links between the current decision to borrow and its future consequences clearer. Thus, it may reduce borrower's present bias.

Finally, borrowers should be provided a cooling-off period during which they may cancel the loan within a specific time frame. The cooling-off period can induce more rational thinking by allowing the consumer to consider the transaction at his convenience. While doing so, the consumer should be able to consider more information about the loan and the existing alternatives in the market. Thus, we should make sure that during the cooling-off period, the videos, tutorials and info-graphs discussed above will be at the borrower's disposal for further review. It might as well be important to ensure that contracts are drafted using plain language, to ensure they are compatible with consumers' level of literacy.

---

[147] *See* Oren Bar-Gill & Franco Ferrari, *Informing Consumers About Themselves*, 3 ERASMUS L. REV. 93 (2010).
[148] Harkin, *supra* note 74.
[149] Harkin, *supra* note 74.
[150] Harkin, *supra* note 74.

Electronic copy available at: https://ssrn.com/abstract=3235810

As an additional positive side effect, a cooling-off period may change the incentives that the lender has *ex ante*. A cooling-off period will make the lender hesitate a while before acting slyly or presenting the transaction dishonestly or misleadingly.[151] The very knowledge that the customer can reflect on the loan *ex post* and terminate the transaction after it has been formed is likely to weaken the dealer's incentive to manipulate the customer in the first place.

iii. Taking Personalization and Differentiated Regulation Seriously

While some interventions have been found productive in general, different populations and groups may require different treatments. However, firms often tend to adopt a generic and universal approach to compliance with consumer protection measures, which may harm poor consumers.[152] Therefore, it is imperative to move beyond "one-size-fits-all" types of regulation and consider more individually tailored and nuanced interventions.[153] According to this line of reasoning, personal and demographic characteristics may be taken into account in order to better align the protections afforded to the needs and preferences of borrowing consumers.

Interestingly, consumer heterogeneity is evident in the results of some policy interventions. In our context, there is growing evidence that social programs may well have diverse effects on different groups. For instance, an interesting intervention to help poor families – the parents academy – helped White and Hispanic people, but not Blacks.[154] The same varied effects may be true regarding different age groups. In this context, it has been argued that "[a]ntipoverty programs vary in their effectiveness, with the elderly benefiting most and being affected least by the work disincentives built into many of the programs."[155] All this further demonstrates that the solution to complex problems – such as the regulation that should govern payday loans – is not likely to be the same for everyone.

First, we may consider personalized disclosures, reminders and messages. With the rise of big data, sophisticated algorithms, artificial intelligence, and machine learning, legal scholars have started exploring the idea of personalized laws.[156] In the context of disclosures in consumer

[151] *Id*., at 1240.
[152] *See* Paul Ali et al., *Financial Hardship Assistance Behind the Scenes: Insights from Financial Counsellors*, 52 AUSTRALIAN J. SOCIAL ISSUES 241 (2017).
[153] Feldman and Lobel, Beyond the Land of Behavioral Economics…
[154] Roland G. Fryer Jr., Steven D. Levitt & John A. List, *Parental Incentives and Early Childhood Achievement: A Field Experiment in Chicago Heights*, NBER (2015).
[155] Schuck, *supra* note 9, at pp. 25-26.
[156] *See, e.g.,* Anthony Casey & Anthony Niblett, *Self-Driving Law,* 66 U. TORONTO. L. J. 430 (2016). *See also* the forthcoming issue of the CHI. L. REV., dedicated to personalized law.

Electronic copy available at: https://ssrn.com/abstract=3235810

law, it has been suggested that "[i]mpersonal information duties and standardized notices could be replaced by granular legal norms which provide personalized disclosures based on informational needs of an individual and personal preferences."[157] Tailoring disclosures in such a way will promote their effectiveness while optimizing costs. Same is true with regards to reminders and messages, which can be personalized based on each borrower's characteristics and circumstances. Along similar lines, ". . . the Consumer Financial Protection Bureau could identify particular default contractual provisions that are well suited to particular types of consumers and require firms to offer the terms to customers with those profiles."[158]

Second, consider over-optimism. While this bias is relevant to people from different backgrounds and ages, it is in its lowest rates at midlife. This may entail that policy intervention may be tailored according to age. Thus, young borrowers will deserve an extra-vigilant approach, intended to ensure the engagement of System 2. Such an approach may necessitate using premortems,[159] where borrowers will be asked to imagine a future failure to repay, and then asked what may have caused such a failure. Similarly, borrowers may be informed about overall failure rate (of other borrowers) and asked to consider whether and why this rate is different than their own personal estimation.[160] The need to justify one's optimism when confronted with challenging data may as well reduce over-optimism.

