Utah Law Review

Volume 2022 | Number 3 Article 2

8-2022

Consumer Law's Equity Gap

Vijay Raghavan
Brooklyn Law School, vijay.raghavan@brooklaw.edu

Recommended Citation
Vijay Raghavan,Consumer Law's Equity Gap, 2022 ULR 511 (2022) doi:10.26054/0d-07ze-6fmf

CONSUMER LAW'S EQUITY GAP

Vijay Raghavan*

Abstract

This Article is about the views that shape and constrain the development of consumer law. Consider the market for short-term, high-cost loans. Policymakers tend to justify intervening in these markets on inefficiency grounds (consumers exhibit present bias) and rarely on equitable grounds (these loans cost too much). Why? One recent explanation suggests that policymakers may focus on inefficiency because they believe access to credit is essential for social and economic development. In this Article, I offer an alternative explanation. The lack of equity in consumer law is not just a function of narrow conceptions internal to consumer law but the external view that the law should prioritize efficiency and ignore equity. The dominant rationale for this view is that redistribution through legal rules distorts economic behavior more than redistribution through an income tax. Here, I discuss the longstanding and recent critiques of this rationale and build on those critiques to show why it is a fundamental mistake to ignore distribution in consumer law. In particular, background legal rules shape consumer demand in individual markets. These background conditions may mean that seemingly irrational exchanges are, in fact, rational. An approach tethered to consumer preferences may struggle to justify altering the terms of rational exchanges. To overcome this problem, I suggest that we center distribution in the way we justify interventions and conceptualize solutions to problems in consumer financial markets. I detail what centering distribution in consumer law might look like and conclude by considering some objections to redistributive policies in consumer law.

 Assistant Professor of Law, Brooklyn Law School. For valuable comments and feedback, I thank Abbye Atkinson, Sara Sternberg Greene, Andrew Hayashi, Luke Herrine, Frank Pasquale, Alexandra Sickler, Jeff Sovern, and Rory Van Loo. I am grateful to participants in the 2021 Consumer Law Scholars Conference, the Inframarginalism & Internet Conference, the AALS Junior Consumer Scholars Workshop, and faculty workshops at Brooklyn Law School. A special thank you to Susan Hazeldean, Joy Kanwar, and the wonderful students in Rory Van Loo's Law of Consumer Markets class. Finally, I thank Laura Kent-Jensen, Kaitlynn Morgan, and the editors of the *Utah Law Review* for their insightful feedback and generous edits, which substantially improved this Article. Financial support for this Article was provided by the Brooklyn Law School Dean's Summer Research Stipend Program.

INTRODUCTION

In the runup to the 2020 Presidential election, a once-obscure and controversial idea—that the President can and should unilaterally cancel student debt—briefly went mainstream.[1] Endorsed by a diverse cast of liberal politicians from Elizabeth Warren[2] to Bernie Sanders[3] to Chuck Schumer,[4] there appeared to be broad Democratic support for swift executive action. But the support for student debt relief engendered an equally strong backlash from notable liberal economists. As an example, here is Jason Furman, chair of the Council of Economic Advisers under President Obama, on the wisdom of pursuing student debt relief: "Student loan debt forgiveness likely has a multiplier close to zero. Forgiveness is taxable. If this negative cash flow effect outweighs interest savings would even be net negative. And wealth effect small in short run. Arbitrary/regressive $1T for ~$0 GDP, not a great idea."[5]

On the surface, these critiques are about the purported regressivity of massive student loan debt relief.[6] But lurking beneath the surface of these critiques is a deeper and more foundational objection to using the law to redistribute income.[7] This

---

[1] *See* Astra Taylor, *How the Biden Administration Can Free Americans from Student Debt*, NEW YORKER (Nov. 23, 2020), https://www.newyorker.com/news/essay/how-the-biden-administration-can-free-americans-from-student-debt [https://perma.cc/2DQP-7WW7]; Luke Herrine, *The Law and Political Economy of a Student Debt Jubilee*, 68 BUFF. L. REV. 281 (2020).

[2] Elizabeth Warren (@ewarren), TWITTER (Oct. 16, 2020, 9:23 AM), https://twitter.com/ewarren/status/1317123919069982720 [https://perma.cc/S5PF-U5EE].

[3] Bernie Sanders (@SenSanders), TWITTER (Aug. 27, 2020, 10:31 AM), https://twitter.com/SenSanders/status/1299021647392002049 [https://perma.cc/GT2S-7N8T].

[4] Chuck Schumer (@ChuckSchumer), TWITTER (Oct. 16, 2020, 9:40 AM), https://twitter.com/chuckschumer/status/1317128255279857664?lang=en [https://perma.cc/2Q2N- H76S].

[5] Jason Furman (@JasonFurman), TWITTER (Nov. 15, 2020, 9:31 PM), https://twitter.com/jasonfurman/status/1328193936364539909?lang=en [https://perma.cc/HLU2-993Q]; *see also* Aarthi Swaminathan, *Former Treasury Secretary Larry Summers Is 'Skeptical' About Student Loan Forgiveness*, YAHOO! FIN. (Nov. 21, 2020), https://finance.yahoo.com/news/student-loan-forgiveness-larry-summers-skeptical-173401447.html [https://perma.cc/KR36-PSM5] (explaining that the former Treasury Secretary is also skeptical about the proposed student debt forgiveness).

[6] *But see* Charlie Eaton, Adam Goldstein, Laura Hamilton & Frederick Wherry, *Student Debt Cancellation IS Progressive: Correcting Empirical and Conceptual Errors*, ROOSEVELT INST. (June 8, 2021), https://rooseveltinstitute.org/publications/student-debt-cancellation-is-progressive/ [https://perma.cc/GW8W-4LRE] (challenging the view that student debt cancellation is regressive).

[7] And recent news suggests this backlash has temporarily succeeded in preserving the status quo. *See* Pia Peterson, *Student Loan Relief Has Changed the Lives of Millions of Americans. It Ends in September*, BUZZFEED NEWS (May 25, 2021, 12:59 PM), https://www.buzzfeednews.com/article/piapeterson/student-loan-relief-savings-forbearance [https://perma.cc/J949-E42Q].

Article is about that foundational objection, its recent history, and its vitality as a constraint on redistributive policies in consumer law.[8]

Interventions in consumer financial markets are typically justified on narrow, technical grounds.[9] Policymakers primarily view consumer law as a tool to correct market imperfections caused by cognitive bias or imperfect information.[10] Distribution is rarely an explicit goal of consumer law, and consumer law does not use a broad set of distributional levers to attack inequality in consumer financial markets.[11]

---

[8] A brief note on terminology. This Article is primarily about interventions in consumer financial markets but uses the term consumer law as opposed to consumer financial law or consumer financial protection law. Much like the term private law, consumer law is a broad term that "eludes precise definition." John C.P. Goldberg, *Introduction: Pragmatism and Private Law*, 125 HARV. L. REV. 1640, 1640 (2012). I use the term here for both its simplicity, and because this Article is a dialogue with recent articles that use the same term. *See* Rory Van Loo, *Broadening Consumer Law: Competition, Protection, and Distribution*, 95 NOTRE DAME L. REV. 211 (2019); Andrew T. Hayashi, *Myopic Consumer Law*, 106 VA. L. REV. 689 (2020).

[9] *See* discussion *infra* Section II.B.3; Van Loo, *supra* note 8, at 220 ("Many existing consumer protection laws, and many calls for new regulation by legal scholars, aim to lessen information asymmetries and behavioral biases, in part because . . . foundational economic theory holds that markets function best, and society benefits most, when consumers are informed and rational.").

[10] *See id.*

[11] *See* Howell E. Jackson & Paul Rothstein, *The Analysis of Benefits in Consumer Protection Regulations*, 9 HARV. BUS. L. REV. 197, 256–65 (2019) (citing information failures and cognitive biases as common rationales for consumer protection regulation). Even where legal scholarship argues for intervention on distributional grounds, the basis for unequal distribution is tied to market failure. *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 64, 98–100 (2008) (explaining that disparate impact due to differences in information and rationality may warrant intervention in consumer financial markets). I must make a few important qualifications to the broader argument of this Article. Equitable considerations are certainly relevant in the design of federal housing policy and education policy, which both intersect with consumer law. Moreover, equity is a central concern of consumer bankruptcy, which has an important function as social insurance. *See* Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 1 (2005) ("Bankruptcy scholars generally agree that consumer bankruptcy functions, at least in part, as a form of social insurance."). In arguing that equity plays little to no role in the structure and design of consumer financial regulation, I do not mean to suggest that there is no equity in consumer law broadly defined. My argument is instead centered on the federal regulation of consumer markets by the Consumer Financial Protection Bureau (CFPB) and, to a lesser extent, the Federal Trade Commission (FTC). The CFPB and the FTC play a central role in regulating consumer financial markets. As noted above, concerns about the distribution of resources in consumer financial markets have been a longstanding theme of consumer scholarship. Indeed, these concerns appeared to undergird the push to fundamentally reshape the regulatory landscape in 2010. Yet, in formal policymaking, equity is either an afterthought or understood as best addressed outside consumer law.

This narrow focus on market failure stands in stark contrast to the broader concerns about inequity in consumer financial markets voiced by many scholars. A longstanding theme in popular works on consumer finance is the extreme financial cost of poverty. From David Caplovitz's classic sociological study *The Poor Pay More* to Mehrsa Baradaran's recent *How the Other Half Banks*, scholars have documented the chronic and widening gaps between the rich and the poor in the financial marketplace.[12] These works show that access to our financial system is unequally distributed in our society, and this unequal distribution has significant costs.[13] The prescriptions across these and other works vary,[14] but they suggest that consumer law can play a role in combating inequality.

What accounts for the gap between the broader distributional concerns in popular scholarship and consumer law's narrow prescriptions? One recent explanation is there is no gap.[15] Policymakers are sensitive to distributional issues

---

[12] *See, e.g.*, DAVID CAPLOVITZ, THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES (1967); JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR (1994); GARY RIVLIN, BROKE, USA: FROM PAWNSHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS (2010); MICHAEL S. BARR, NO SLACK: THE FINANCIAL LIVES OF LOW-INCOME AMERICANS (2012) [hereinafter BARR, NO SLACK]; MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY (2015).

[13] As an example, consider unbanked consumers (consumers who do not have a bank account) and underbanked consumers (consumers who have access to at least one bank account but use fringe financial services). A recent poll suggests that the percentage of unbanked consumers has doubled since the pandemic and the number of underbanked consumers has increased to close to 25% since 2017. *See* Charlotte Principato, *How the Roughly One-Quarter of Underbanked U.S. Adults Differ from Fully Banked Individuals*, MORNING CONSULT (Aug. 17, 2021, 12:01 AM), https://morningconsult.com/2021/08/17/unbanked-underbanked-demographic-profile/ [https://perma.cc/52N7-5XLM]. For pre-pandemic figures, see FED. DEPOSIT INS. CORP., *How America Banks: Household Use of Banking and Financial Services* (2020) (2019 unbanked figures); FED. DEPOSIT INS. CORP., *2017 FDIC National Survey of Unbanked and Underbanked Households* (2020) (2017 underbanked figures). Consumers who lack access to conventional banking services turn to costly fringe financial services. *See* Michael S. Barr, *Banking the Poor*, 21 YALE J. REGUL. 121, 123–24 (2004) [hereinafter Barr, *Banking*]. This has impacted both the distribution of federal aid and the efficacy of it. *Cf.* Paul Kiel & Jeff Ernsthausen, *Debt Collectors Have Made a Fortune This Year. Now They're Coming for More*, PROPUBLICA (Oct. 5, 2020), https://www.propublica.org/article/debt-collectors-have-made-a-fortune-this-year-now-theyre-coming-for-more [https://perma.cc/P5LR-D3WR]; David Dayen, *Your Coronavirus Check Is Coming. Your Bank Can Grab It*, AM. PROSPECT (Apr. 14, 2020), https://prospect.org/coronavirus/banks-can-grab-stimulus-check-pay-debts/ [https://perma.cc/A2SV-8KBX].

[14] *See* BARR, NO SLACK, *supra* note 12, at 152–53 (proposing a combination of improved disclosures, transparency, and "behaviorally informed techniques"); *see also* Mehrsa Baradaran, *It's Time for Postal Banking*, 127 HARV. L. REV. F. 165 (2014) (proposing publicly administered deposits through the Post Office).

[15] *See* Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093,

but believe any bad consequences that flow from the unequal distribution of resources in consumer financial markets are the product of market failure. This belief stems from a deep faith in credit as an important social and economic lever and the capacity of properly functioning markets to deliver affordable and safe products.[16]

But the recent debate over student debt cancellation suggests that this account is incomplete. When policymakers move away from market failure and towards distribution, they are met with stiff opposition. This opposition suggests that the lack of distribution in consumer law is not solely a function of narrow conceptions internal to consumer law but also external constraints. And here, I argue that one of the primary external constraints on the development of consumer law is the widely held view that law should prioritize efficiency over equity and leave redistribution to the tax system.[17]

This view, which is better known as the "double-distortion" argument, is commonly attributed to Louis Kaplow and Steven Shavell.[18] Drawing on foundational principles from optimal tax theory, Kaplow and Shavell argued that redistributing wealth through a legal rule distorts behavior more than the same redistribution through an income tax.[19] As such, legal rules should be designed to maximize efficiency, and the distributional costs of efficient legal rules, to the extent they matter, should be handled through the tax system.[20] Kaplow and Shavell initially advanced the double-distortion argument to discourage equity-based allocations of entitlements in private law.[21] But the double-distortion argument has

---

1097–99 (2019) [hereinafter Atkinson, *Rethinking*] (arguing that consumer scholars and advocates view credit "as a viable mechanism of smoothing consumption or as a catalyst for social mobility" but ignore economic realities that undermine the effectiveness of credit as social provision). To be sure, Atkinson's critique is not about the narrowness of policymaking in consumer law. Instead, it is a broader normative critique of credit policy and credit regulation as anti-poverty measures.

[16] *See id.*

[17] To be clear, I am not arguing that this view is a hard constraint on distribution in consumer law. Instead, I am arguing that it is an implicit background assumption that shapes the way policymakers justify and design regulatory interventions in consumer financial markets.

[18] David Gamage, *How Should Governments Promote Distributive Justice?: A Framework for Analyzing the Optimal Choice of Tax Instruments*, 68 TAX L. REV. 1, 4 n.14 (2014) ("The phrase 'double-distortion argument' is primarily used in the existing literature to refer to Louis Kaplow and Steven Shavell's analysis of distribution through legal rules."); Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667–68 (1994).

[19] *See* Gamage, *supra* note 18, at 73 (explaining the connection between Kaplow and Shavell's double-distortion argument and the Atkinson-Stiglitz model for analyzing optimal-choice-of-tax-instruments questions); Steven Shavell, *A Note on Efficiency v. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 AM. ECON. REV. 414 (1981).

[20] *See* Kaplow & Shavell, *supra* note 18.

[21] *Id.* at 669 (comparing income-insensitive and income-sensitive strict liability rules

since been extended to regulation[22] and is the background principle behind the prevailing view that regulators should focus exclusively on cost-benefit analysis and ignore distributional issues.[23]

If the double-distortion argument is correct, then it is sensible to use market failure as a framework to justify regulatory interventions. But recent critiques make clear that strict adherence to the double-distortion argument is increasingly unjustified. Within the tax literature, scholars have challenged the assumptions underlying the double-distortion argument and shown that redistribution through a legal rule may be less distortionary and preferable to redistribution through an income tax.[24] Outside the tax literature, scholars have argued that the double-distortion argument ignores the political impediments to redistribution through the tax system.[25] Perhaps the deepest challenge to the orthodoxy comes from Zachary Liscow's work on efficiency. Liscow's work shows that efficient legal rules are generally biased towards the rich,[26] and this effect may compound over time.[27] Liscow's work highlights the costs of pursuing efficiency without any wealth redistribution.[28] Taken together, these critiques make clear that the double-distortion argument does not always hold, and the failure to take distribution seriously in designing legal rules may have played a role in growing income inequality.

---

for accidents); Zachary Liscow, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478, 2487 (2014) [hereinafter Liscow, *Reducing Inequality*] (discussing the choice of the appropriate legal rule as an entitlement transfer).

[22] *See* Richard L. Revesz, *Regulation and Distribution*, 93 N.Y.U. L. REV. 1489, 1506–10 (2018) (tracing the extension of the double-distortion argument from common law rules to regulatory policy in the work of Kaplow & Shavell and others).

[23] *See id.* at 1490 ("The dominant academic view with respect to regulatory policy holds that individual regulations should not concern themselves with questions of distribution. Instead, rules should be designed to maximize net benefits—their benefits minus their costs."); CASS R. SUNSTEIN, THE COST-BENEFIT REVOLUTION 42 (2018) ("It is important to see that in general, the best response to unjustified inequality is a redistributive income tax, not regulation—which is a crude and potentially counterproductive redistributive tool."); *see also* Zachary Liscow, *Is Efficiency Biased?*, 85 U. CHI. L. REV. 1649, 1688 (2018) [hereinafter Liscow, *Efficiency*] ("Arguably the most prominent use of efficiency analysis by government actors is that by federal government administrative agencies . . . .").

[24] *See* discussion *infra* Section II.B.

[25] *See* discussion *infra* Section II.C.

[26] Liscow, *Efficiency*, *supra* note 23, at 1651.

[27] Zachary Liscow & Daniel Giraldo Paez, *Inequality Snowballing* 1 (Aug. 29, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3327460) [https://perma.cc/AGZ3-B4GL].

[28] *See generally* Liscow, *Efficiency*, *supra* note 23. Liscow's basic insight, as described in more detail in Sections I.D and II.A *infra*, is that the declining marginal utility of income means policy analysis tied to preference aggregation will generally be biased towards the rich, and this bias can increase over time.

In this Article, I build on this scholarship to show why it is a fundamental mistake to ignore distribution in consumer law.[29] Background legal conditions may create demand for expensive private credit. For example, a welfare state contraction may trigger increased demand for short-term, high-cost loans. Policymakers may seek to intervene in these markets to cure market imperfections, but they will likely run into two objections. The first is that the intervention is inefficient because consumers willingly enter into these transactions aware of the costs and risks.[30] The second is that the intervention is regressive because there will be no redistribution to offset the costs of reducing the supply of expensive private credit. These critiques grow stronger as the welfare state contracts and the cost of credit increases. In this Article, I detail how these critiques shape and constrain the development of consumer law using recent regulatory interventions as examples.[31]

To break free from these constraints, I argue that policymakers must rethink how they justify interventions in consumer financial markets and expand the set of tools they use to address market abuse. Policymakers should consider centering distribution in the way we justify interventions and conceptualize solutions to problems in consumer financial markets. This means examining consumer financial markets to see if cost and access are unequally distributed and intervening in these markets to address unequal distribution (as opposed to merely correcting market inefficiency). In addition, policymakers should consider tools that address the demand for credit and not just the supply of credit. Building on the emerging literature on infrastructure regulation,[32] I sketch out three such tools: rate and term restrictions, mandates, and transfers. Rate and term restrictions are common in

[29] In this sense, my Article is different than recent scholarship on consumer law as a site for redistribution. *See* Van Loo, *supra* note 8, at 213–14; John Linarelli, *Debt in Just Societies: A General Framework for Regulating Credit*, 14 REGUL. & GOVERNANCE 409 (2020) [hereinafter Linarelli, *Debt*]; John Linarelli, *Equality and Access to Credit: A Social Contract Framework*, 84 L. & CONTEMP. PROBS. 165 (2021); *see also* Ramsi A. Woodcock, *Personalizing Prices to Redistribute Wealth in Antitrust and Utility Rate Regulation*, WIS. L. REV. (forthcoming), https://ssrn.com/abstract=3378864 [https://perma.cc/AND3-PPX7] (last visited Sept. 19, 2021). Although I broadly agree with these scholars, my goal is not to convince policymakers and scholars that consumer law is a viable site for redistribution. Instead, my goal is to convince policymakers and scholars that consumer law cannot effectively discipline markets if it ignores distribution.