Third, fair lending may require lenders to assess the borrower's ability-to-pay. The basic idea here is to ensure that borrowers can repay their loans. While clearly there are legal limitation that prevent people from using certain attributes of individuals from being considered by lenders,[161] with abundant information and big data systems, lenders can consider a large variety of aspects and information which are not based on forbidden discriminatory proxies relatively easy.[162] Thus, regulators should stay vigilant as to what is, and is not, being considered

---

[157] Christoph Busch, *Implementing Personalized Law: Personalized Disclosures in Consumer Law and Privacy Law*, CHI. L. REV. (forthcoming, 2018).
[158] Ariel Porat & Lior Jacob Strahilevitz, *Personalizing Default Rules and Disclosure With Big Data*, 112 MICH. L. REV. 1417, 1440 (2013).
[159] *See, e.g.,* Soll et al., *supra* note 130.
[160] Soll et al., *supra* note 130.
[161] Yan Zhang, *Assessing Fair Lending Risks Using Race/Ethnicity Proxies*, 64 MANAG. SCI. (2016).
[162] For a general discussion of the potential of big data for decision such as those of creditors, see Einav, Liran, and Jonathan Levin. "The data revolution and economic analysis." *Innovation Policy and the Economy* 14, no. 1 (2014): 1-24. For a more detailed discussion of the potential problems in big data analysis of borrowers' history see Hurley, Mikella, and Julius Adebayo. "Credit scoring in the era of big data." *Yale JL & Tech.* 18 (2016): 148.

Electronic copy available at: https://ssrn.com/abstract=3235810

in this respect. Hopefully, such a personalized approach may yield more just results as well, where borrowers are not discriminated against based on color or ethnicity.[163]

3. *Responsible Lending: Revisiting Lenders' Obligations*

i. Ex ante Measures

In 2016, the CFPB proposed "12 CFR Part 1041"[164] – a new federal rule that requires high-cost credit lenders to examine customers' ability to pay back loans.[165] According to Richard Cordray, the CFPB's director, "consumers are being set up to fail with loan payments that they are unable to repay."[166] The suggested rule also forbids lenders from offering new loans to pay off the old ones. This is of key significance since according to the CFPB, more than 80 percent of such loans are rolled over within a month, making said loans a snowball trap.

As part of responsible lending, regulators can require lenders to verify that borrowers take advantage of government assistance programs. Additionally, as is the case under New Zealand law, lenders have a duty to make reasonable inquiries to assure that the credit they provide will meet the borrowers' requirements and objectives.[167] We may as well think of more intrusive interventions, such as requiring lenders to inquire the loans' purpose. If the borrower's intent is to pay for utility, a medical bill or other necessity, the lender can deposit the loan directly to the relevant account or otherwise ensure the money is used for said purpose.

At the same time, if it is not a necessity that drives the loan, this may serve as a warning sign. In such cases, the lender may be required to report the loan further (e.g., to community or aid services). Alternatively, the borrower may be asked to watch a special tutorial and answer some written questions prompting further thought. Additionally, we may require the buyer to reflect during an *ex ante* cooling off period – asking him to fill the relevant loan forms and return in a few days to execute it.

[163] For discussing lending discrimination based on mortgage data *see* Robert Bartlett et al., *Consumer Lending Discrimination in the FinTech Era* (December 7, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3063448.
[164] PAYDAY, VEHICLE TITLE, AND CERTAIN HIGH-COST INSTALLMENT LOANS.
[165] Integrating "pre-agreement" assessment as part of responsible lending has been experienced in various jurisdictions. *See, e.g.,* C. M. Van Heerden & Reinhard Steennot, *Pre-Agreement Assessment as a Responsible Lending Tool in South-Africa, and Belgium: Part 1*, 21 POTCHEFSTROOM ELECT. L. J. (2018). It has also been employed in other domains. *See* Joseph Sanders & and Vijay Raghavan, *Improvident Student Lending*, UTAH L. REV., (forthcoming, 2018).
[166] CPFB, *Consumer Financial Protection Bureau Proposes Rule to End Payday Debt Traps,* (June 2, 2016), at 2.
[167] Responsible Lending Code (Minister of Commerce and Consumer Affairs, 2015), available at https://www.consumerprotection.govt.nz/assets/PDFs/responsible-lending-code.pdf