[30] And, as discussed in Part II *infra*, even if consumers are present-biased, interventions may still be suboptimal under an efficiency framework.

[31] The interventions I explore here concern fringe financial products. But these critiques extend beyond the regulation of fringe finance. For example, you will find similar critiques of attempts to regulate for-profit schools. *See* Anthony J. Guida Jr. & David Figuli, *Higher Education's Gainful Employment and 90/10 Rules: Unintended "Scarlet Letters" for Minority, Low-Income, and Other At-Risk Students*, 79 U. CHI. L. REV. 131, 132 (2012).

[32] *See, e.g.*, K. Sabeel Rahman, *The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept,* 39 CARDOZO L. REV. 1621 (2018); Alan M. White, *Banks as Utilities*, 90 TUL. L. REV. 1241 (2016); Morgan Ricks, *Money as Infrastructure*, 2018 COL. BUS. L. REV. 757 (2018).

consumer law, but mandates and transfers are not.[33] These three are best understood as mutually reinforcing tools that can help consumer law leverage cross-subsidies in consumer financial markets to redistribute resources. The techniques explored here are common regulatory approaches used outside consumer financial markets.[34] And it is time that consumer law formally embrace a broader policy toolkit.

There are several objections one could raise to more distribution in consumer law. One I focus on here is path dependency.[35] In her history of twentieth-century American political economy, Monica Prasad suggests that the development of America's complex public-private financial system may have undermined the development of a European-style welfare state in America.[36] For Prasad, there is a tradeoff between what she terms "mortgage Keynesianism"—social provision through the financial system—and direct social provision through tax-and-transfer.[37] Building on Prasad's work, Abbye Atkinson makes a compelling normative case against credit as a social provision.[38] Credit is an intertemporal transfer (cash or in-kind) between two or more time periods. Per Atkinson, credit can only work as a social provision if a consumer becomes independently wealthier or receives additional public support in the gap between when the consumer receives the transfer

[33] Most states cap interest rates on consumer loans and restrict the terms of these loans. *See* STATE RATE CAPS FOR $500 AND $2000 LOANS, NAT'L CONSUMER L. CTR. (2021), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/FS_State_Rate_Caps_2021.pdf [https://perma.cc/GJ43-EVGZ]; Heather Morton, *Payday Lending State Statutes*, NAT'L CONF. STATE LEGISLATURES (Nov. 12, 2020), https://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx [https://perma.cc/ZF6B-ZR6Q]. Outside the Military Lending Act federal caps on interest rates are less common. *See* 10 U.S.C. § 987 (2019) (establishing an interest rate cap of 36% on most consumer loans to service members to protect from predatory lending practices). Additionally, federal law sets restrictions on the terms of various consumer loans. *See* 26 C.F.R. § 1026.43 (2014) (mortgage loans); 26 C.F.R. § 1026.51 (2013) (credit cards). Some federal banking laws, such as the Community Reinvestment Act, 12 U.S.C. § 2901 (2019), and the Community Development Financial Institutions Act, *Id.* § 4701, include soft and somewhat amorphous mandates. I distinguish these mandates from the ones I am proposing *infra* Section III.B.

[34] *See* John Brooks, Brian Galle & Brendan Maher, *Cross Subsidies: Government's Hidden Pocketbook*, 106 GEO. L.J. 1229, 1231 (2018) (discussing some of the advantages that government created cross-subsidies have over taxes).

[35] Path dependency, as I use it here, is broadly consistent with Jacob Hacker's classic description of the term in the context of welfare design. *See* JACOB S. HACKER, THE DIVIDED WELFARE STATE 9 (2002) ("Small initial differences in circumstances [between public and privately administered social provision] may have large eventual effects as self-reinforcing processes encourage continued reliance on established institutions of [privately administered] social provision.").

[36] *See* MONICA PRASAD, THE LAND OF TOO MUCH: AMERICAN ABUNDANCE AND THE PARADOX OF POVERTY 250 (2012) (postulating that "a set of progressive interventions taken [by the United States] during the early twentieth century produced decidedly non-progressive results").

[37] *Id.* at 221, 227.

[38] Atkinson, *Rethinking*, *supra* note 15.

and must repay the transfer.[39] More recently, Anne Fleming's history of "the private law of the poor" shows that the early development of consumer credit regulation during the *Lochner* era was often explicitly in tension with the expansion of the welfare state.[40]

Taken together, this scholarship should give any person who favors more redistribution in consumer financial markets serious pause. Redistribution of resources in consumer financial markets is unequivocally not a solution to poverty.[41] If redistributive policies in consumer law are used as a wedge to fracture current support for massive expansions of the welfare state, then perhaps the project should be abandoned. But in my view, the path dependency argument proves too much.[42]

It is difficult to draw clear lessons from the complex web of political, social, and economic factors that resulted in the development of the modern American financial system. For example, Prasad's work suggests that development of the progressive income tax was a key component in underwriting American mortgage Keynesianism.[43] Yet few proponents of a robust social safety net would conclude that we should scrap the progressive structure of the income tax because of this fact. Moreover, whether credit can function as social provision turns less on the mechanics of credit as an abstract notion and more on the concrete set of legal obligations tied to the credit relationship.[44]

---

[39] *Id.* at 1098–99.

[40] Anne Fleming, *The Public Interest in the Private Law of the Poor*, 14 HARV. L. & POL'Y REV. 159, 175–79 (2019) (tracing the history of anti-pauperist arguments in favor of credit restrictions).

[41] As Abbye Atkinson explains, "the problem of entrenched and enduring poverty that leaves people consistently unable to afford basic necessities cannot be addressed by a device that requires future prosperity and economic growth." *See* Atkinson, *Rethinking*, *supra* note 15, at 1093.

[42] In Part IV *infra*, I consider a narrower variant of the path dependency argument: that redistributive policies in consumer law might crowd out efforts to radically reshape our financial system.

[43] *See* PRASAD, *supra* note 36, at 253–54. Prasad's historical account, which is summarized in more detail *infra* Part IV, suggests that America failed to develop a robust welfare state because of populist interventions in the early twentieth that sought to break up concentrations of wealth and redistribute resources to agrarians. Per Prasad, these interventions created a consumption-based political economy that was hostile to the kind of flat or regressive taxes common in European welfare states.

[44] For example, in recent scholarship, Atkinson suggests that at least part of the problem with credit as social provision is the distinct way federal law treats credit and debt. Abbye Atkinson, *Borrowing Equality*, 120 COLUM. L. REV. 1403, 1406–07 (2020) [hereinafter Atkinson, *Borrowing*]. Federal policy simultaneously encourages access to credit but discourages defaulting or discharging debt. *Id.* at 1407–09. Per Atkinson, this "acoustic separation" ensures that debt functions as a tool of subordination, which undermines the effectiveness of credit as social provision. *Id.* at 1410. In order to address the problem, Atkinson suggests a uniform approach to credit and debt and more permissive rules around debt discharge might help. *Id.* at 1412.

In other words, I still think there is a strong case for distributionally-oriented consumer law as a complement to expansions of the safety net. There will inevitably be gaps in the potential expansions of our social safety net and public infrastructure, which the private market will exploit.[45] Armed with adequate tools, consumer law can play an important role in curbing some of this abuse.[46] Our recent history shows that efforts to narrowly channel our distributive energy have been rewarded with rising inequality and a shrinking welfare state. The problem of inequality is large and complex. A plural approach to distributional equity may make more sense than the singular approaches of the past.[47]

* * *

The remainder of this Article proceeds in four parts. Part I summarizes the debate surrounding the double-distortion argument. Although the double-distortion argument has been the subject of fierce debate within tax scholarship, the implications of this debate have not been internalized outside tax scholarship. As a result, it is common for scholars writing outside tax or for non-tax audiences to dismiss attempts to use regulation to redistribute income without engaging with the broader critiques of the double-distortion argument.[48] Part II builds on the critiques of the double-distortion argument to show how the argument can stifle the development of law in certain areas. In particular, where the welfare gains from regulatory interventions are small and difficult to measure, and where the underlying market fills in gaps in the social safety net, the double-distortion argument provides critics with a handy framework to oppose interventions as both inefficient and regressive. In Part III, I offer thoughts on what distributionally-oriented consumer law might look like. I consider three policy levers: rate and term restrictions, mandates, and transfers. I briefly sketch how we might use these tools to leverage cross-subsidies in consumer financial markets. I take up the problem of path

[45] We can imagine several kinds of gaps: gaps in substance, gaps in process, and gaps in scope. As a substantive matter, safety net expansions may not reach all Americans, pushing some Americans towards high-cost credit. *See, e.g.,* Fleischer & Hemel, *The Architecture of a Basic Income*, 87 U. CHI. L. REV. 625, 688–89 (2020) (discussing the likelihood that predatory lending will persist when citizens receive UBI). As a procedural matter, there may be gaps in the benefit distribution, which is filled by costly, private intermediaries. *See* Dayen, *supra* note 13 (discussing problems with our current distribution of benefits). Finally, safety net expansions may not address sources of inequality in our present system, such as outstanding debt. *See* Kiel & Ernsthausen, *supra* note 13 (detailing increased debt collection during the pandemic as a result of stimulus payments).

[46] For a discussion of how consumer law can address these problems, see *infra* Part III.

[47] Zachary Liscow, *Redistribution for Realists*, 107 IOWA L. REV. 495 (2022) (calling this a "thousand points of equity" approach).

[48] *See* Fleming, *supra* note 40, at 195–96 ("[T]he past four decades of law and economics scholarship has shown a fundamental flaw in the argument for redistribution through private law."); Hayashi, *supra* 8, at 752 ("Although we might consider regulating the terms of trade in order to affect redistribution between the buyer and the seller, there are compelling arguments that redistribution is best handled through the tax system.").

dependency in Part IV and conclude by considering the institutional implications of more distribution in consumer law.

I. THE DOUBLE-DISTORTION ARGUMENT AND ITS DISCONTENTS

A. The "New" Efficiency Rationale

Should legal rules be used to redistribute resources in society? The prevailing answer to this question in legal scholarship is no: legal rules should focus exclusively on efficiency and ignore distributional equity.[49]

The early literature on the economic analysis of the law provided several rationales for why the law should prioritize efficiency over equity.[50] These classic efficiency rationales included the view that equity was irrelevant or, to the extent equity mattered, corrective transfers through a broad-based tax were better than redistribution through legal rules.[51] The theory was that a broad-based tax can achieve more redistribution than a narrowly tailored legal rule and is less susceptible to manipulation.[52]

Classic efficiency rationales, however, did not resolve the efficiency-versus-equity debate. In 1994, Louis Kaplow and Steven Shavell proposed a "new efficiency rationale," which seemed to permanently tilt the scales towards

[49] *See* Revesz, *supra* note 22, at 1501 (noting that Kaplow & Shavell's argument against non-tax redistribution is extremely influential and widely embraced).

[50] Prioritizing efficiency over equity can be traced back to Progressive Era debates over rate regulation. Realists, such as Robert Hale, who were attempting to apply Fabian rent theory to rate regulation confronted two problems: 1) setting rates at levels that would incentivize production but discourage extraction; and 2) ensuring that marginal borrowers were not priced out of markets. *See* BARBARA H. FRIED, THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT 201–03 (1998). Channeling all redistribution through the tax system was offered as a solution to "the problem of ensuring that producers earn enough to cover the costs of production in industries in which fixed costs are large but marginal costs are small." Woodcock, *supra* note 29, at 18 (crediting this view to Herbert Hotelling). For a discussion on why a pivot back towards rate regulation in consumer law may avoid these problems, see discussion *infra* Section III.A.

[51] *See* Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003, 1006 (2001) ("Justifying this exclusive focus on efficiency has always required adopting at least one of two beliefs: that the distribution of economic well-being has no part in what defines the just society, or that the state possess the knowledge and ability to effect the sort of perfectly corrective transfers that could costlessly and precisely undo any undesired distributional effects of a legal rule."); Ronen Avraham, David Fortus & Kyle Logue, *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 IOWA L. REV. 1125, 1126–27 (2004) ("One of the arguments traditionally offered to support this view is that redistribution through the legal system is by nature more haphazard (in the sense of less comprehensive and less precise) than redistribution through the tax system.").

[52] *See* Sanchirico, *supra* note 51, at 1006.

efficiency.[53] Drawing on foundational principles from optimal tax theory, Kaplow and Shavell argued that the question of whether we should pursue redistribution through legal rules could be reduced to a determination of which of two tax instruments—legal rules or an income tax—is less distortionary.[54]

A central question in optimal tax theory is which tax instruments maximize revenue while minimizing economic distortions.[55] In a perfect world, the state could tax individuals based on their different endowments and tastes in order to achieve vertical and horizontal equity.[56] In practice, however, individuals' endowments and tastes are not directly observable, and the state must rely on indirect proxies such as income or consumption.[57] Relying on indirect proxies is problematic because individuals have some control over these proxy measures.[58] Individuals can reduce their tax liability by changing their behavior (working less or consuming differently).

An early framework for optimal taxation was proposed by Frank Ramsey.[59] To minimize economic distortions, the Ramsey model sets "tax rates on different commodities inversely proportional to the elasticity of demand for a good."[60] Tax rates should be set higher where demand is inelastic and lower where demand is elastic.[61] By tying rates to elasticity, the Ramsey model is arguably regressive: suggesting "tax rates ought to be highest on the necessities of life like food and shelter, and lowest on discretionary luxury purchases like yachts."[62] Moreover, the Ramsey model assumed that different taxes distort behavior in the same way.[63]

A more recent framework comes from Anthony Atkinson and Joseph Stiglitz. The Atkinson and Stiglitz framework suggests that under certain conditions, an income tax may distort behavior differently than an excise tax.[64] The basic argument is that individuals can reduce their tax liability under both an income tax and an excise tax by exchanging taxable labor for untaxable leisure.[65] Thus, both a labor tax

---

[53] *See id.* at 1005–07; Avraham et al., *supra* note 51, at 1127.

[54] *See* Gamage, *supra* note 18, at 73.

[55] *See* A.B. Atkinson & J.E. Stiglitz, *The Design of Tax Structure: Direct Versus Indirect Taxation*, 6 J. PUB. ECON. 55, 56 (1976); *but see* Gamage, *supra* note 18, at 16–17 (noting that distributional equity also matters for optimal tax theory: "[a] government could minimize distortionary costs by levying only lump sum taxes . . . . The reason governments do not typically levy lump-sum taxes is distributional equity").

[56] *See* Atkinson & Stiglitz, *supra* note 55, at 56.

[57] *See id.* ("It is the difficulties associated with observing characteristics which make the theory of taxation an interesting and difficult problem.").

[58] *See* Gamage, *supra* note 18, at 16.

[59] *See* F.P. Ramsey, *A Contribution to the Theory of Taxation*, 37 ECON. J. 47 (1927).

[60] *See* FRIED, *supra* note 50, at 203.

[61] *Id.* ("[T]he less price-sensitive one's desire is for a given good, the less likely one is to be deterred from purchasing it if the price is raised by a tax.").

[62] *Id.* at 204.

[63] *See id.*

[64] *See* Gamage, *supra* note 18, at 23.

[65] *See id.* ("[T]he Atkinson-Stiglitz model introduces a form of consumption—called 'leisure'—that is assumed to be exempt from taxation under all possible tax instruments.").

and an excise tax reduce work incentives and result in a "labor-to-leisure" distortion.[66] Individuals can also avoid an excise tax by "shift[ing] from purchasing higher-taxed consumer goods to purchasing lower-taxed consumer goods."[67] Thus, an excise tax imposes an additional distortion on consumption. This extra distortion or "double distortion" implies that an income tax, which distorts behavior in one dimension, may be preferable to an excise tax, which distorts behavior in two dimensions.[68]

In their now-famous paper, "Why the Legal System is Less Efficient than an Income Tax in Redistributing Income," Kaplow and Shavell extended the Atkinson and Stiglitz framework to legal rules.[69] Viewing legal rules as tax instruments, Kaplow and Shavell argued that redistribution through legal rules distorts labor incentives in the same manner as redistribution through an income tax.[70] But legal rules, like excise taxes, carry an added distortion: changing behavior subject to the legal rule.[71] As such, an efficient legal rule and more redistribution through an income tax are preferable to an inefficient legal rule and less redistribution through an income tax.

Kaplow and Shavell illustrated the basic intuition behind their argument with a simple example. Suppose the government is trying to raise an additional 1% of revenue from the rich to redistribute to the poor.[72] The government has two choices: increase marginal rates for the rich by 1% or modify legal rules to raise an additional 1% of revenue from the rich.[73] For example, the additional revenue could be raised by modifying the efficient strict liability rule for accidents, where individuals pay for the harm they caused, to an inefficient legal rule, where the rich pay more and the poor pay less.[74] As Kaplow and Shavell explained, both the inefficient legal rule and the increased income tax result in the same labor-to-leisure distortion because each is tied to income.[75] One can avoid a higher marginal rate or higher damages by trading labor for leisure.[76] But the inefficient legal rule, like an excise tax, has the added cost of reducing the amount of care below the amount under an efficient regime.[77]

---

[66] *See id.*
[67] *Id.*
[68] *See id.* at 24.
[69] *See id.* at 73 (explaining that Kaplow and Shavell's support for their argument "is an extension of the [Atkinson & Stiglitz] double-distortion argument against the use of luxury excise taxes").
[70] Kaplow & Shavell, *supra* note 18, at 668.
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.* at 669.
[75] *Id.* at 668.
[76] *Id.*
[77] *Id.* at 680.

Kaplow and Shavell's work was initially concerned with inefficient and equitable allocations in private law.[78] But the double-distortion argument has since been extended to regulatory design. And today, it provides the intellectual foundation for the dominant view that regulatory design should focus exclusively on cost-benefit analysis and ignore distribution.[79] Indeed, Cass Sunstein, the leading evangelist of cost-benefit analysis in the legal academy, relies on Kaplow and Shavell's framework to generally argue against using regulation to address distributional concerns.[80] Sunstein's support highlights an important point that is worth emphasizing about the double-distortion argument. The double-distortion argument is not an argument against redistribution but rather an argument in favor of the least distortionary means to redistribute income. Kaplow and Shavell's framework is perfectly compatible with extensive redistribution but requires we use the tax system to redistribute income.[81]

B. Internal Critiques

The double-distortion argument has long been controversial and subject to debate among tax scholars. Internal critiques of the argument generally fall into two categories. First, scholars challenge the assumptions about taxpayer homogeneity and nonseparable preferences that undergird Kaplow and Shavell's framework. Second, even if the assumptions underlying the double-distortion argument are correct, scholars suggest redistribution through a legal rule may be less distortionary and preferable to redistribution through an income tax. David Gamage recently added a third and more foundational critique of the empirical assumptions underlying Kaplow and Shavell's framework.

This section summarizes these internal critiques. At the outset, it is important to note that few scholars suggest we abandon Kaplow and Shavell's framework or conduct most of our redistribution through the legal system. Instead, these internal critiques make clear that the strongest conclusion of the double-distortion argument—we should never redistribute income through legal rules—is unjustified.

---

[78] Kaplow and Shavell offer the example of a tort rule that tied damages to the tortfeasor's income. *Id*. at 669.

[79] *See* Revesz, *supra* note 22, at 1490.

[80] SUNSTEIN, *supra* note 23, at 42.

[81] *See* David A. Weisbach, *Should Legal Rules Be Used to Redistribute Income?*, 70 U. CHI. L. REV. 439, 446–51 (2003).

1. Assumptions and Exceptions

The double-distortion argument rests on two, somewhat-unrealistic assumptions: 1) "taxpayers are homogeneous except in their ability to earn labor income"; and 2) "taxpayer preferences are weakly separable between labor and income."[82] As David Gamage explains, the first "implies that the ability to earn labor income is the only characteristic of taxpayers relevant for distribution."[83] And the second "implies that, for a given level of after-income-tax income, individuals will allocate their disposable income among commodities in the same manner regardless of the level of labor effort required to generate that level of income."[84]

Relaxing these assumptions and recognizing heterogeneity with respect to ability and consumption shows that Kaplow and Shavell's framework may not always hold. Legal rules may be able to "tag" attributes that are associated with ability but difficult to capture with an income tax.[85] For example, redistributing income through tort may capture the harm of pollution in a way an income tax does not. As Zachary Liscow explains, the tax code will treat "an individual who develops asthma as a result of pollution, causing her income to drop from H to L" like all other individuals earning income L.[86] But "[r]edistributing more through the tort 'tags' the asthma-sufferer and compensates for the failure of the tax code to use all available information relevant to redistribution."[87] Similarly, Ronen Avraham, David Fortas, and Kyle Logue argue that taxpayers may be heterogeneous with respect to their ability to take care, even fixing income.[88] In such a case, different care capacities of tortfeasors may change the labor-to-leisure tradeoffs.[89]

Proponents of double distortion recognize that the double-distortion argument may not always hold but continue to advocate for income tax-based redistribution on the grounds that the information on non-income attributes is very difficult to elicit and, therefore, the state should use income as a baseline.[90] It is unclear why this should be true. As Chris Sanchirico explains, all signals of "immutable characteristics of individuals" are imperfect.[91] Because all signals are imperfect,

[82] Gamage, *supra* note 18, at 52. The double-distortion argument rests on several other assumptions, but these two assumptions receive the most attention.

[83] *Id.*

[84] *Id.*

[85] *Id.* at 53; Liscow, *Reducing Inequality*, *supra* note 21, at 2504.

[86] Liscow, *Reducing Inequality*, *supra* note 21, at 2504.

[87] *Id.*

[88] Avraham et al., *supra* note 51, at 1130.

[89] Rich tortfeasors with lower care capacity may optimize their behavior by lowering their income rather than changing their behavior. *See id.* at 1143. To be sure, Avraham, Fortus & Logue do not believe that income redistribution should be done through the legal system, but that Kaplow & Shavell do not provide a robust basis for using the tax system over the legal system.

[90] *See* Gamage, *supra* note 18, at 54.

[91] Sanchirico, *supra* note 51, at 1009.

there is no a priori reason to favor one signal over another.[92] Instead, Sanchirico argues the state should not make assumptions about equity-efficiency tradeoffs with respect to tax instruments and should gather information to make this determination.[93]

Even if the assumptions underlying the double-distortion argument hold, scholars suggest that redistribution through a legal rule may still be appropriate. The double-distortion argument is based on distortions created by income-dependent changes to legal rules (damages explicitly tied to income) but may not reach income-independent changes to legal rules (damages not explicitly tied to income).[94] Redistribution through an income-independent change to a legal rule may be less distortionary than redistribution through the tax code.[95]

In addition, redistribution through an income tax cannot compensate individuals for non-monetary harms.[96] An income tax cannot effectively redistribute income to individuals who experience higher morbidity or other health risks as a result of an efficient legal rule.[97] These harms are easiest to conceptualize when dealing with a polluting factory but may exist in financial markets.[98] Private insurance is theoretically designed to mitigate the costs of these non-monetary harms, but there are large gaps in the private insurance market, and the poor may not be able to afford private insurance.[99] Where an efficient legal rule results in non-monetary harms not protected by private insurance, Liscow and Revesz suggest we should pursue redistribution through a legal rule.

---

[92] *Id*. at 1010.

[93] *Id*.

[94] *See id*. at 1017.

[95] Liscow provides one example: where the efficiency costs of redistribution through an income-independent legal rule are cheaper than redistribution through the tax code. Liscow, *Reducing Inequality*, *supra* note 21, at 2482–83. This generally holds where two rules are equally efficient, but one is more equitable. *Id.* For example, if efficiency does not change under either a strict liability rule or negligence standard, a strict liability rule is preferable because it compensates the victims of pollution below a negligence threshold. *Id.* at 2487. *See* Sanchirico, *supra* note 51, at 1022. Specifically, Sanchirico explains that an efficient legal rule is one that maximizes aggregate utility. *Id.* Because the maximum point of aggregate utility is mathematically the "point where marginal aggregate utility with respect to the legal rule is precisely zero," small departures from the efficient rule that result in substantially more equity will have negligible efficiency costs. *Id.*

[96] Liscow, *Reducing Inequality*, *supra* note 21, at 2505; Revesz, *supra* note 22, at 1512.

[97] Revesz explains that latency and heterogeneity of health harms make the income tax, which "redistributes on an ex post basis, considering losses and gains already realized," ill-suited to compensate non-monetary harms. Revesz, *supra* note 22, at 1513–18.

[98] *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 881–84 (2007) (noting potential health and financial harms that may stem from payday lending); Melissa B. Jacoby, *Does Indebtedness Influence Health? A Preliminary Inquiry*, 30 J.L. MED. & ETHICS 560, 561 (2002).

[99] Liscow, *Reducing Inequality*, *supra* note 21, at 2506.

2. Tax Gaming

David Gamage offers a more foundational critique of the labor-to-leisure distortions Kaplow and Shavell's framework is built around.[100] Gamage explains that the foundational ideas in optimal tax theory were developed at a time when "both the empirical and theoretical literatures offered reason to infer that labor-to-leisure distortions should be a first-order concern for tax design problems."[101] But recent empirical and theoretical literature suggests "that labor-to-leisure distortion may be of only secondary importance."[102]

The principal empirical insight from the public finance literature is that taxpayers do not respond to tax increases by trading labor for leisure but instead respond by gaming the tax system:

> [T]he recent empirical literature finds essentially no evidence that high-income taxpayers significantly reduce their labor effort in response to taxation. In contrast, there is a plethora of evidence documenting that high-income taxpayers respond to taxation through a diverse variety of tax gaming strategies.[103]

Building on empirical and theoretical work in public finance, Gamage proposes a neo-Ramseyian framework to evaluate tax instruments.[104] Rather than assume that one tax instrument[105] is always preferable to all other tax instruments, Gamage suggests policymakers evaluate tax instruments based on the tradeoffs between what Gamage calls "single-instrument" distortions.[106] Single-instrument distortions are distortions that are unique to a tax instrument, such as tax gaming for a labor tax increase or behavioral changes in response to an inefficient legal rule.[107]

Because a labor tax carries single-instrument distortions in the form of tax gaming, policymakers can minimize the magnitude of the distortionary costs of redistribution by redistributing income through multiple tax instruments. The upshot

---

[100] Gamage, *supra* note 18, at 72.

[101] *Id.* at 4.

[102] *Id.* at 5.

[103] *Id.*

[104] *Id.* at 27–29.

[105] Gamage defines a "tax instrument" as "any policy variable that a government might adjust in order to raise revenues or to promote distributional equity," which includes legal rules. *Id.* at 6.

[106] *Id.* at 27–29.

[107] Gamage provides several empirical parameters to evaluate different tax instruments: "(1) the marginal single-instrument distortions that would be generated by adjusting the tax rates of each instrument to be evaluated; (2) the marginal instrument-shifting distortions that would be generated by adjusting the gaps between the effective tax rates of each set of tax instruments to be evaluated; (3) the distributional implications of adjusting the tax rates of each tax instrument to be evaluated; and (4) the marginal overhead costs that would be generated by levying each tax instrument and by adjusting the rates of each tax instrument to be evaluated." *Id.* at 45.

of Gamage's neo-Ramseyian framework as applied to legal rules is that marginal amounts of redistribution through legal rules are preferable to relying exclusively on the tax system.[108]

(a) Political Constraints and the Invariance Hypothesis

Outside the tax literature, scholars have criticized the double-distortion argument on several grounds.[109] The simplest and most compelling external critique is the political impediments to redistribution.[110] Put simply, there has been no tax redistribution to offset the distributional costs of efficiency. Complaints that Kaplow and Shavell ignore the political impediments to redistribution are not new.[111] In fact, Kaplow and Shavell address and largely dismiss these concerns in their original 1994 article:

> An argument sometimes offered in favor of redistribution through legal rules is that the tax system falls short of optimal redistributive taxation—perhaps because of the balance of political power in the legislature. This argument raises questions that we do not seek to address about the function of courts in a democracy. In any case, it seems unlikely that courts can accomplish significant redistribution through the legal system without attracting the attention of legislators.[112]

Lee Fennell and Richard McAdams show that Kaplow and Shavell make similar arguments in later works.[113] Fennell and McAdams argue that Kaplow and Shavell's rejection of political constraints as a valid objection to their framework highlights an implicit assumption that is central to the double-distortion argument: "the distributive pattern in a society will be invariant to the political form of redistribution."[114]

Fennell and McAdams term this the invariance hypothesis.[115] The invariance hypothesis consists of two separate claims about political invariance. The first, what Fennell and McAdams term "aspirational invariance," is "the claim that any effort

---

[108] *Id.* at 72.

[109] *See generally* Richard S. Markovits, *Why Kaplow and Shavell's "Double-Distortion Argument" Articles are Wrong*, 13 GEO. MASON L. REV. 511 (2005) (arguing against Kaplow and Shavell's framework on moral and other grounds); *see also* Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653 (1998) (challenging the assumptions under the double-distortion argument on behavioral grounds).

[110] *See* Revesz, *supra* note 22, at 1492–93.

[111] Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051, 1074 n.69 (2016).

[112] Kaplow & Shavell, *supra* note 18, at 675.

[113] Fennell & McAdams, *supra* note 111, at 1074–76.

[114] *Id.* at 1069–70.

[115] *Id.* at 1055.

to use legal rules to *improve* distribution (according to some metric) beyond the level indicated by the current political equilibrium will be countered by an adjustment to the tax-and-transfer system that will return distribution to its baseline condition."[116] The second, what Fennell and McAdams term "corrective invariance," is "the claim that a legal rule or policy that *worsens* distribution (according to some metric) will not have any lasting unwanted effect on distributive results because it will be corrected through tax-and-transfer."[117]

Fennell and McAdams argue that the invariance hypothesis is not ancillary to Kaplow and Shavell's framework but the "logical linchpin" of the move from formal superiority of the tax system to prescriptive superiority of the tax system.[118] Because Kaplow, Shavell, and other law and economics scholars are largely agnostic about distribution, prescriptive tax superiority can only be justified on the grounds "that any distributive pattern that is politically achievable at all can . . . be achieved through the tax system."[119] If the converse were true, then a distributive outcome through a legal rule might be superior to a distributive outcome through the tax code due to political constraints. But, per Kaplow and Shavell, a superior distributive result outside the tax system will ultimately be undone by the state because a society's distributive equilibrium is fully captured by its tax system.[120]

The invariance hypothesis is plainly false. With respect to corrective invariance, there is little evidence that we redistribute income through the tax system to correct for inequality in the legal system.[121] Indeed, as Fennell and McAdams note, "the tax-and-transfer system has not generally adjusted over time to correct for changes in the national income distribution."[122] And the major changes to the tax law have been regressive and contractionary as opposed to progressive and expansionary.[123] With respect to aspirational invariance, there is little evidence that policymakers undo redistribution outside the tax system. In fact, empirical evidence suggests the opposite is true: that distributional effects are sticky and are not undone legislatively.[124]

---

[116] *Id.* at 1077.

[117] *Id.*

[118] *Id.* at 1070.

[119] Fennell & McAdams, *supra* note 111, at 1071.

[120] *See id.* at 1057.

[121] *Id.* at 1080 (noting that while "[i]t is . . . possible that Congress responds nimbly through tax policy to distributive changes that emanate from legal rules . . . it is difficult to imagine the set of institutional features that would produce such a pattern").

[122] *Id.* at 1079.

[123] David Kamin, David Gamage, Ari Glogower, Rebecca Kysar, Darien Shanske, Reuven Avi-Yonah, Lily Batchelder, J. Clifton Fleming, Daniel Hemel, Mitchell Kane, David Miller, Daniel Shaviro & Manoj Viswanathan, *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1441, 1487 (2019) (stating that the 2017 tax legislation, "the most expansive tax legislation in decades," was largely regressive, with major reductions in corporate and income taxes).

[124] *See* Zachary Liscow, *Are Court Orders Sticky? Evidence on Distributional Impacts from School Finance Litigation*, 15 J. EMPIRICAL LEGAL STUD. 4, 6 (2018).

(b) Efficiency's Costs

The most serious challenge to Kaplow and Shavell's framework comes from Liscow's work on efficiency.[125] Liscow's work shows that pursuing efficiency in legal rule design and ignoring distribution has costs.[126] Efficiency carries a systemic bias towards the rich.[127] If the distributional inequity of efficiency is not offset by redistributive tax policy, then efficiency's costs can compound over time and expand the wealth gap.[128]

Liscow's work raises the question of what the distributional consequences of efficient policies are. To answer that question, Liscow first explains the way efficiency is defined in the law and economics literature. Efficiency typically means Kaldor-Hicks ("K-H") efficiency, which "measures the willingness to pay of the parties affected by various policy options and then chooses the policy that maximizes the sum of the willingness to pay of those parties."[129] K-H efficiency "seeks the arrangement of goods, services, and externalities" that, given existing wealth distribution, maximize surplus.[130] Unlike Pareto efficiency, K-H efficiency is satisfied if a set of policies increases the economic pie but leaves some individuals worse off.

To evaluate the distributional consequences of efficient policies, Liscow introduces a simple taxonomy of distributional outcomes—efficient policies can be neutral, rich-biased, or poor-biased:

> *Neutral* efficient policies do not change the distribution of legal entitlements to individuals as their income increases. *Rich-biased* efficient policies distribute *more* of a legal entitlement to individuals as their income increases. *Poor-biased* efficient policies distribute *less* of a legal entitlement to individuals as their income increases.[131]

Liscow shows that efficient policies are often rich-biased because efficiency measures willingness to pay. The intuition behind this result can be explained in terms of utility. A good is rich-biased if "the marginal utility of consumption decreases with income more rapidly than the marginal utility of the good decreases with income."[132] Conversely, a good is poor-biased if the marginal utility of consumption decreases with income less rapidly than the marginal utility of income.[133] In simpler terms, "as a person's income increases, her willingness to pay for a good is measured by how much she would rather have another unit of that good

[125] Liscow, *Efficiency*, *supra* note 23.
[126] *Id.*
[127] *Id.* at 1656.
[128] Liscow & Paez, *supra* note 27.
[129] Liscow, *Efficiency*, *supra* note 23, at 1658.
[130] *Id.* at 1658–59.
[131] *Id.* at 1667.
[132] *Id.* at 1682.
[133] *Id.* at 1707.

versus another dollar."[134] Because of the declining marginal utility of income, the rich are generally more willing to pay for things. For an efficient policy to be poor-biased, the poor must gain more utility than the rich, which can only happen if the rich derive very little utility from a policy.

Liscow gives examples of rich-biased policy, which includes public spending on pharmaceutical research, road safety, law enforcement, voting, and transportation.[135] In fact, policies that rely on efficiency analysis, such as regulatory cost-benefit analysis, often display a bias towards the rich.[136] Liscow illustrates this point by describing the procedure the Department of Transportation ("DOT") uses to allocate funds. DOT relies on the value of time travel savings ("VTTS") to determine how to allocate transportation funds. Under this approach, more funds are allocated for air and high-speed rail than other modes of transportation. As a DOT memorandum explains: "Since these modes charge higher fares to travelers who place a greater value on time saving, it is reasonable to derive a distinct VTTS from the higher incomes of their passengers."[137]

Recent work from Liscow and Daniel Paez suggests that the costs of rich-biased efficient policies can compound over time.[138] The basic idea is that the costs of rich-biased policies pursued in period one will be more severe in subsequent periods if there are no distributional offsets. To illustrate this point, Liscow and Paez return to the familiar example of a polluting factory operating under a strict liability regime. In period one, the factory must decide whether to locate in a rich neighborhood or a poor neighborhood.[139] Because damages in the poor neighborhood will be lower than in the rich neighborhood, the factory chooses to locate in the poor neighborhood.[140] In period two, a new factory must decide between the rich and poor neighborhood. Because wages in the poor neighborhood are lower because of pollution, the factory chooses the poor neighborhood, further depressing wages.[141] The cycle continues in subsequent periods leading to what Liscow and Paez term "inequality snowballing."[142]

II. EFFICIENCY AND PREDATION: THE PROBLEM OF FRINGE FINANCE

Critics of the double-distortion argument generally do not suggest we abandon efficiency as the touchstone for regulatory design. Instead, they propose modest measures to introduce equity into the analysis.[143] In this Part, I sketch out why we

[134] *Id.* at 1682.
[135] Liscow, *Efficiency*, *supra* note 23, at 1674–76.
[136] *See id.* at 1688.
[137] *Id.* at 1690.
[138] Liscow & Paez, *supra* note 27.
[139] *Id.* at 2.
[140] *Id.* at 3.
[141] *Id.*
[142] *Id.* at 2.
[143] Gamage proposed a neo-Ramseyian framework. *See infra* Section II.B.3; Fennell

should abandon efficiency as the primary touchstone for regulatory design in consumer financial markets. To make this case, I build on Liscow's observation that initial resource allocations can affect allocations in subsequent periods.