Electronic copy available at: https://ssrn.com/abstract=3235810

Lenders' responsibility and their assessment of borrowers' ability-to-repay can be measured *ex post* by examining, for instance, the rate of rollovers. Where this rate exceeds a specific threshold – to be determined by experts – lenders will have to refute a presumption that their policy is improper. Another possibility is measuring whether the credit indeed achieved the borrower's goal. All these measures will be published and generally accessible. This may result in two positive outcomes: first, it will inform borrowers, policymakers and aid organizations; second, the mere fact that there is a public and legal surveillance *ex post* is likely to induce a more careful and fair business behavior *ex ante.*[168] At the second stage, this data should be aggregated to form some grade or ranking. If this becomes a salient aspect for consumers, business will align their behavior accordingly so as not to undermine their reputation. Of course, there should be additional economic incentives, such as fines and loan forgiveness, when lenders do not comply with the law.

ii. Ex post: Revisiting the Doctrine of Unconscionability

The unconscionability doctrine was incorporated in the U.C.C. Section 2-302, titled "Unconscionable Contract or Clause." The prevailing opinion regarding the doctrine of unconscionability is that courts can and should use the doctrine to review both substantive and procedural contractual aspects.[169] As the famous case of *Williams v. Walker-Thomas Furniture Co.*[170] illustrates, courts use the unconscionability doctrine to protect an allegedly weak party from being exploited by the stronger party.

In *Williams*, the court dealt with the conscionability of a repossession clause in a rent-to-own contract, which purported to lease the purchased items to appellant, a poor credit borrower, for monthly rent payments. The federal court of appeals explained that "unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."[171]

[168] Paul R. Kleindorfer, *What if You Know You Will Have to Explain Your Choices to Others Afterwards? Legitimation in Decision Making*, THE IRRATIONAL ECONOMIST – MAKING DECISIONS IN A DANGEROUS WORLD (2010) p. 72.

[169] *See* Eisenberg, Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 752-54 (1982); Robert A. Hillman, *Rolling Contracts*, 71 FORDHAM L. REV. 743, 749 (2002); Daniel T. Ostas, *Postmodern Economic Analysis of Law: Extending the Pragmatic Visions of Richard A. Posner*, 36 AM. BUS. L. J. 193, 228 (1998).

[170] Williams v. Walker Thomas, 350 F.2d 445 (D.C. Cir. 1965), *rev'g*, 198 A.2d 914 (D.C. 1964).

[171] *Walker*, 350 F.2d at 449.

Electronic copy available at: https://ssrn.com/abstract=3235810

Section 208 of the *Restatement*, titled "Unconscionable Contract or Term," reflects a similar idea.

The doctrine of unconscionability could also be used by courts to assess, *ex post*, high-cost credit transactions.[172] Indeed, unconscionability has been regarded as "the Law of the Poor."[173] Most prominently, the doctrine is an important judicial tool for coping with transactions entered with imperfect information and lack of meaningful choice.[174] Similarly, courts have developed a "reasonably communicated" test in order to assure that the weaker party had a reasonable chance to observe the importance and meaning of a specific contractual clause.[175] Assuming no ex ante regulation of payday loan contracts, courts may consider, among other things, the readability of these contract.[176] Given the psychology of scarcity, unconscionability and similar or related doctrines can play a more significant role in judicial scrutiny of high-cost credit transactions.

IV. CONCLUDING REMARKS

"Poverty is like punishment for a crime you didn't commit."[177]

Poverty is a serious problem with far-reaching consequences. Tackling poverty requires a cross-disciplinary understanding, useful data, a systematic evidence-based analysis, and a holistic approach. Alleviating poverty demands ongoing and deep commitment toward building human capital, individual capabilities and supporting society. This cannot be done effectively without addressing the causes and consequences of poverty throughout the life course. Nonetheless,

[172] Baird, for instance, explains that important contractual aspects should be undertaken in "an environment that allows for reflection and deliberation." Douglas G. Baird, *The Boilerplate Puzzle*, 104 MICH. L. REV. 933, 944 (2006).
[173] Ann Fleming, *The Rise and Fall of Unconsciounability as the Law of the Poor*, 102 GEO. L. J. 1383 (2013).
[174] *Cf.* Shmuel I. Becher, *Asymmetric Information in the Market for Contract Terms: The Challenge That Is Yet to Be Met*, 45 AM. BUS. L. J. 723 (2008). Moreover, the flexibility of the unconscionability doctrine allows the creation and development of other related doctrines, such as unfair surprise which courts use to refrain from enforcing contract provisions that violate the reasonable expectations of a contracting party. *See, e.g.,* Donald B. King, *Standard Form Contracts: A Call for Reality*, 44 ST. LOUIS U. L.J. 909, 911 (2000).
[175] Such as forum selection clauses. *See generally* Kaustuv M. Das, Note & Comment: *Forum-Selection Clauses in Consumer Clickwrap and Browsewrap Agreements and the "Reasonably Communicated" Test*, 77 WASH. L. REV. 481, 492-96 (2002).
[176] As noted above, payday loan contracts are written in a language that prevents a typical borrower from being able to read and understand them. *See supra* note 141 and accompanying text.
[177] Attributed to Eli Khamarov, Stanford Center on Poverty and Inequality.