If DOT allocates more transportation resources to a rich neighborhood in period one, living standards in a poor neighborhood may decline. In period two, DOT is likely to allocate even more resources to the rich neighborhood because the rich are more willing to pay, and the poor are less willing (or able) to pay. In consumer financial regulation, the issue is often deallocation or deregulation. In period one, public assistance to the poor is cut back. Fringe financial products emerge to fill in gaps in the social safety net. In period two, policymakers attempt to rein in "predatory" practices by fringe financiers. But, for the reasons explained below, these interventions could be inefficient and diminish aggregate utility. Inter-period redistribution can change these dynamics. But if there is no inter-period redistribution and policymakers are bound by efficiency, the initial decision to allocate or deallocate resources can become entrenched.[144]

In this Part, I explain how initial decisions to deallocate resources structure the boundaries of policymaking in subsequent time periods.

A. Inferiority and Marginal Utility

As explained in Part I, a good is poor-biased if the marginal utility of consumption decreases with income less rapidly than the marginal utility of the good. Because of the declining marginal utility of income, poor-biased goods are exceedingly rare. Liscow explains, "poor-biased goods are equivalent to what economists term 'inferior' goods, for which demand increases as income decreases."[145] As an example, bus-based transportation could be an inferior good because an individual's willingness to pay likely increases as the individual's income decreases.

Although inferior goods are generally uncommon, products resembling inferior goods (though not goods themselves) are common in fringe financial markets. Payday loans, title loans, pawn loans, and bail bonds primarily exist to meet the needs of poor consumers. These products generally do not have rich analogs, and rich consumers derive virtually no utility from the existence of these products. The existence of products with the properties of inferior goods poses a problem for

---

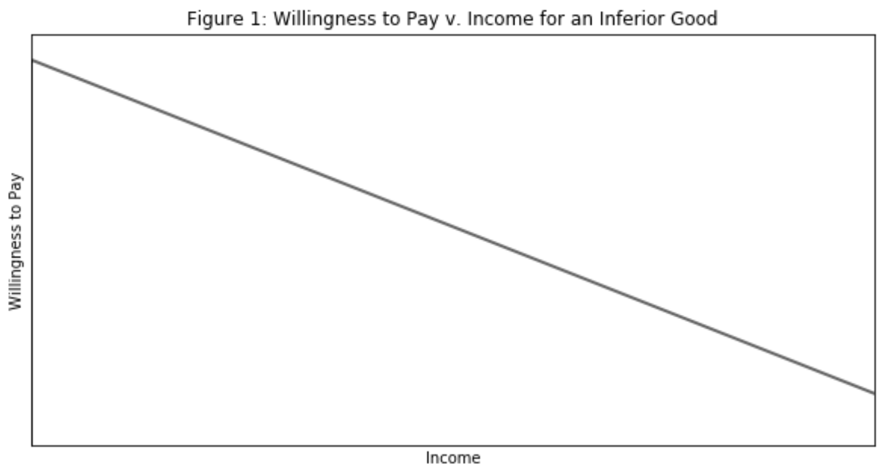
and McAdams propose further research to determine when political action costs favor redistribution outside tax-and-transfer. Fennell & McAdams, *supra* note 111, at 1124. Liscow proposes a simple decision tree for distributionally informed efficiency analysis. Liscow, *Efficiency*, *supra* note 23, at 1695. If a policy is rich-biased and the distributional consequences are sticky, the policymaker should adopt an inefficient policy that is distributionally neutral. *Id.* If the policy is neither rich-biased nor are the distributional consequences sticky, then the policymaker can adopt the efficient policy without modification. *Id.*

144 The emergence of payday loans and debate around the regulation of payday loans largely captures these dynamics. *See infra* Section II.B.

145 Liscow, *Efficiency*, *supra* note 23, at 1678.

policymakers who seek to regulate fringe financial markets within an efficiency framework.

Because demand for inferior goods is inversely related to income, the poor are generally more willing to pay for inferior goods than the rich. *Figure 1* shows consumer willingness to pay as a function of income for an inferior good:[146]



As *Figure 1* shows, richer consumers are generally less willing to pay for inferior goods and derive much less utility from inferior goods. Thus, rich consumers prefer to keep their income because the marginal utility of income is greater than the negligible utility of inferior goods.

Figure 1 suggests that the relationship between income and willingness to pay for an inferior good or product with inferior good-like properties is linear. But this is likely incorrect. Demand may be discontinuous at the point where cheaper alternatives exist. For example, demand for private transportation may be lower where public substitutes exist. Similarly, demand for high-cost, small-dollar credit may be lower where low-income consumers are eligible for public assistance. We can represent this discontinuity graphically by introducing a "Safety Net" block at the bottom of the income distribution.

[146] *Id.* at 1716.

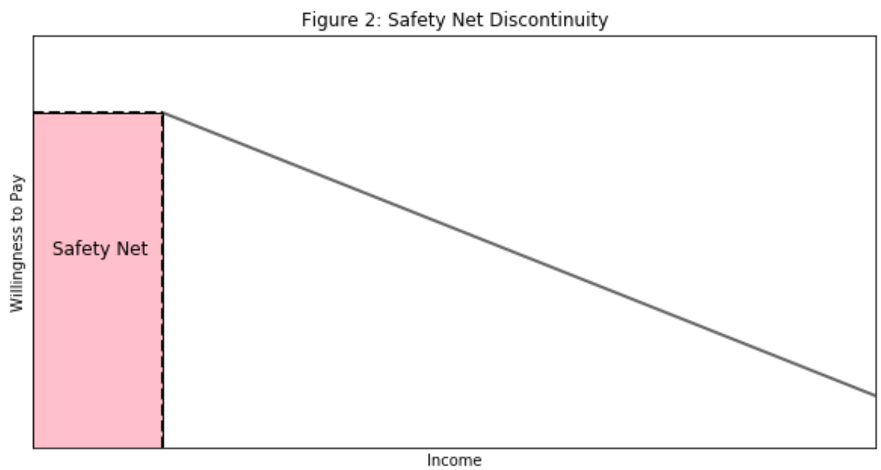
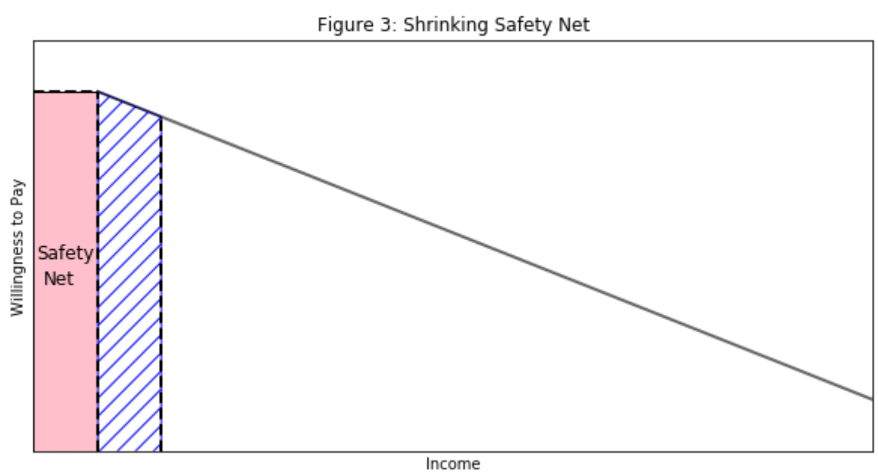


Figure 2 suggests that the relationship between willingness to pay and income for an inferior good or product with similar properties is discontinuous at the point where the public safety net's protections are triggered. Low-income consumers eligible for public assistance are unwilling to pay for private substitutes. What happens when the welfare state contracts? *Figure 3* shows a shrinking safety net with private substitutes replacing public assistance.



We can think of *Figure 2* and *Figure 3* as representing two sequential periods in a policymaking world. In the first period, represented by *Figure 2*, the safety net eliminates demand for a particular inferior good at the lowest-income deciles. In the second period, represented by *Figure 3*, the safety net shrinks and serves only the lowest-income consumers. Because there are no offsetting public transfers, safety net reductions generate new demand for private substitutes.

Any regulation that sets out to decrease the availability of private substitutes after the second period runs the risk of being criticized as inefficient. The basic argument is that because the poor are generally willing to pay quite a lot for these private substitutes, restricting access may diminish aggregate utility. Somewhat perversely, as *Figures 2* and *3* suggest, efficiency-based arguments against the regulation of inferior-like goods grow stronger as the welfare state contracts and demand for these products increases.[147]

As an example, assume the state shrinks cash transfers to the poor by a marginal amount. This marginal decrease in welfare triggers a marginal increase in demand for extremely expensive, short-term loans known as "fast cash loans."[148] Because interest rates generally reflect risk and risk is negatively correlated with income, the annual percentage rate ("APR") for fast cash loans was 350% prior to the welfare contraction.

Following the welfare contraction, fast cash lenders expand access to fast cash loans to meet the resulting new demand. Although risk is negatively correlated with income, the relationship is not necessarily linear. Small decreases in income, particularly at the lower end of the income spectrum, may be associated with very large increases in credit risk.[149] As a result, the new fast cash loans carry an APR of 1,000%. Pesky consumer advocates argue the rates for these new fast cash loans are predatory and push for legislation capping the interest rate on fast cash loans. The industry fights back: the new fast cash loans may be expensive but reflect the revealed preferences of poor consumers. Moreover, the added premium reflects a real increase in credit risk that poor consumers are willing to pay for. Restricting access to fast cash loans will diminish aggregate utility.

Substitute payday loans or title loans for fast cash loans, and you have the basic contours of the debates over regulation in consumer law. Consumer advocates and scholars generally respond to efficiency arguments by attempting to demonstrate that regulation will not diminish aggregate utility.[150] The market may not reflect

---

[147] An interest rate cap issued after the contraction in the social safety net (*Figure* 3) may diminish aggregate social surplus more than the same cap prior to the contraction (*Figure 2*), because there is no inter-period redistribution to absorb the additional demand (represented by the blue-shaded region in *Figure 3*). As a result, certain consumers will either be shut of credit markets with offsetting transfers or forced to obtain costlier substitutes they derive utility from. It is important to note that there is some debate in the literature about substitution effects. *See* Angela K. Littwin, *Testing the Substitution Hypothesis: Would Credit Card Regulations Force Low-Income Borrowers into Less Desirable Lending Alternatives?*, 2009 U. ILL. L. REV. 403, 418–19 (2009). My purpose here is not to suggest that interest rate caps will necessarily result in diminished aggregate utility but rather to illustrate how these assumptions structure debates over the wisdom of consumer credit regulation.

[148] Or, more accurately, Fa$t Ca$h Loan$.

[149] *See* Stefania Albanesi, Giacomo De Giorgi & Jaromir Nosal, *Credit Growth and the Financial Crisis: A New Narrative*, 17–18 (Nat'l Bureau of Econ. Rsch., Working Paper No. 23740, 2017) (discussing the relationship between income and credit risk); *but see* Rachael Beer, Felicia Ionescu & Geng Li, *Are Income and Credit Scores Highly Correlated?*, FED. RESERVE (Aug. 13, 2018), https://www.federalreserve.gov/econres/notes/feds-notes/are-income-and-credit-scores-highly-correlated-20180813.htm [https://perma.cc/FGV2-JC79].

[150] *See infra* Section II.B.3.

actual revealed preferences because consumers are present-biased or overly optimistic. But the evidence that consumers are present-biased or overly optimistic might be thin.[151]

And even if consumers are present-biased, critics argue this may not be bad. If a present bias encourages consumers to overconsume goods they undervalue, then market-corrective interventions could be regressive. These regulations will likely limit access to credit for some consumers. The consumers shut out of credit markets are most likely at the bottom of the income spectrum and the ones who benefit the most from expensive products with complex price structures. Because there will be no redistribution through the tax system to offset these costs, critics contend that any regulation of fringe finance is arguably both inefficient and regressive.

The following sections show how these dynamics play out in debates over the regulation of payday loans and refund anticipation loans.

B. Payday Loans

Payday loans are small loans extended for short terms at a very high cost.[152] Payday loans are typically directly or indirectly tied to a consumer's paycheck, and the term for a conventional payday loan is fourteen days or the time between a consumer's paydays.[153] The annualized cost of a payday loan can be quite high: from 391% to well over 1,000%.[154] Although payday loans are formally short-term, they are functionally longer-term, revolving lines of credit. Payday loans are typically rolled over by consumers multiple times and are best understood as a high-cost alternative to credit cards or bank overdrafts.[155]

In his 1996 book on elite dissensus over Aid to Families with Dependent Children ("AFDC"), Steven Teles observed that "[d]espite the relatively modest amounts the nation spends on AFDC, welfare is one of the most ideological, emotional, and contentious issues in U.S. politics today."[156] Much the same can be said about payday loans today. Payday loans account for a relatively small slice of

---

[151] *See infra* Sections II.B.2 and II.B.3.

[152] *See What Is a Payday Loan?*, CFPB (June 2, 2017), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/ [https://perma.cc/2T2Z-2LCP].

[153] *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472, 54,477 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

[154] *See id.* (noting that the median storefront payday loan fee is $15 per $100 borrowed, which results in an annualized cost of credit of 391% for a fourteen-day loan); *see also* King *ex rel.* v. B&B Inv. Group, Inc., 329 P.3d 658, 662 (N.M. 2014) (noting that defendants' loan products carried APRs between 1,147.14% and 1,500%).

[155] *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. at 54,484; Robert DeYoung & Ronnie J. Phillips, *Payday Loan Pricing* 6 (Fed. Rsrv. Bank Kan. City Econ. Rsch. Dep't, Working Paper, RWP 09-07, 2009) ("The centrality of the bank account in the payday loan production function suggests that the closest competitive substitutes for payday loans are not the products offered by fringe financiers, but the overdraft protection offered by mainstream banks, thrifts, and credit unions.").

[156] STEVEN M. TELES, WHOSE WELFARE? AFDC AND ELITE POLITICS vii (1996).

the overall consumer financial market.[157] Despite its modest market share, the regulation of payday loans, like the reform of AFDC three decades ago, is one of the most ideological, emotional, and contentious issues in consumer law.[158] Much like AFDC received disproportionate attention from poverty law scholars relative to its size, payday loans receive disproportionate attention from consumer law scholars.[159]

The disproportionate scholarly attention to the regulation of payday loans stems in part from the extreme facts surrounding these transactions. Consider the following description of a consumer transaction from a recent case:

> One borrower, Oscar Wellito, testified that he took out a signature loan from Defendants after he went bankrupt. He was supporting school-aged children while trying to service debt obligations with two other small loan companies. He earned about $9 an hour at a Safeway grocery store, which was not enough money to make ends meet, yet too much money to qualify

[157] In 2018, combined storefront and online payday loan volume was $29.2 billion. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 85 Fed. Reg. 44,382, 44,384 (July 22, 2020) (to be codified at 12 C.F.R. pt. 1041). By comparison, outstanding non-household debt the same year was $4.01 trillion. *See Household Debt and Credit Report,* FEDERAL RESERVE BANK OF NEW YORK: CENTER FOR MICROECONOMIC DATA, https://www.newyorkfed.org/microeconomics/hhdc [https://perma.cc/JUB4-2X2D] (last visited Sept. 15, 2021).

[158] *See* Atkinson, *Rethinking*, *supra* note 15, at 1106 ("The debates over how best to provide credit to high-risk, low-income borrowers and, relatedly, how best to regulate the fringe lenders who are most likely to lend to such borrowers, have been particularly vociferous with regard to payday lending."); LISA SERVON, THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES 81 (2017) ("Payday loans are perhaps the most hotly debated topic in the area of consumer financial services.").

[159] *See, e.g.*, Yonathan A. Arbel, *Payday*, 98 WASH. U. L. REV. 1 (2020) (excavating the legal architecture behind a bi-weekly paycheck system that pushes low-wage workers into payday loans); Jim Hawkins, *Earned Wage Access and the End of Payday Lending,* 101 BOS. U. L. REV. 705 (2021) (examining the virtues of earned wage access products as a less costly alternative to payday loans); Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, 62 J. L. & ECON. 485 (2019) (suggesting that payday lending leads to increased personal bankruptcy claims); Jacob Hale Russell, *Misbehavioral Law and Economics*, 51 U. MICH. J. L. REFORM 549 (2018) (analyzing the problem of heterogeneous preferences in payday loan regulation); Julia Merton, *Payday Lending and Its Regulation*, 36 REV. BANKING & FIN. L. 52 (2016) (describing a proposed CFPB rule to curtail payday lending); Chrystin Ondersma, *A Human Rights Approach to Consumer Credit*, 90 TUL. L. REV. 373 (2015) (applying a human-rights framework to the regulation of small-dollar, high cost loans); Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563 (2010); Christopher L. Peterson, *Usury Laws, Payday Loans, and Statutory Sleight of Hand: Salience Distortion of American Credit Pricing Limits*, 92 MINN. L. REV. 1110 (2008); Mann & Hawkins, *supra* note 98; Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 OHIO ST. L.J. 653 (2005); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002).

> for public assistance. "That's why," he testified, "I had no choice of getting these loans, to feed my kids, to live from one paycheck to another paycheck." He needed money for groceries, gas, laundry soap, and "whatever we need to survive from one payday to another payday." Mr. Wellito borrowed $100 from Defendants. His loan carried a 1,147.14 APR and required repayment in twenty-six biweekly installments of $40.16 with a final payment of $55.34. Thus, the $100 loan carried a total finance charge of $999.71.[160]

Analyzing extreme transactions such as Mr. Wellito's can help us think through foundational descriptive and normative questions in consumer law.[161] Why were Mr. Wellito's options constrained in this manner? What accounts for the structure and features of the market for small-dollar, high-cost loans? Should the law intervene to set this transaction aside? Why? If the law has no role in this transaction, when does the law have a role?

Efficiency analysis instructs us to ignore this rich set of questions. Instead of questioning the structure and shape of consumer financial markets, we should limit our inquiry to one question: does Mr. Wellito want this loan? If the loan is a private substitute for welfare and has the properties of an inferior good, the answer is almost certainly yes. The next sections discuss payday loans as welfare substitutes, the empirical literature on payday lending, and the debate over the CFPB's Payday Rule.

1. Payday Loans as Welfare Substitutes

Small loans secured by a consumer's income are not new. At the turn of the twentieth century, there was a growing unregulated market for fringe financial products such as chattel loans, salary loans, and salary purchases.[162] These early antecedents to modern payday loans flourished in dense, urban centers and were often structured to evade strict state usury laws.[163] The early and unregulated market for fringe finance was eventually brought within the scope of state law, and demand for expensive small loans appeared to diminish.[164]

The modern iteration of payday lending began in the late 1980s at check-cashing stores.[165] Check cashers began accepting "deferred presentment checks"—

---

160 King *ex rel.* v. B&B Inv. Group, Inc., 329 P.3d 658, 664 (N.M. 2014) (finding the products at issue in the case were longer-term loans the defendants offered to evade state payday lending restrictions).

161 *But see* Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 679–81 (2011) (describing tales of consumer misfortune as "trouble stories" and doubting the value of these anecdotes as a basis for regulation).

162 *See* ANNE FLEMING, CITY OF DEBTORS: A CENTURY OF FRINGE FINANCE 13 (2018).

163 *See id.*

164 As Fleming explains, the decline in small-sum lending was likely a function of both changing demand and rising costs that made this kind of lending under then existing regulations less profitable. *Id.* at 225–28.

165 *See id.* at 237–38.

post-dated checks that were cashed by the store for a discount.[166] The checks were often post-dated for fourteen days or the length of time between pay periods.[167] The discount between the amount of the post-dated check and the amount the consumer received reflected interest.[168] Deferred presentment checks eventually morphed into the modern varieties of payday loans.[169]

Since the 1990s, the payday lending industry has experienced rapid growth with "payday loan volume expand[ing] fivefold to almost $50 billion from the late 1990s to the mid-2000s . . . ."[170] Although this growth has slowed down in recent years, recent data suggests that demand for and consumption of payday loans remain quite high.[171] Why did payday loans seem to disappear in the middle of the twentieth century and then reemerge in the late 1980s?

One answer is that early-twentieth-century payday lending was a relatively modest industry. There are moral hazard and adverse selection risks associated with payday lending, and the original payday lenders lacked the tools to adequately screen potential borrowers.[172] Technological innovations such as credit scoring in the middle of the twentieth century may have "substantially mitigated these costs" and led to the reemergence and growth of payday lending.[173] In addition, the American consumer economy was less developed in the early twentieth century,[174] and perhaps there was just less demand for payday loans.

The more conventional account is the reemergence of payday lending was a product of financial deregulation in the 1970s and 1980s.[175] Per this account, the financial needs of low-income individuals were served by a diverse array of financial institutions during much of the twentieth century. These institutions, which included

---

[166] *See id.*

[167] *See id.* at 238.

[168] *See* Commonwealth v. Bar D Fin. Servs, Inc., 32 Va. Cir. 429, 430–31 (1994).

[169] *See id.* at 238–44.

[170] Neil Bhutta, Paige Marta Skiba & Jeremy Tobacman, *Payday Loan Choices and Consequences*, 47 J. MONEY, CREDIT & BANKING 223, 227 (2015).

[171] *See* Hunt Allcott, Joshua Kim, Dmitry Taubinsky & Jonathan Zinman*, Are High-Interest Loans Predatory? Theory and Evidence from Payday Lending* 6 (Nat'l Bureau of Econ. Rsch., Working Paper No. s28799, 2021) ("In 2016, Americans borrowed $35 billion from storefront and online payday lenders, paying $6 billion in interest and fees.").

[172] *See* DeYoung & Phillips, *supra* note 155, at 4 (describing that in the early 1900s payday lending "was limited in scope, because lenders required soft information about the financial health of employers and the creditworthiness of employees in order to reduce the costs of adverse selection and moral hazard").

[173] *Id.* at 4–5.

[174] THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN & TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY 5 (2014) (explaining that "[t]here simply were few needs before the 1920s" for consumer credit and that "[m]uch of the demand for consumer credit arose with the development of urbanization, mass production of consumer goods, and growth of the middle class" after World War II).

[175] *See, e.g.*, Barr, *Banking*, *supra* note 13, at 152; Mehrsa Baradaran, *How the Poor Got Cut Out of Banking*, 62 EMORY L.J. 483, 487 (2013) [hereinafter Baradaran, *Poor*]; FLEMING, *supra* note 162, at 235–40.

credit unions, savings and loans, industrial loan companies, personal finance companies, and traditional banks, decreased demand for predatory and unregulated "loan sharks."[176] The emergence of new financial instruments and institutions in the middle of the twentieth century (e.g., credit cards, home equity lines of credit, and money market mutual funds), however, fundamentally unsettled this balance.[177]

Facing increased competition, banks put pressure on Congress to eliminate restrictions on deposits and lending.[178] Congress, aided by the Supreme Court, responded to this pressure with a number of deregulatory moves in the 1970s and early 1980s that fundamentally altered the consumer financial landscape.[179] The initial deregulation of consumer financial markets had two consequences. First, conventional financial institutions (such as credit unions) that previously served low-income communities faced intense competitive pressure as a result of banking deregulation.[180] These institutions responded by dropping services for low-income consumers and pushing federal and state governments for further deregulation.[181] Second, less conventional financial institutions (such as personal finance companies) abandoned low-income communities for newer and more profitable opportunities created by deregulation.[182] Thus, deregulation precipitated an unraveling of traditional financial services for low-income consumers. Payday lenders stepped into this financial vacuum to serve the needs of low-income consumers.

The deregulation story is a compelling one, but it suggests that welfare state contractions played little role in the recent growth of payday loans. There are some reasons to doubt this is true. First, the growth in payday lending lagged financial deregulation by over a decade. Although payday loans emerged in the late 1980s, much of the growth in the industry took place in the late 1990s and early 2000s.[183] This growth tracks reductions in the welfare state, culminating in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 ("PRWORA"),

---

[176] *See* Baradaran, *Poor*, *supra* note 175, at 486–87; FLEMING, *supra* note 162, at 231–35.

[177] *See* FLEMING, *supra* note 162, at 231–35 (discussing the growth of credit cards and home equity lines of credit); Baradaran, *Poor*, *supra* note 175, at 514–15 (describing the emergence of money market mutual funds and deregulatory pressure).

[178] *See* FLEMING, *supra* note 162, at 228–31.

[179] *Id.* (describing the Supreme Court's interpretation of the preemptive scope of the National Bank Act in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), and deregulatory efforts that followed to level the playing field between federal and state-chartered banks); *see also* Baradaran, *Poor*, *supra* note 175, at 515 (describing efforts to repeal Regulation Q).

[180] Baradaran chronicles the competitive pressure credit unions, savings & loans, and industrial loan companies faced from traditional banking and the resulting deregulation of the financial markets. Baradaran, *Poor*, *supra* note 175, at 505–09, 514–19, 523–26.

[181] *See id.*

[182] *See* FLEMING, *supra* note 162, at 231–35 (discussing the pivot of personal finance companies towards credit cards and home equity lines of credit during the deregulatory era).

[183] *See* Bhutta et al., *supra* note 170, at 277.

which replaced AFDC with Temporary Aid for Needy Families ("TANF").[184] AFDC was a means-tested program that provided monthly cash assistance to families with limited restrictions.[185] TANF, by contrast, was designed to have a much smaller footprint. TANF "imposed lifetime limits on receiving aid, subjected able-bodied participants to work requirements, incentivized states to cut welfare rolls, and transformed welfare into a block grant program that gave states wide flexibility in how they spend welfare funds."[186] These restrictions dramatically reduced enrollment such that "the public safety net is by many accounts dead."[187]

Second, Prasad's analysis of the demand for credit in advanced industrial economies suggests that there is an inverse relationship between the size of the welfare state and demand for credit.[188] Per Prasad, "deregulation is associated with a higher demand for credit in countries where the welfare state is less well developed but not in countries where the welfare state is well developed."[189] To be sure, Prasad's analysis does not suggest that deregulation is irrelevant but that both deregulation and the size of the welfare state impact the demand for credit. As Prasad explains:

> If the rise of credit were simply a response to the easier availability of credit rather than to demand for credit, deregulation would lead to a similar rise in credit in developed welfare states. Because it does not, we may conclude that deregulation *allows* the credit-welfare state trade-off to emerge: regulation suppresses credit in less well-developed welfare states, while deregulation allows the credit-financed consumption of goods and services that would be provided by the welfare state elsewhere.[190]

Prasad is not strictly looking at payday loans. Prasad's analysis is based on household debt across advanced industrial economies.[191] But there is some empirical and administrative data that suggests a negative correlation between the availability of cash transfers and the demand for payday loans. Paige Skiba finds some evidence that the availability of small tax rebates may diminish short-run demand for certain

---

[184] Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996) (codified in scattered sections of 42 U.S.C.).

[185] *See* Sara Sternberg Greene, *The Bootstrap Trap*, 67 DUKE L.J. 233, 244 (2017) [hereinafter Greene, *Bootstrap*].

[186] *Id.* at 236.

[187] *Id.* at 236–37 (noting that the number of welfare recipients dropped 81 percent from 14.2 million in 1994 to 2.7 million in 2016).

[188] *See* PRASAD, *supra* note 36, at 235.

[189] *Id.*

[190] *Id.* (internal citation omitted).

[191] *Id.* at 229 (using "household debt minus household assets as a percent of GDP for the dependent variable" for a regression analysis on the relationship of credit and welfare across advanced industrial countries).

credit-constrained borrowers.[192] Administrative data also suggests there may be a relationship between the availability of public transfers and demand for payday loans.

Below is data from the Division of Financial Institutions of the Illinois Department of Financial & Professional Regulation on the monthly transaction volume for various small-dollar loans in Illinois collected from 2012–2019.[193] Illinois law previously imposed mandatory reporting obligations on licensed small-dollar lenders and issued annual reports compiling this data.[194] The figure below[195] shows the transaction volume for four types of small-dollar loans permitted in Illinois law prior to 2021: 1) small consumer loans ("SCL")—loans of $4,000 or less with a maximum APR of 99%; 2) payday loans ("PL")—loans with a term of 45 days or less and a maximum APR of 404%; 3) installment payday loans ("IPL")—loans with terms of 180 days or less and a maximum APR of 404%; and 4) title loans ("Title")—loans of $4,000 or less secured by a consumer's vehicle.[196]

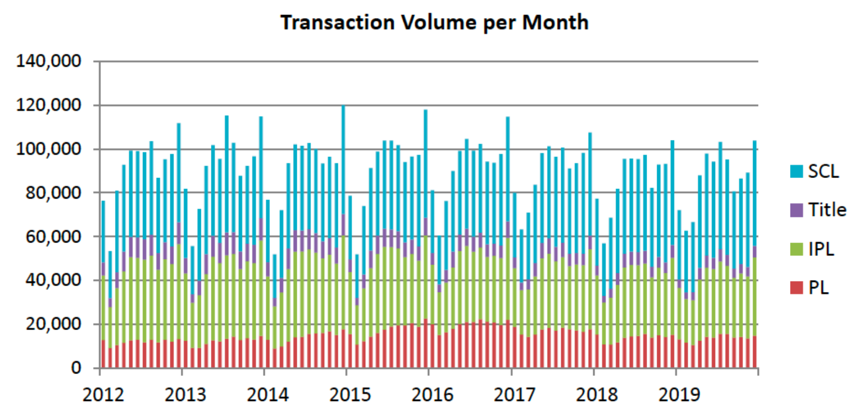
[192] *See* Paige Marta Skiba, *Tax Rebates and the Cycle of Payday Borrowing*, 16 AM. L. & ECON. REV. 550 (2014) (finding that a $300 tax rebate decreased the short-run probability that credit-constrained, infrequent borrowers will take out a payday loan).

[193] *Illinois Trends Report Select Consumer Loan Products Through December 2019*, ILL. DEP'T FIN. & PROF'L REG. (Sept. 28, 2020) [hereinafter *Illinois Trends Report*], https://www.idfpr.com/Forms/DFI/CCD/IL%20Trends%20Report%202019.pdf [https://perma.cc/4V9U-SFU2]. The figure was producted by Veritec Solutions on behalf of the Illinois Department of Financial & Professional Regulation. Use of the figure in this Article was authorized by the Illinois Department of Financial & Professional Regulation and Veritec Solutions.

[194] Illinois previously required certain lenders licensed in Illinois to report information to an approved third-party reporting service for each transaction. This information was reported at the time a transaction was entered into or shortly thereafter. The compiled information was then aggregated and summarized in annual reports. *See Illinois Trends Report*, *supra* note 193, at 6 (describing Illinois then-existing reporting requirements).

[195] *Illinois Trends Report, supra* note 193, at 9.

[196] The definitions for each of these loans existed in scattered parts of the Illinois Compiled Statutes and the Administrative Code. *See id*. at 2 (referencing the various relevant statutes). On March 23, 2021, Illinois passed the Predatory Loan Prevention Act, which capped the rates for all consumer loans at 36% and repealed prior inconsistent law. S.B. 1792, 101st Gen. Assemb. Reg. Sess. (Ill. 2021); *see* Kate Berry, *Illinois Caps Interest Rates on Consumer Loans at 36%*, AMERICAN BANKER (Jan. 15, 2021, 1:15 PM), https://www.americanbanker.com/news/illinois-caps-interest-rates-on-consumer-loans-at-36 [https://perma.cc/7JXD-VWB8].



The figure shows a pattern of seasonal borrowing with decreased transaction volume from January through March of each year. This pattern is interesting for a few reasons. The decreased transaction volume correlates with the availability of the earned income tax credit ("EITC"). And the pattern is relatively consistent across the different small-dollar loans. This suggests that the substitution effects across different small-dollar loans may be smaller than the substitution between small-dollar loans and cash transfers. This pattern tracks some findings in the literature on the substitution effects between different loan products.[197]

This evidence is certainly not conclusive. However, when the studies cited in this section are viewed together, it suggests we should view monocausal explanations of payday loan growth with some skepticism.

2. Payday Loan Demand

The extensive empirical literature on payday lending suggests that most of the demand for payday loans comes from credit-constrained consumers.[198] Much of the literature focuses on the welfare effects of payday lending. And on this account, the literature is mixed, with some studies finding that payday loans are arguably welfare-

---

[197] *See* Littwin, *supra* note 147. In fact, payday lenders themselves tend to view public spending as an important competitive threat. *See* David Dayen, *Payday Lenders Suffer Rare Attack of Honesty*, AM. PROSPECT (Nov. 11, 2019), https://prospect.org/power/payday-lenders-suffer-rare-attack-of-honesty/ [https://perma.cc/K6Y2-8WBP] (noting payday lending industry opposition to Arizona legislation that would increase the minimum wage).

[198] *See, e.g.*, Adair Morse, *Payday Lenders: Heroes or Villains?*, 102 J. FIN. ECON. 28, 30 (2011) ("Individuals restricted in access to credit [offered by mainstream banking, mortgage companies and credit cards] often resort to borrowing from high interest lenders."); Bhutta et al., *supra* note 170, at 231 ("[I]nitial payday loan applications occur precisely when consumers' access to liquidity from mainstream creditors is lowest."); Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472, 54,474 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041) ("[C]onsumers living paycheck to paycheck and with little to no savings have also used credit as a means of coping with financial shortfalls.").

enhancing[199] and other studies finding the payday loans have zero or negative welfare effects.[200]

The mixed results stem in part from the difficulty distinguishing between good and bad uses of payday loans. Payday loans can either provide emergency liquidity or supplement a consumer's income.[201] As emergency liquidity, payday loans are arguably useful. A credit-constrained consumer may need emergency funds after a medical emergency or other exogenous shock.[202] As an income supplement, payday loans are arguably more problematic. A consumer who relies on payday loans to supplement their income and smooth consumption intertemporally may not understand the true cost of a payday loan or the consumer's default risk.[203]

---

[199] *See, e.g.*, Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap*, 34 J. BANKING & FIN. 546 (2010) (finding that restricting access to payday loans caused deterioration in the overall financial condition of Oregon households with former payday loan users shifting partially into plausibly inferior alternatives); Morse, *supra* note 198 (finding positive welfare effects associated with payday lending following natural disaster); Donald P. Morgan, Michael R. Strain & Ihab Seblani, *How Payday Credit Access Affects Overdrafts and Other Outcomes*, 44 J. MONEY, CREDIT & BANKING 519 (2012) (finding mixed welfare effects: payday bans decrease Chapter 13 rates but increase complaints against lenders and debt collectors and shifting into bank overdraft); Susan Carter & Bill Skimmyhorn, *Much Ado About Nothing? New Evidence on the Effects of Payday Lending on Military Members*, 99 REV. ECON. & STAT. 606, 606 (2017) (finding few adverse effects for service members with payday loan access).

[200] *See, e.g.*, Scott Carrell & Jonathan Zinman, *In Harm's Way? Payday Loan Access and Military Personnel Performance*, 27 REV. FIN. STUD. 2805 (2014) (finding payday loan access causes financial distress and severe misbehavior for relatively young, inexperienced, and financially unsophisticated airmen; and finding negative welfare effects were larger in high unemployment areas with payday lending); Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q. J. ECON. 517 (2011) (finding no evidence that payday loans alleviate economic hardship and evidence that loan access leads to increased difficulty paying mortgage, rent and utilities bills); Bhutta et al., *supra* note 170 (finding the long-run effect of payday borrowing on credit scores and other measures of financial well-being is close to zero).

[201] *See, e.g.*, Atkinson, *Rethinking*, *supra* note 15, at 1107 (distinguishing payday loans as a limited solution to unexpected emergency expenses but also as a poor solution to recurring expenses); Paige Marta Skiba, *Regulation of Payday Loans: Misguided?*, 69 WASH. & LEE L. REV. 1023, 1027–28 (2012) (noting that "if a consumer's car breaks down and she would be fired if she could not get to work tomorrow, it may be rational for her to borrow at extremely high interest rather than forgo all wage income for the foreseeable future"; but payday loans may not be utility-enhancing if used "for purposes other than avoiding emergency situations").

[202] *See* Morse, *supra* note 198, at 28–29 (noting that "[i]ndividuals frequently experience some sort of personal emergency (e.g., an out-of-pocket medical expense or car breakdown) leaving them without cash for their short-term obligations" and in these common scenarios, payday lenders can be "heroes").

[203] *See* Skiba, *supra* note 201, at 1032 ("Payday loans can help consumers if used sparingly and for emergencies—they have never been meant for long-term credit.").

Because payday loans are formally closed but functionally revolving, it can be difficult to tell if a consumer has taken out a payday loan on an emergency basis or is using the payday loan to supplement their income. In both cases, the consumer will likely default on their initial obligation and roll the loan over one or more times. The optimal policy should strike a balance between permitting useful emergency credit and limiting harmful consumption credit.[204] Evaluating different state law restrictions on payday lending, Paige Skiba suggests that laws that set restrictions on rollovers and renewals strike this balance better than outright bans on payday loans.[205] These laws would arguably encourage welfare-enhancing short-term borrowing but discourage welfare-diminishing long-term borrowing.

Skiba's conclusion was based, in part, on an assumption that payday loans that are repeatedly rolled over are not welfare-enhancing.[206] But it is not clear this is correct. The literature on the welfare effects of payday loans generally ignores consumer preferences. But consumer preferences matter for consumer welfare analysis. When the literature discusses consumer preferences, there is an assumption that short-term borrowing does not reflect revealed preferences because credit-constrained consumers are present-biased (significantly discount future benefits) or overly optimistic (hold unrealistic expectations about the future).[207] Recent scholarship suggests that these assumptions are either insufficient to justify regulatory intervention or wrong.