Electronic copy available at: https://ssrn.com/abstract=3235810

policymakers often channel their attention to short-term financial fixes, which appeal to the public and enhance their image or reputation.[178]

Though merely one piece of a significant and challenging puzzle, consumer finance plays an important role in poverty policy.[179] Indeed, one of the pillars of poverty eradication is minimizing costs. This can be achieved by taking out low-cost credit and accumulating savings that can serve as a safety net and a buffer.

Along these lines, we focused on borrowing practices from a consumer law perspective. We explained the biases that may lead people to overborrow and over-spend. We also reviewed the unique psychological and cognitive forces that can induce poor consumers to make counterproductive financial decisions. With that in mind, we examined policy interventions that may be better tailored to cope with the genuine sources of the problem.

The policy interventions discussed in this chapter may raise a few legitimate concerns. One such concern relates to unintended negative consequences, such as stereotyping and negative reinforcement. Unfortunately, sometimes well-intended social program can severely backfire. If poor people are treated differently, they might be reminded repeatedly of their low socioeconomic status. Such reminders may cause negative identity priming and enhance a sense of helplessness.[180] This can further one's worries, which may reinforce weaknesses and problems, rather than solving them.

Studies show that intellectual performance can be impaired by internalizing negative stereotypes such as ethnicity and social class. In the context of poverty, one study found that priming low-income students by asking them to provide demographic information led to worse performance on a test, when compared to the performance of low-income students that were not primed in that direction.[181] This is a stereotype threat: concerns about one's identity create a

---

[178] For a detailed discussion in the context of consumer law *see* Becher, *supra* note 112.
[179] *Cf.* Norman I. Silber, *Discovering That the Poor Pay More: Race Riots, Poverty, and the Rise of Consumer Law*, 44 FORDHAM URB. L. J. 1319 (2017) (discussing David Kaplovitz's book The Poor Pay More, the importance of consumer finance, and the recommendation to address social grievances through legal revisions).
[180] Cf. Helmer, *supra* note 104, at 31.
[181] Bettine Spencer & Emanuele Castano, *Social Class is Dead. Long Live Social Class! Stereotype Threat among Low Socioeconomic Status Individuals,* 20 SOC. JUST. RES. 418 (2007).

Electronic copy available at: https://ssrn.com/abstract=3235810

mental load which saps the cognitive system and working memory, thus leading to suboptimal performance.[182]

Another important concern is privacy. One set of our recommendations discussed tailoring the legal treatment of poor consumers. This entails using consumers' personal information. When it comes to indigent consumers, this should be carefully viewed given the argument that marginalized populations enjoy merely "weak versions" of privacy.[183]

More generally, we hope that the framework we outlined in this chapter may be applicable to other financial contexts of impoverished people. Consider, for instance, gambling and lottery – which disproportionally affect the poor; or the consumption and the regulation of unhealthy products – such as soda drinks, fast food, alcohol and tobacco. In these and other domains, such as housing and schooling, poverty has an impact on decision-making processes, and legal policy should look for ways to facilitate a better reality. Introducing psychological and behavioral insights in this process may result in more effective policies and a more compassionate society. Following this reason, the psychology of scarcity can shed further light on other, non-financial related, domains.[184]

Ineffective tools and interventions provide the poor with a false feeling of protection – which may make them even more tempted to make bad decisions. It further provides the wealthy and the fortunate a false sense of empathy regarding the underprivileged and prevents them from taking effective action to aid the poor. Regulators can help improve the financial situation of the poor by understanding how financial decisions are made and adopting behaviorally informed interventions. We hope this chapter makes a modest step towards that end.

[182] Jean-Claude Croizet et al., *Stereotype Threat Undermines Intellectual Performance by Triggering a Disruptive Mental Load*, 30 PERS. & SOC. PSYC. BULLETIN 721 (2004); Sian Beilock, *Stereotype Threat and Working Memory: Mechanisms, Alleviation, and Spillover*, 136 J. EXPERIMENTAL PSYC. GENERAL 256 (2007).
[183] *See* KHIARA M. BRIDGES, THE POVERTY OF PRIVACY RIGHTS (STANFORD UNIVERSITY PRESS, 2017) (discussing the privacy of poor mothers).
[184] University entry and academic scholarships may be additional contexts where policies can be changed in order to accommodate the psychology of scarcity. If poverty or scarcity explain why poor people do worse in their exams and assessments, this may provide an additional angle (and justification) for policies that benefit the poor.

Electronic copy available at: https://ssrn.com/abstract=3235810