For example, Andrew Hayashi suggests that present-biased consumption may be welfare-enhancing.[208] In particular, when durable goods with deferred benefits are bundled with loans, a seemingly misleading cost structure may encourage utility-maximizing consumption.[209] As Hayashi explains, "credit products with low initial costs and higher backend costs are less pernicious, and may, in fact, be beneficial, when they must be used to finance the purchase of a good or service with deferred benefits."[210] The key, for Hayashi, is the cost structure may make the benefits of the good more salient and the costs less salient:

> The teaser loan converts the temporal pattern of costs and benefits associated with the durable good (which from a rational perspective she should buy) from one that is unappealing to her—because it involves incurring current costs to generate future benefits—to one that is appealing

---

[204] *See id.* at 1045.

[205] *Id.* at 1029.

[206] *Id.* at 1028.

[207] *See* Bar-Gill & Warren, *supra* note 11, at 44–46 ("A customer who misestimates her ability to repay the loan in fourteen days will likely roll the loan over . . . ."); PEW CHARITABLE TRUSTS, HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS (2013), https://www.pewtrusts.org/-/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf [https://perma.cc/JK8W-P2Y6] (emphasizing the premise that borrowers "hold unrealistic expectations about payday loans").

[208] Hayashi, *supra* note 8, at 693.

[209] *Id.*

[210] *Id.* at 709–10.

> because it provides current benefits in exchange for deferred costs. The individual is effectively tempted through the financing to do the right thing with respect to the durable good purchase.[211]

For Hayashi, present-biased consumers may undervalue socially desirable consumption if it is only accessible through conventionally structured loans.[212] Complex pricing, such as a low-teaser that resets to a higher rate based on a fluctuating index, that corrects this bias may be utility-maximizing, and regulation that discourages unconventional cost structures may be harmful and regressive.

Hayashi assumes scholars and regulators correctly capture the behavioral dynamics of consumer credit transactions but challenges their welfare conclusions.[213] Others, however, question whether scholars and regulators analyze the behavioral psychology correctly. For example, Ronald Mann has questioned the general conclusion that payday consumers are overly optimistic.[214] In 2012, Mann designed a survey to test for present bias in payday lending.[215] Mann's survey, which was given at the time consumers initially took out a payday loan from a large national payday lender, asked how long consumers expected to continue borrowing and stay in debt.[216] Mann compared the survey answers to loan performance data the lender provided. The results of Mann's survey revealed several surprising results: (1) "most borrowers expected that they would continue borrowing for some time after the initial loan"; (2) "60 percent of the borrowers predicted the final repayment date with reasonable accuracy"; and (3) the "strongest and most consistently significant predictor of accuracy" was "heavy prior use of the product" and not demographics.[217]

In 2019, Hunt Allcott, Joshua Kim, Dmitry Taubinsky, and Jonathan Zinman conducted a more robust survey to test for present bias in payday lending.[218] The 2019 survey offered experimental incentives to test consumers' ability to accurately predict their likelihood of reborrowing. Consumers could choose between two

---

[211] *Id.* at 706.

[212] Or what Elizabeth Warren calls "plain vanilla" loans. Elizabeth Warren, *Three Myths About the Consumer Financial Product Agency*, THE BASELINE SCENARIO (July 21, 2009), https://baselinescenario.com/2009/07/21/three-myths-about-the-consumer-financial-product-agency/ [https://perma.cc/2Y7T-VL5Y].

[213] To be sure, Hayashi does not necessarily concede that consumers are, in fact, present-biased. Hayashi adopts that view to illustrate why present-biased consumption may still be rational.

[214] Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers*, 21 SUP. CT. ECON. REV. 105, 111–12 (2013) ("[I]t is not at all clear that optimistic behavior reflects poor financial choices . . . . [I]t seems far too simple to attribute misperception of product use to a vague and general bias toward 'optimism.'").

[215] *Id.*

[216] *Id.* at 119–20.

[217] *Id.* at 118.

[218] *See* Allcott et al., *supra* note 171, at 3 (providing experimental evidence suggesting that experienced payday borrowers may accurately predict their likelihood of future borrowing).

rewards: (1) $100 if the borrower did not borrow from any payday lender over the next eight weeks, or (2) a certain cash payment for a lesser amount. The survey results were largely consistent with Mann's study: (1) "people almost fully anticipate their likelihood of repeat borrowing," and (2) experience matters, with more experienced borrowers accurately predicting their likelihood of reborrowing.[219]

The debate over consumer preferences is not just academic. Evidence of consumer preferences would play a central role in the CFPB's fight to regulate payday loans.

3. *The Survey Wars*

Shortly after it was created in 2011, the CFPB began to explore federal regulation of payday loans.[220] After countless stakeholder meetings, white papers, and a proposed rule that received over 1.4 million comments,[221] the CFPB promulgated the Payday Rule on November 17, 2017.[222] The approach the CFPB settled on in its Payday Rule mirrored the approach Skiba recommended in 2012: permitting payday lending but setting restrictions on rollovers and renewals.[223]

The CFPB accomplished this in a somewhat indirect manner. The CFPB created a general requirement that payday lenders must make a reasonable determination that consumers "will have the ability-to-repay the loans according to its terms."[224] The CFPB then provided a safe-harbor for what it called principal step-down loans: loans of $500 or less that rolled over no more than twice with a declining principal balance each time the loan is rolled over.[225] As payday lenders generally

---

[219] *Id.* at 2.

[220] The CFPB held its first public field hearing on payday lending on January 19, 2012. *See* Request for Comments: Hearing on Payday Lending, 77 Fed. Reg. 16,817 (Mar. 22, 2012).

[221] *See Payday Loan Protections*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/payday-rule/ [https://perma.cc/3SLE-RTLW] (last visited Sept. 12, 2021) (outlining a timeline of the CFPB's rulemaking effort); *Proposed Rule: Payday, Vehicle Title and Certain High-Cost Installment Loans*, REGULATIONS, https://www.regulations.gov/document?D=CFPB-2016-0025-0001 [https://perma.cc/DN34-EUHY] (last visited Sept. 12, 2021) (listing the 1,413,787 comments the CFPB received for its proposed rule).

[222] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

[223] *Id.*

[224] *Id.* at 54,874.

[225] *Id.* at 54,876. The Payday Rule set several additional structural and underwriting requirements on principal step-down loans, all of which were initially codified at 12 C.F.R. § 1041.6. Structural requirements included that the loan must amortize pursuant to a fixed amortization schedule; the lender cannot take a security interest in the consumer's vehicle as collateral for the loan; and the loan cannot be structured as open-end credit. Underwriting requirements included that the consumer must not have had an outstanding covered loan in

engage in minimal to no underwriting, the Payday Rule effectively banned loans outside the safe harbor.

As an independent regulatory agency, the CFPB rulemaking is not subject to review by the Office of Information and Regulatory Affairs. But the CFPB is still subject to some cost-benefit constraints. Section 1022 of Dodd-Frank provides that the CFPB shall consider the following in exercising its rulemaking authority:

> [T]he potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule.[226]

The CFPB promulgated the Payday Rule under its general authority to prohibit unfair, deceptive, or abusive acts or practices ("UDAAP").[227] The definition of unfairness under the Consumer Financial Protection Act incorporates a cost-benefit test. An act or practice is unfair if:

> (A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and
> (B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.[228]

The statutory definition of abusiveness does not formally require that the CFPB conduct a cost-benefit analysis[229] but provides that the consumer's understanding of the transaction may be relevant. An act or practice is abusive if it:

> (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
> (2) takes unreasonable advantage of—
>> (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;

---

the past 30 days; the loan cannot result in the consumer having a loan sequence of more than three covered loans; and the loan cannot result in the consumer having during any consecutive 12-month period: more than six covered short-term loans outstanding or covered short-term loans outstanding for an aggregate period of more than 90 days. Finally, to meet the Payday Rule's safe harbor, a lender must not subsequently make a covered or non-covered loan to the consumer during the period the safe-harbored step-down loan is outstanding and 30 days thereafter.

[226] Codified at 12 U.S.C. § 5512(b)(2)(A)(i) (2010).

[227] *See generally id.* § 5531 (prohibiting unfair, deceptive, or abusive acts or practices in connection with consumer financial transactions).

[228] *Id.* § 5531(c)(1).

[229] *See* Adam J. Levitin, *"Abusive" Acts and Practices: Towards a Definition?*, 2019 GEO. UNIV. L. CENT. 1, 20 (2019).

> (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
> (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[230]

Thus, in promulgating the Payday Rule, the CFPB had to engage with some of the then-existing literature on present bias and optimism in payday lending. This included the results of Mann's 2012 survey.

Five years,[231] 854 pages in the Federal Register,[232] and over a million comments later,[233] the fate of the Payday Rule would ultimately turn on two pages in the Federal Register devoted to the Mann study.[234] In its commentary to the final Payday Rule, the CFPB pushed back on the conclusions Mann and others drew from the 2012 survey on a few grounds. First, the CFPB cited conflicting literature that suggested payday borrowers did, in fact, suffer from present bias.[235] Second, the CFPB disputed Mann's interpretation of his own survey data. In particular, the CFPB argued that while the survey data provided some evidence that borrowers accurately forecast their default risk, the data did not support a conclusion that borrowers with long borrowing sequences accurately predicted this outcome.[236] As the CFPB put it, "a large share of borrowers who anticipated no reborrowing remain in debt for multiple loans, and many are unable to even offer a guess as to the duration of their indebtedness, let alone a precise prediction."[237] Because the Payday Rule favored short sequences over long sequences, the CFPB concluded that Mann's survey data did not contradict the CFPB's belief that borrowers did not understand the risks associated with payday loans.[238]

---

[230] 12 U.S.C. § 5531(d).

[231] The CFPB's first field hearing was in January 2012. *See* Request for Comments: Hearing on Payday Lending, 77 Fed. Reg. 16,817 (Mar. 22, 2012). Its final rule was promulgated in November 2017. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

[232] The CFPB's proposed rule was 355 pages. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864, 47,864–48,218 (July 22, 2016) (to be codified at 12 C.F.R. pt. 1041). Its final rule was 449 pages. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. at 54,472–54,921.

[233] *See generally* Consumer Fin. Prot. Bureau*, Payday, Vehicle, Title and Certain High-Cost Installment Loans*, REGULATIONS, https://www.regulations.gov/docket/CFPB-2016-0025 [https://perma.cc/J7SU-6ARJ] (last visited Sept. 12, 2021) (indicating that the CFPB received 1,413,787 comments to its proposed rule).

[234] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. at 54,836–37.

[235] *Id.*

[236] *Id.*

[237] *Id.* at 54,837.

[238] *Id.*

A week after the CFPB promulgated its Payday Rule, the CFPB's leadership changed. Richard Cordray resigned[239] and was first replaced by Mick Mulvaney[240] and, eventually, Kathy Kraninger.[241] Mulvaney and Kraninger made clear from the outset that they intended to rescind the Payday Rule.[242] The Kraninger CFPB began this process in early 2019 and finalized its rescission of the underwriting requirement of the Payday Rule on July 7, 2020.[243]

The analytic linchpin of the Kraninger CFPB's rescission of the Payday Rule was the Cordray CFPB's purported failure to give adequate weight to Mann's survey data. In particular, the Kraninger CFPB argued that the Cordray CFPB cherry-picked data from Mann's study to support its argument that borrowers did not understand the risks associated with payday loans.[244] As the Kraninger CFPB explained: "[T]he Mann study's data overall indicates that payday borrowers in general—*i.e.,* including consumers who engage in short sequences of payday loans—are able to predict the length of their loan sequences with reasonable accuracy."[245] The new CFPB concluded that the thin evidence the old CFPB relied on was insufficient to fundamentally reshape the payday industry.[246]

Consumer advocates attempted to address the Kraninger CFPB's concerns by citing separate surveys from Nathalie Martin and others that found payday consumers did not understand the APR or dollar cost of payday loans.[247] The Kraninger CFPB summarily dismissed these findings: "These studies do not ask the direct and relevant question of whether consumers understand the magnitude and

---

239 Avie Schneider, *Richard Cordray Stepping Down as Head of U.S. Consumer Protection Agency*, NPR (Nov. 15, 2017, 12:35 PM), https://www.npr.org/sections/thetwo-way/2017/11/15/564349200/richard-cordray-stepping-down-as-head-of-u-s-consumer-protection-agency [https://perma.cc/TTM7-VAKG].

240 *Statement on President Donald J. Trump's Designation of OMB Director Mick Mulvaney as Acting Director of the Consumer Financial Protection Bureau*, WHITE HOUSE (Nov. 24, 2017), https://trumpwhitehouse.archives.gov/briefings-statements/statement-president-donald-j-trumps-designation-omb-director-mick-mulvaney-acting-director-consumer-financial-protection-bureau/ [https://perma.cc/UFC4-EUXM].

241 Emily Sullivan, *Senate Confirms Kathy Kraninger as CFPB Director*, NPR (Dec. 6, 2018, 2:17 PM), https://www.npr.org/2018/12/06/673222706/senate-confirms-kathy-kraninger-as-cfpb-director [https://perma.cc/S62U-TSB2].

242 *See CFPB Statement on Payday Rule*, CFPB (JAN. 16, 2018), https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-payday-rule/ [https://perma.cc/W5C2-PJDS]; Daniella Cheslow, *Consumer Protection Bureau Aims to Roll Back Rule for Payday Lending*, NPR (Feb. 6, 2019, 2:23 PM), https://www.npr.org/2019/02/06/691944789/consumer-protection-bureau-aims-to-roll-back-rules-for-payday-lending [https://perma.cc/8SZ6-LT4Y].

243 *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 85 Fed. Reg. 44,382 (July 22, 2020) (to be codified at 12 C.F.R. pt. 1041).

244 *Id.* at 44,401.

245 *Id.*

246 *Id.*

247 *Id.* at 44,403.

likelihood of risk of harm associated with covered loans sufficient for them to anticipate that harm and understand the need to take steps to avoid injury."[248]

Though the focus of the Kraninger CFPB's critique of the Payday Rule centered on the Cordray CFPB's failure to give adequate weight to the benefits payday consumers derive from using their preferred form of credit, the Kraninger CFPB also criticized the Cordray CFPB's failure to consider the harm the Payday Rule might cause. In particular, the Kraninger CFPB argued that the Payday Rule would dramatically reduce the availability of payday loans to consumers who need emergency funds to avoid potential harm.[249]

Are there lessons we can draw from the Payday Rule saga? On the one hand, the effort to rescind the rule was deeply cynical and dispiriting (and perhaps fraudulent). The Kraninger CFPB was motivated to find reasons to rescind the Payday Rule, and the Mann study and other survey evidence provided a convenient justification.[250] The Kraninger CFPB simply ignored other survey data, and there were reasons to think the Cordray CFPB was correct to view studies that were favorable to payday lenders with some skepticism.[251]

On the other hand, the Payday Rule saga highlights the challenge of justifying interventions in consumer financial markets on narrow grounds. Dodd-Frank placed some soft limits on the CFPB's rulemaking authority.[252] The CFPB attempted to navigate this terrain by highlighting imperfections in the market for payday loans.[253] But the economics of the payday lending market are structured by conditions that exist outside that market. By engaging on the issue of consumer preferences, the CFPB was vulnerable to attacks such as the following one from Mann: "The problem

---

[248] *Id.* at 44,396.

[249] *Id.* at 44,412.

[250] *See* David Dayen, *How to Buy a Regulation in Six Short Months*, AM. PROSPECT (Dec. 19, 2019), https://prospect.org/power/how-to-buy-a-regulation-in-six-short-months/ [https://perma.cc/6N9W-XPFS]; Nicholas Confessore & Stacy Cowley, *Trump Appointees Manipulated Agency's Payday Lending Research, Ex-Staffer Claims*, N.Y. TIMES (Apr. 29, 2020), https://www.nytimes.com/2020/04/29/business/cfpb-payday-loans-rules.html [https://perma.cc/J8HZ-PXDG].

[251] *See* Christopher Werth, *Tracking the Payday-Loan Industry's Ties to Academic Research*, FREAKONOMICS RADIO (Apr. 6, 2016, 11:00 PM), https://freakonomics.com/podcast/industry_ties_to_academic_research/ [https://perma.cc/C38C-PFBR] (detailing how the firm that conducted the survey for Mann's study was hired and paid for by a lawyer within the payday lending industry).

[252] *See* 12 U.S.C. § 5512(b)(2)(A) (2019); *see id.* § 5531(c)–(d).

[253] *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472, 54,568–72 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

isn't that payday loans are expensive, it's that we live in a capitalistic society and don't have a safety net, and lots of people make less than other people and can't make ends meet."[254] That is not to suggest the Kraninger CFPB got the behavioral psychology right but rather to suggest the limits of tying interventions to consumer rationality.

C. *Refund Anticipation Loans*

Critiques that interventions are inefficient and regressive are not limited to the regulation of private welfare substitutes but extend to the regulation of financial products used to access the transfer system. Refund anticipation loans or RALs are one such example. This section provides background on RALs and then explores a critique of recent interventions in the RAL market.

1. Background

Clinton-era welfare reform consisted of two important changes to the safety net. First, as described above, PRWORA eliminated AFDC and replaced it with TANF, a much narrower program.[255] Second, Congress significantly expanded access to the EITC.[256] The EITC is a refundable tax credit that is often described as the "largest federal anti-poverty program."[257] However, the EITC is not strictly an anti-poverty program. It is best understood as a work incentive for low-wage earners with children.[258] The EITC features a phase-in—where the credit increases as an individual's income increases—and then plateaus before phasing out.[259] The

---

[254] Kate Berry, *One Study, Two Vastly Different Visions for CFPB Payday Rules*, AM. BANKER (Jan. 23, 2019), https://www.americanbanker.com/news/one-study-two-vastly-different-visions-for-cfpb-payday-rules [https://perma.cc/S5PS-NXQ3].

[255] *See supra* Section II.B.1.

[256] *See* Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, 88 N.Y.U. L. REV. 515, 533–36 (2013) [hereinafter Greene, *Safety Net*] (describing the rise of the EITC in conjunction with the fall of traditional welfare).

[257] *Id.* at 519.

[258] Indeed, proponents of EITC expansion explicitly advocated for it as "anti-welfare." *See id.* at 535 (noting that then President Bill Clinton emphasized the EITC "reward[s] work over welfare"); Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 539 (1995) ("Congressional proponents of the [EITC] emphasized in 1993 that the EITC 'is the furthest thing from a handout' and 'is not welfare, by any means.'").

[259] *See* Ariel Jurow Kleiman, *Low-End Regressivity*, 72 TAX L. REV. 1, 3 (2018) (arguing that the EITC and other refundable credits that "prioritize working families with children create 'low-end regressivity,' in which certain poorer households face higher average federal tax rates compared to better-off households"); Matt Bruenig, *It's Time for Democrats to Abandon the Earned Income Tax Credit*, JACOBIN (May 18, 2020), https://jacobinmag.com/2020/05/iearned-income-tax-credit-eitc-poverty-welfare-benefits-

somewhat regressive structure of the EITC is designed to incentivize low-wage earners or TANF recipients to earn more with the carrot of a larger wage subsidy.[260]

Since its inception, the design and administration of the EITC have been criticized. With respect to design, critics have argued that the EITC's effectiveness is largely undermined by the legal structure of U.S. markets.[261] Labor markets are structured in a way that disadvantages low-wage workers and single mothers—the intended beneficiaries of the EITC.[262] The U.S. also has a threadbare social safety net and relies on markets to deliver "primary goods like health care, housing, [and] child care."[263] Moreover, low-wage workers experience regular bouts of unemployment.[264] Because the EITC is only distributed once a year, the unemployed and underemployed turn to high-cost loans to supplement their income.[265] These forces result in what Greene calls the bootstrap trap—welfare reform promotes and requires self-sufficiency, but this self-sufficiency is undermined by costly private substitutes for welfare.[266]

With respect to administration, the EITC is distributed through the tax code, and qualification turns on complex questions about the definition of income and families.[267] The Internal Revenue Service ("IRS") lacks the institutional capacity to administer the EITC as public assistance.[268] As a result, the administration of the EITC largely falls to private tax preparers.[269] However, there is a natural gap between the publicly generated demand for low-income tax preparation services and the cost of those services. Low-income wage earners need tax preparers to qualify for the EITC but typically cannot afford to pay tax preparation fees.[270] Consumer finance fills this gap.

---

clinton [https://perma.cc/482G-PL9S] (describing the EITC's regressive trapezoid structure).

[260] *See* Greene, *Bootstrap*, *supra* note 185, at 237; *see also* Alstott, *supra* note 258, at 541 (describing the EITC as "a 'backwards' income-transfer program, because it provides greater dollar benefits to those with higher earnings and no benefits at all to those without wages, regardless of need").

[261] *See* Anne L. Alstott, *Why the EITC Doesn't Make Work Pay*, 73 LAW & CONTEMP. PROBS. 285, 287 (2010) ("[T]he EITC . . . cannot 'make work pay,' because it operates in a legal context that creates deep disadvantage for low-wage workers and their children.").

[262] *Id.* at 297.

[263] *Id.* at 304.

[264] *Id.* at 300.

[265] *See* Greene, *Safety Net*, *supra* note 256, at 523.

[266] Greene, *Bootstrap*, *supra* note 185, at 240.

[267] *See* Alstott, *supra* note 258, at 570.

[268] *See* David A. Super, *Privatization, Policy Paralysis, and the Poor*, 96 CALIF. L. REV. 393, 434 (2008) ("The IRS has no system of local offices to help claimants apply, to answer their questions about the [EITC's] rules, or to examine verification of their eligibility.").

[269] *See* Hayashi, *supra* note 8, at 722 (noting that "paid preparers are especially common in areas with large numbers of EITC claimants").

[270] *See* Chi Chi Wu & Jean Ann Fox, *Big Business, Big Bucks: Quickie Tax Loans*

The tax preparation industry created two financial products to meet the new demand for low-income tax preparation: refund anticipation checks ("RACs") and refund anticipation loans ("RALs"). RACs allow consumers to defer the cost of tax preparation by financing tax preparation with their refund.[271] For RAC-issued tax returns, the IRS sends the taxpayer's refund to a temporary bank account set up by the tax preparer.[272] The tax preparer then disburses the funds to the consumer minus any fees.[273] Although RACs allow low-income consumers to obtain tax preparation services without an immediate cash outlay, RACs make the costs of tax preparation less salient.[274]

Less salient fees mean it is harder for tax preparers to compete on price. RALs were designed to address this problem. RALs are short-term loans secured by a consumer's tax refund.[275] RALs are offered before and during tax season toward the end of the year[276] and can be used as promotional devices tax preparers use to compete for business.[277] RALs and RACs are often bundled together.[278] A consumer who applies for a RAL with a tax preparer will likely have that same preparer file the consumer's return and finance the cost of return preparation with RAC.[279]

2. *Intervention and Critique*

From a consumer protection perspective, RALs and RACs present a few potential problems. First, RALs are expensive.[280] Second, the lack of price transparency may create opportunities for tax preparers to inflate the cost of tax preparation.[281] Present-biased consumers may not be sensitive to these price increases, which are bad both because they are extractive and because they misdirect

---

Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers at Risk, NAT'L CONSUMER L. CTR. 15–17 (2009), https://www.nclc.org/images/pdf/high_cost_small_loans/ral/2009-ral-report.pdf [https://perma.cc/NVJ2-WQD9].

[271] NAT'L CONSUMER L. CTR., 2020 TAX SEASON: MORE DELAYS AND HIGHER COSTS FOR STRUGGLING TAXPAYERS 2 (Jan. 30, 2020) [hereinafter NCLC 2020 Report], https://www.nclc.org/images/pdf/taxes/rpt-tax-time-jan2020.pdf [https://perma.cc/82P7-XUFW].

[272] *Id.*

[273] Refunds are typically dispersed by check, direct deposit, or a prepaid card. *See id.*

[274] *Cf. id.* at 1–2.

[275] *See id.* at 3.

[276] *See id.*

[277] Chi Chi Wu & Jean Ann Fox, *One Step Forward, One Step Back: Progress Seen in Efforts Against High-Priced Refund Anticipation Loans, but Even More Abusive Products Introduced*, NAT'L CONSUMER L. CTR. 2 (2007), https://www.nclc.org/images/pdf/high_cost_small_loans/ral/2007_ral_report.pdf [https://perma.cc/V2YV-WLUH] (describing the emergence of holiday RALs and paystub RALs offered before tax season).

[278] *Cf. id.* at 14–15.

[279] *Cf. id.*

[280] *Id.* at 10.

[281] *See* NCLC 2020 Report, *supra* note 271, at 5–6.

EITC funds to tax preparers.[282] In the last ten years, there have been a number of federal and state interventions to address these concerns.

The most important intervention was by the IRS. Like payday loans, RALs are thinly underwritten.[283] A preparer will generally offer a consumer a RAL if the preparer can confirm that the borrower will likely receive a tax refund.[284] Prior to 2010, this verification was provided by the IRS in the form of a federal debt indicator.[285] The debt indicator indicates if a taxpayer's refund is subject to federal offset for federal debt or certain other obligations.[286] Yielding to pressure from consumer advocates, the IRS stopped providing the federal indicator to tax preparers in 2010.[287] Federal banking regulators followed the IRS by putting pressure on banks to stop financing RALs.[288] And state lawmakers followed these regulatory moves with state legislation setting interest caps on non-bank RALs and limiting the fees preparers could charge for RALs and RACs.[289]

Were the welfare effects of these changes positive? Hayashi is dubious. Building on his durable goods framework, Hayashi suggests that EITC benefits may be undervalued without RALs.[290] The EITC is, for better or worse, "the heart of the public safety net."[291] As such, maximum consumption of the EITC is socially optimal. Because we rely on financial intermediaries to deliver these benefits to consumers, it is important to ensure that there are minimal barriers to this financial intermediation. RALs are expensive, but the benefits of receiving and claiming the EITC may be sufficient to overcome bounded rationality.

---

[282] *See* Wu & Fox, *supra* note 270, at 12; Super, *supra* note 268, at 437 (noting that "EITC claimants spend an estimated $1.75 billion per year out of their $30 billion credits to purchase services").

[283] Chi Chi Wu, *Corporate Welfare for the RAL Industry: The Debt Indicator, IRS Subsidy, and Tax Fraud*, NAT'L CONSUMER L. CTR. 5 (2005), https://www.nclc.org/images/pdf/high_cost_small_loans/ral/debt_indicator_white_paper.pdf [https://perma.cc/XQ8W-J82Q].

[284] *Id.*

[285] *Id.* at 2.

[286] *Id.*

[287] Chi Chi Wu & Jack Gillis, *Consumer Advocates Applaud End of IRS-Provided Service to Refund Anticipation Lenders*, NAT'L CONSUMER L. CTR. & CONSUMER FED'N AM. (2010), https://www.nclc.org/images/pdf/high_cost_small_loans/ral/pr-ral-irs-debt-indicator-08-10.pdf [https://perma.cc/73BU-4PGX].

[288] *See* Republic Bank & Trust Co., FDIC-10-079b (2011); OCC Bulletin 2010-7, *Tax Refund Anticipation Loans* (Feb. 18, 2010), *replaced by* OCC 2015-36, *Tax Refund-Related Products: Risk Management Guidance* (Aug. 4, 2015).

[289] *See* Chi Chi Wu, Tom Feltner & Jean Ann Fox, *Something Old, Something New in Tax-Time Financial Products: Refund Anticipation Checks and the Next Wave of Quickie Tax Loans*, NAT'L CONSUMER L. CTR. & CONSUMER FED'N AM. 28–31 (2013), https://www.nclc.org/images/pdf/high_cost_small_loans/ral/ral-report-2013.pdf [https://perma.cc/E62X-YYCW] (summarizing state legislation and federal and state enforcement actions against tax preparers).

[290] Hayashi, *supra* note 8, at 719–20.

[291] Greene, *Safety Net*, *supra* note 256, at 519.

Hayashi tests whether the regulatory changes led to underconsumption of the EITC and finds "that eliminating RALs is associated with reduced demand for tax preparation services, decreased rates of EITC take-up, and substitution of RACs for RALs."[292] Although Hayashi cannot distinguish between taxpayers who were harmed by the elimination of RALs or made better off because of "some self-defeating bias," the "high degree of substitution from RALs to RACs" suggests most of the consumers impacted by the changes were either credit-constrained or extremely present-biased.[293] The lesson Hayashi draws from his research is "regulators should be wary about current efforts to curtail the market for RACs, since this product provides one of the last financing options for taxpayers who need tax assistance but are otherwise credit constrained and do not have cash on hand."[294] More fundamentally, consumer law scholarship that draws on "present bias" research "is itself myopic" in neglecting to consider "what borrowed funds are used for."[295]

But there is a sense in which Hayashi's own analysis reflects a different kind of myopia in legal scholarship. And that is a blindness to the politics of redistribution. Regulation of tax-related financial products was pursued for both consumer protection and tax administration purposes. The EITC has a high error rate, and there is some evidence that tax compliance problems with the EITC are associated with tax preparer error.[296] This issue is important because the EITC's error rate has been used as a cudgel by opponents of the welfare state to beat back efforts to expand the EITC.[297]

A natural policy response to preparer error might be to directly regulate tax preparers as opposed to limiting access to products that may be correlated with preparer error. In fact, the IRS initially attempted to do this but was told it lacked the statutory authority to regulate preparers.[298] One way to understand RAL regulation then is a second-best effort to get at the issue of tax compliance.

---

[292] Hayashi, *supra* note 8, at 717.

[293] *Id.* at 718.

[294] *Id.* at 719.

[295] *Id.* at 692.

[296] *See* Super, *supra* note 268, at 438 (noting that returns prepared by local or informal paid preparation services may be associated with high error rates); *but see* Leslie Book, *Refund Anticipation Loans and the Tax Gap*, 20 STAN. L. & POL'Y REV. 85, 98–104 (2009) (explaining that while preparers may be responsible for noncompliance, the relationship between the availability of RALs and noncompliance is less clear).

[297] *See* Robert Rector & Jamie Bryan Hall, *Reforming the Earned Income Tax Credit and Additional Child Tax Credit to End Waste, Fraud, and Abuse and Strengthen Marriage*, HERITAGE FOUND. (Nov. 16, 2016), https://www.heritage.org/welfare/report/reforming-the-earned-income-tax-credit-and-additional-child-tax-credit-end-waste [https://perma.cc/2MMY-3JH5] (advocating narrowing the EITC to increase efficacy and limit fraud and false payments).

[298] *See* Loving v. I.R.S., 742 F.3d 1013, 1015 (D.C. Cir. 2014).

Understood this way, less redistribution may be justified if it increases tax compliance and reduces pressure to pare back the EITC.[299]

None of this is to suggest that either Hayashi's analysis of RALs or Mann's analysis of payday loans is misguided. Hayashi's durable goods framework and Mann's survey results highlight the limits of justifying consumer financial regulation within an efficiency framework. Bounded rationality may be good if it prevents underconsumption of certain goods, and consumers may enter into transactions fully aware of the attendant risks. Where I depart from Hayashi and Mann is the view that consumer financial regulation should be tethered to efficiency in the first place.

For Mann, the "best case against payday lending is that the market is plagued by cognitive failures."[300] And Hayashi argues that "when consumers are acting rationally, there should be a high bar for justifying the regulation of the substantive terms of the product or service."[301] But it is unclear why either view is correct. Hayashi fairly faults policymakers for ignoring "the broader economic and legal system in which demand for the product arose [and] what demand for this product tells us about the system."[302] But he stops short of suggesting policymakers restructure the legal system to reshape demand. In the next Part, I suggest we make that leap.

III. DISTRIBUTIONAL EQUITY AND REGULATORY DESIGN

The law shapes markets and the distribution of wealth and power within markets. Within these constraints, market exchanges that appear superficially irrational might be perfectly rational. Credit-constrained consumers may understand the risks associated with high-cost, small-dollar credit and willingly enter these transactions because there are no meaningful alternatives. And even if consumers exhibit present bias, products that exploit present bias might be welfare-enhancing if a temporal mismatch between the immediate costs and delayed benefits of certain durable goods causes present-biased consumers to undervalue these goods.

Does consumer law have a role in restructuring the terms of rational exchanges? One answer is no. Unless there is evidence of market failure, we should not intervene.[303] Alternatively, we can admit that the current cost and distribution of resources in consumer financial markets is shaped by the law, and we can reallocate this distribution by changing the law. The notion that the law is constitutive of markets and matters for distribution is, of course, not new. This view was common

[299] *See* Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867 (2005) (defending the IRS's increased emphasis on compliance on the grounds that tax-type administration of the EITC is preferable to welfare-type administration).

[300] Mann & Hawkins, *supra* note 98, at 884.

[301] Hayashi, *supra* note 8, at 752.

[302] *Id.* at 754.

[303] *See supra* Section II.C.2.

among legal realists during the Progressive Era.[304] Recently, there has been an effort to revive this older tradition along with older modes of regulation centered around distribution that have fallen out of favor.[305]

It is this recent move towards what some call infrastructure regulation that I draw on in this section. The emerging literature on infrastructure regulation emphasizes public obligations—negative obligations to cease conduct or positive obligations to provide services—as a core component of the broader infrastructure toolkit.[306] Consumer law should draw on this component of the infrastructure toolkit to advance distributional goals in consumer financial markets. Here I consider three such policy levers: rate and term restrictions, mandates, and transfers. Rate and term restrictions are common in consumer financial regulation; mandates and transfers are not.[307] These are best understood as complementary tools. In this section, I briefly sketch how we might use these tools together in consumer financial regulation to pursue distributional ends.

Although I am drawing on older ideas, the specific policy levers examined here reflect a common approach to redistribute income outside consumer financial markets: cross-subsidies. Cross-subsidies generally exist when there is a pool of consumers, and within that pool, some consumers pay higher in-pool costs to subsidize lower in-pool costs for other consumers.[308] Cross-subsidies exist in health insurance regulation, family leave policy, patent law, and even class actions.[309] In some sense, the more modest aim of this Article is to encourage policymakers to leverage cross-subsidies to address inequality in consumer financial markets in the same manner we leverage cross-subsidies in other domains. This section outlines how we can use rate and term restrictions, mandates, and transfers to cross-subsidize cheaper services in consumer financial markets.

One note before proceeding. Although I argue that policymakers should center distribution in evaluating and justifying interventions in consumer financial markets, that does not mean I believe policymakers should ignore other justifications. For example, we may want to intervene in consumer financial markets where the distributional effects are unclear (or arguably regressive), but the intervention is necessary on efficiency, moral, or other grounds. Moreover, an intervention might be both efficient and have positive distributional effects.[310] It seems strange to suggest we ignore pro-efficiency arguments when they exist. And I do not mean to rule out these and other grounds for intervention.

My primary goal in this article is to argue that distribution should play a more central role in regulatory design. This is particularly important where interventions are motivated by distributional concerns, and it may be very difficult to justify the

[304] *See* FRIED, *supra* note 50.

[305] *See, e.g.*, Rahman, *supra*, note 32.

[306] *See id.* at 1626; Ricks, *supra* note 32, at 768.

[307] *See supra* note 33 (discussing rate restrictions, transfers, and mandates).

[308] *See* Brooks et al., *supra* note 34, at 1235.

[309] *Id.* at 1246–49.

[310] S*ee generally* Michael Guttentag, *Law and Surplus: Opportunities Missed*, 2019 UTAH L. REV. 607 (2019) (discussing efficiency and distribution).

intervention on efficiency grounds. As I argue in Parts I and II above, policymakers should not view efficiency as a hard constraint on regulatory design and should feel comfortable justifying interventions on purely distributional grounds.

A. Redistributive Rate and Term Restrictions

Rate and term restrictions are some of the oldest forms of consumer credit regulation. Usury laws have an ancient pedigree,[311] and restrictions on the terms of loans date back to the early twentieth century.[312] Both rate and term restrictions continue to be used to regulate various consumer credit products.[313] A natural question then is whether this proposal reflects a departure from current practices. My proposal is distinct from conventional approaches to rate and term restrictions in two ways: it asks us to reconsider 1) how we justify imposing rate and term restrictions and 2) how we use these restrictions.

Modern rate and term restrictions tend to be justified on two grounds. The first is to correct market imperfections—the common justification for regulatory interventions discussed and critiqued in Part II. Excessively high interest rates and unorthodox terms may be prevalent in markets plagued by behavioral biases or information asymmetries.[314] Rate and term restrictions can overcome these biases and asymmetries and transform costly and inefficient exchanges into efficient and welfare-enhancing exchanges.[315]

A second justification is to prevent extraction.[316] Lenders may have lopsided bargaining power because of exogenous forces. Restrictions on rates or terms can correct this imbalance and prevent lenders from exploiting borrowers' weak bargaining position. These two justifications are not necessarily mutually exclusive.

---

[311] *See* Peterson, *supra* note 159, at 1113 ("Usury law, 'the oldest continuous form of commercial regulation,' dates back to the earliest recorded civilizations, and continues to constrain payday lending in many American states.").

[312] *See* FLEMING, *supra* note 162, at 61–77 (explaining the history of the Uniform Small Loan Law).

[313] For examples of modern rate and term restrictions, see 10 U.S.C. § 987 (2019) (the Military Lending Act); UTAH CODE ANN. § 7-23-101 (2020) (state law regulating high-cost, small-dollar loans); 15 U.S.C § 1639 (2019) (federal restrictions on high-cost mortgages); and Qualified Mortgage Definition Under the Truth in Lending Act, 86 Fed. Reg. 22,844, 22,845 (Apr. 30, 2021) (to be codified at 12 C.F.R. pt. 1026) (the Qualified Mortgage Rule). *Cf.* Consumer Credit Protection Act of 1968, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § 1601).

[314] *See* Bar-Gill & Warren, *supra* note 11, at 26–46.

[315] This is the essential argument made by proponents of payday regulation in *supra* Section II.B.3. Setting restrictions on the size and terms of payday loans can combat inefficiency because of imperfect information or behavioral bias. *See also* Bar-Gill & Warren, *supra* note 11, at 98–100 (advocating ex-ante regulation of consumer credit markets to correct for inefficiency as a result of information asymmetry and bounded rationality).

[316] *See* Levitin, *supra* note 229, at 29–36 (defining "abusive" in terms of unjust enrichment through "supracompetitive" pricing and "repeated efforts to extract funds" from consumers).

In fact, it is not unusual for scholars and regulators to justify interventions in consumer financial markets on both grounds.[317] The two justifications, however, reflect different orientations toward market misconduct.

Market imperfection justifications are focused primarily on the consumer: the consumer's lack of financial sophistication, education, or income, and how these factors may impair an otherwise rational exchange. For example, financial distress may bias consumers towards expensive and financially detrimental exchanges. By contrast, extractive justifications are focused on the lender: the lender's knowledge, the structure of the relevant market, and how these factors facilitate potentially extractive exchanges. For example, if consumers are price-insensitive and demand is inelastic, lenders may be able to charge supracompetitive prices.[318] These exchanges may be rational, but intervention might be warranted to prevent lenders from exploiting consumers.

We can trace extractive justifications to Progressive-era concerns about the distribution of bargaining power in markets. Realists such as Karl Llewelyn and Friedrich Kessler were concerned that adhesion contracts facilitated extractive exchanges by parties with superior bargaining power.[319] Similarly, Robert Hale believed that all market exchanges were structured by coercion.[320] In Hale's famous formulation, both buyers and sellers exert coercive pressure in market exchanges, but "[t]he amount of pressure which each can exert is very unevenly distributed, with the result that some are economically strong, others economically weak."[321] For Llewelyn, the solution was legal standards such as unconscionability to balance uneven exchanges.[322] Hale, however, pushed for more than just balanced exchanges.

---

[317] *See* Adam J. Levitin, *The Fast and the Usurious: Putting the Brakes on Auto Lending Abuses*, 108 GEO. L.J. 1257 (2020) [hereinafter Levitin, *Auto*] (arguing that interventions in auto lending markets are necessary to prevent extraction but also suggesting there may be behavioral grounds that justify intervention); Levitin, *supra* note 229, at 31–32 (explaining that a practice may be abusive because of unjust enrichment or because a consumer lacks understanding, and noting that the CFPB cited both grounds in promulgating its Payday Rule).

[318] *See* Levitin, *Auto*, *supra* note 317, at 1289–96.

[319] *See* Karl N. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704 (1931); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

[320] Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923) (presenting a coercion framework). Hale's framework may seem extreme in certain contexts, but it is quite clear both critics and proponents of consumer credit regulation understand consumer credit markets as structured by coercion.

[321] ROBERT L. HALE, FREEDOM THROUGH LAW: PUBLIC CONTROL OF PRIVATE GOVERNING POWER 131 (1952); *see also* William Boyd, *Just Price, Public Utility, and the Long History of Economic Regulation in America*, 35 YALE J. REG. 721, 760 (2018) (describing Hale's views on coercion).

[322] *See* Anne Fleming, *The Rise and Fall of Unconscionability as the "Law of the Poor*,*"* 102 GEO. L.J. 1383, 1402–05 (2014) [hereinafter Fleming, *Unconscionability*].

For Hale, legal rules such as rate restrictions could be used to redistribute what he termed "unearned [producer] surplus or rent" from those with more power to those with less.[323]

Modern unconscionability doctrine and loan restrictions are largely disconnected from Realist era conceptions.[324] But there is some evidence of a shift away from consumer preferences and towards lender knowledge and market structure.[325] My push for rate and term restrictions draws on this history and recent shift in two ways. First, we should pursue interventions where resources in consumer financial markets appear unequally distributed. And second, we should design rate and term restrictions to address this unequal distribution.

Although my push for redistributive rate and term restrictions draws on Realist era concepts, it departs in important ways. Drawing on marginalist theory, Hale sought to intervene in markets where market conditions facilitated extraction in the

---

[323] *See* Boyd, *supra* note 321, at 760.

[324] Although extraction is relevant in modern unconscionability doctrine, the consumer's experience in the bargaining process remains central to the analysis. *See* Jacob Hale Russell, *Unconscionability's Greatly Exaggerated Death*, 53 U.C. DAVIS 965, 988 (2019) (noting that in analyzing procedural unconscionability, "the court is supposed to focus on the consumer's bargaining process, and whether the consumer experienced 'unfair surprise' or the absence of 'meaningful choice'"). The same is largely true for the federal and state loan restrictions, as demonstrated by the debate over the Payday Rule discussed *infra* Section III.B. The tension between extraction and consumer preference existed at the time the Uniform Commercial Code was initially drafted and in the earliest decisions on unconscionability. *See* Fleming, *Unconscionability*, *supra* note 322324, at 1402–05. As Anne Fleming explains, Judge Skelly Wright's initial draft of the famous *Williams v. Walker-Thomas* decision focused the fact on that Walker-Thomas Furniture "knew, or obviously should have known, that, because of the purchaser's circumstances, a default in monthly payments and, hence, repossession of all items purchased in the past three years would almost inevitably ensue." *Id.* at 1417. Skelly Wright ultimately abandoned this reasoning in the actual decision focusing instead on the fact that Williams and Thorne appeared "intellectually deficient, helpless, and in need of protection." *Id.*

[325] We can see signs of this shift in doctrine and scholarship. Several recent cases suggest that some courts may be open to unconscionability and unfairness claims based on structural arguments as opposed to consumer preference. *See* De La Torre v. CashCall, Inc., 422 P.3d 1004, 1007 (Cal. 2018) (holding that under California law, an interest rate can be so high that it renders the loan unconscionable); CFPB v. ITT Educ. Servs. Inc., 219 F. Supp. 3d 878, 913, 918–21 (S.D. Ind. 2015) (holding for-profit school's practices were abusive and unfair where the school steered students into loans with a known default rate in excess of 60 percent); Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548, 554 (Mass. 2008) (holding mortgage lender's practices were unfair where lender extended credit on terms the lender knew or should have known meant that the loans were "doomed to foreclosure"). In addition, some scholars have recently argued for interventions in consumer financial markets to address extractive pricing. *See generally* Levitin, *Auto*, *supra* note 317; Van Loo, *supra* note 8; *see generally* Luke Herrine, *The Folklore of Unfairness*, 96 N.Y.U. L. REV. 431 (2021) (tracing the evolution of federal unfairness from an expansive doctrine to a narrow doctrine focused on consumer preference and arguing for a return to a more expansive conception of unfairness).

form of producer surplus and to redistribute this producer surplus. As this Article is a broad attack on efficiency frameworks, I am less sanguine about tying interventions to extraction and surplus. Instead, I draw on these concepts in a softer way. I believe we should intervene to address unequal distribution, even if it is difficult to demonstrate extraction (e.g., a captured market and supracompetitive pricing) and the opportunity to redistribute surplus. Put simply, we should feel comfortable intervening in markets if the loans cost too much.

Even a soft neo-Haleian move towards redistributive regulation must address the problems Hale and others faced in attempting to redistribute producer surplus 80 years ago. The first issue Hale and others confronted was where to set rate restrictions.[326] Rates had to be set at a level sufficient to redistribute producer surplus but encourage production and prevent fungible capital from exiting heavily regulated markets.[327] The second issue was the incidence of rate restrictions. It was unclear who bore the costs of rate restrictions and if, on balance, redistributed producer surplus was ultimately a progressive intervention or a regressive one.[328]

As Barbara Fried notes, Ramseyian taxes suffered from similar problems.[329] Ramseyian taxes are like Haleian rate restrictions except focused on redistributing consumer surplus as opposed to producer surplus.[330] Because Ramseyian taxes work best where demand is inelastic, the case for Ramseyian taxes is strongest for necessities as opposed to luxuries.[331] As discussed in Part II, the regressive implications of Ramseyian taxes led scholars to abandon Ramseyian taxes (and Haleian rate restrictions) in favor of redistribution through tax-and-transfer.[332]

There are a few reasons to think a neo-Haleian or neo-Ramesyian move in consumer financial regulation might avoid these problems. First, consumer financial markets are already regressive. In certain consumer financial markets, low-income consumers finance, through higher prices, cheaper services for rich consumers. Natasha Sarin provides some examples of these regressive cross-subsidies. One is overdraft markets. Banks offer free or low-cost checking accounts, pricing these services below cost.[333] Banks can afford this, as Sarin explains, "because fee income generated primarily from low-income consumers, such as overdraft revenue, helped cover the cost of providing these services."[334]

Another example is interchange fees in conventional retail transactions. Credit card companies charge merchants interchange fees, which are passed onto consumers in the form of higher retail prices for goods. Low-income consumers who pay with either cash or debit cards generally absorb these costs. By contrast, wealthy

---

[326] FRIED, *supra* note 50, at 201–02.
[327] *Id.* at 201.
[328] *Id.* at 204.
[329] *Id.* at 203–04.
[330] *Id.*
[331] *Id.*
[332] *See id.* at 204.
[333] Natasha Sarin, *Making Consumer Finance Work*, 119 COLUM. L. REV. 1519, 1569 (2019).
[334] *Id.*

consumers with credit cards and rewards plans often receive cashback, which minimizes the interchange distortion. Indeed, as Sarin explains, "[o]n average, card-using households receive over $1,100 from cash users every year. Rewards are subsidized by higher retail prices for low-income consumers."[335] In both cases, these consumers may be perfectly rational, but rate and term restrictions can help unwind these regressive cross-subsidies.[336]

Second, flexible standards can minimize some of the distortions and reduce some of the complexity associated with setting rate and term restrictions.[337] Rate and term restrictions may be overinclusive and capture consumers who can afford more expensive loans.[338] Lenders may shift the costs of this lost expected revenue by increasing fees for other services. Although cross-subsidies contemplate cost-shifting, too much cross-shifting, as discussed below, can cause the cross-subsidy to unravel.

Conversely, rate and term restrictions might be underinclusive and allow lenders to saddle some consumers with loans that are likely to fail. In addition, it is relatively easy for lenders to structure loans to avoid rate and term restrictions.[339] To avoid these issues, policymakers are increasingly turning to ability-to-repay standards—requirements that a lender evaluate a borrower's ability to repay the loan—in consumer financial regulation.[340] Ability-to-repay standards exist in

---

[335] *Id.* at 1571 (citation omitted).

[336] For example, we could cap or ban overdraft or attempt to minimize interchange fees. As noted in the next section, these restrictions in isolation would not necessarily ensure that wealthier cross-subsidize poorer consumers. Indeed, banks could respond by eliminating services for poor consumers or increasing incentives for wealthier consumers to offset increased costs. Thus, mandates and transfers are both necessary complements to achieving distributionally just outcomes.

[337] Ramsi Woodcock notes that the advent of machine-learning driven personalized pricing might make distortions from redistributive policies less significant. *See* Woodcock, *supra* note 29.

[338] Consider two examples: a loan-to-value ("LTV") limit of 90% and a prohibition on adjustable rates. There may be consumers who would prefer larger loans or can absorb and manage interest rate risk better than other consumers.

[339] Lenders can restructure loans (by, for example, increasing the size of the loan or fees) to achieve the same cash flows the lender would have realized before the rate restriction. *See* Brian T. Melzer & Aaron Schroeder, *Loan Contracting in the Presence of Usury Limits: Evidence from Automobile Lending* 9–10 (Consumer Fin. Prot. Bureau Off. of Rsch., Working Paper No. 2017-02, 2017), https://ssrn.com/abstract=2919070 [https://perma.cc/XP93-79N6] (finding in an empirical study that car dealers that provide seller financing evade binding usury restrictions by pricing credit risk through the mark up as opposed to the interest rate).

[340] *See* Adam Levitin, *Usury 2.0: Toward a Universal Ability-to-Repay Requirement*, CREDIT SLIPS (Jan. 1, 2019, 11:37 PM), https://www.creditslips.org/creditslips/2019/01/toward-a-universal-ability-to-repay-requirement.html [https://perma.cc/5F8F-X4BN] (explaining "that the move in consumer credit regulation has been away from the bright lines of usury laws to more flexible 'ability to repay' standards").

mortgage regulation,[341] credit card regulation,[342] and the recently rescinded Payday Rule.[343] Adopting a flexible standard over a static restriction might minimize some of the problems associated with redistributive rate and term restrictions.

B. Mandates and Transfers

There are a few limits to pursuing rate and term restrictions in isolation. First, poor consumers may rely on financial services outside conventional banking arrangements. For these unbanked and underbanked consumers, it might be difficult to cross-subsidize cheaper services. Second, rate restrictions pursued in isolation can cause the implicit cross-subsidy to unravel. Cross-subsidies "by their nature typically operate only within pools."[344] Financial institutions can respond to a rate or term regulation by dropping the product or raising fees on wealthier consumers to offset reduced revenue from the rate cap.[345] If financial institutions drop the product, low-income consumers may have to turn to costlier alternatives.[346] If financial institutions raise fees on wealthier consumers too much, these consumers may leave the pool, causing prices to spike. This can cause the pool to unravel as financial institutions have to raise fees to account for a smaller pool, which leads to more departures.

The common way to tackle these problems in the regulation of other markets is to expand the pool through mandates and transfers. By mandates, I am referring to what Morgan Ricks calls "universal service requirements,"[347] or Sabeel Rahman describes as "positive obligations to proactively provide equal, affordable, and accessible services to under-served constituencies."[348] These are common devices in the regulation of other markets. Increasingly, there is a recognition that mandates belong in financial markets. Financial institutions distribute public funds and essential services and presently allocate these services in a way that exacerbates economic inequality.[349] Consumer financial markets are broadly regressive, with expensive products for the poor and cheaper products for the rich.[350] Mandates may

[341] 12 C.F.R. § 1026.43 (2021).

[342] *Id.* § 1026.51.

[343] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

[344] Brooks et al., *supra* note 34, at 1274.

[345] *But see* Sarin, *supra* note 333, at 1578–81 (questioning whether banks will pass the costs of regulation on to consumers).

[346] *But see* Littwin, *supra* note 147.

[347] Ricks, *supra* note 32, at 768.

[348] Rahman, *supra* note 32, at 1626. In this sense, the mandates I call for are distinct from soft mandates to provide credit without specific terms that have been criticized as misguided and ineffective. *See* Mehrsa Baradaran, *Jim Crow Credit*, 9 U.C. IRVINE L. REV. 887, 887–88 (2019) [hereinafter Baradaran, *Jim Crow*].

[349] White, *supra* note 32, at 1268–74.

[350] Baradaran, *Jim Crow*, *supra* note 348, at 907–16.

be a way to create larger cross-subsidies to address pervasive regressivity in financial markets.

As an illustration, consider the overdraft example from above. We could use rate and term restrictions to drive down the cost of overdraft and use mandates to ensure that overdraft consumers get access to revolving or other credit on equal terms. These regulations would likely drive up the cost of credit for wealthier consumers, and financial institutions could use those costs to cross-subsidize cheaper services for poor consumers. But rate and term restrictions and mandates are likely insufficient. Financial institutions still may argue they cannot offer services to poor consumers at or below cost without significant fees on rich consumers.[351] And even under a rigorous ability-to-repay standard, loans will continue to be unaffordable for some consumers. Transfers may be able to address both issues of cost and affordability.

We can think of two kinds of transfers: ex ante and ex post. Ex ante subsidies could reduce the burden of providing loans below marginal cost.[352] Ex ante subsidies could also address the issue of unaffordability. If a consumer cannot afford monthly payments on a loan because of insufficient income, then an indirect subsidy could help bridge that gap. But subsidies present a host of other problems and are likely a weak tool to address unaffordability. It may be hard to determine how to target these subsidies. Subsidies may also encourage undesirable consumption.[353] And subsidies do not address the problem of consumers who fall behind after entering into a loan.

Some measure of subsidies may be inevitable, but the better way to handle unaffordability is with ex post debt relief.[354] Relieving existing private debt outside bankruptcy is likely not viable outside some adversarial process. As I have argued elsewhere, a more capacious understanding of UDAAP authority might result in enforcement actions that could restructure costly private debt.[355] But in the absence of these actions, there are likely few avenues to modify existing private debt. The story with new debt is quite different. We can explicitly build in debt relief for new loans in several ways. For example, payments could be scaled to a consumer's income, and the debt could be forgiven after a certain period. We could also empower a regulator to periodically forgive debt as a macroeconomic lever or as a sanction for lender misconduct.

---

[351] This concern may be disingenuous. And I do not view this concern or the tool to address it—subsidies—as critical to my general proposal.

[352] *See* Barr, *Banking*, *supra* note 13, at 222–33 (discussing subsidies to financial institutions).

[353] On the dangers of subsidizing credit, *see* Pamela Foohey, *Consumers' Declining Power in the Fintech Auto Loan Market*, 15 BROOK. J. CORP. FIN. & COM. L. 5, 41–46 (2020) [hereinafter Foohey, *Auto*]; Pamela Foohey, *Bursting the Auto Loan Bubble in the Wake of COVID-19*, 106 IOWA L. REV. 2215, 2235 (2021).

[354] For a similar proposal, see Linarelli, *Debt*, *supra* note 29, at 415–16 (arguing for relaxing the rigidity of debt).

[355] *See* Joseph Sanders & Vijay Raghavan, *Improvident Student Lending*, 2018 UTAH L. REV. 919, 928–31.

The above is just a brief sketch of ways we might try to address the unequal distribution of resources in consumer financial markets. Together, these tools can address demand-side issues in consumer financial regulation and may make it easier to intervene in consumer financial markets on more expansive grounds.

C. Revisiting Student Loans

I began this Article with the example of student loans and then spent the bulk of it discussing fringe financial products. Let me briefly defend that choice.

The approaches outlined above are all features of the regulatory landscape in student lending. Student loan regulation includes loan restrictions, universal access, and transfers.[356] Some have suggested that the way to fix the student debt crisis is by making the cross-subsidies in student lending more transparent and progressive.[357] There is a lack of parity between the way we structure and regulate student loans and fringe financial markets. Using a broader policy toolkit that includes distributional levers can address financial market inequity and harmonize our approach to regulation across different lending sectors.

One obvious objection to the comparison is that student loans are fundamentally different from fringe financial products. The student loan market is shaped and controlled by the federal government, which makes it both easier to use an expansive set of tools and to defend that choice. But it is important to remember that the federal structure of higher education financing was not always explicit or well-understood.

The late twentieth-century shift in higher-education policy from low tuition and direct subsidies to high tuition and indirect subsidies obscured the public nature of higher education financing.[358] And this colored the way the scholars and policymakers approached problems in higher education financing.[359] Recovering the way higher education financing is a species of public law was an active project. Scholars worked to reshape our understanding of how federal policy shapes higher education financing, and how we can change this policy.[360]

There is an emerging shift in legal scholarship away from conceptualizing markets as private and self-correcting to publicly constructed and actively governed.

---

[356] *See* John R. Brooks, *The Case for More Debt: Expanding Affordability by Expanding Income-Driven Repayment*, 2018 UTAH L. REV. 847, 848–50; John R. Brooks, *Income-Driven Repayment and the Public Financing of Higher Education*, 104 GEO. L.J. 229, 251 (2016) [hereinafter Brooks, *Repayment*].

[357] *See* Brooks, *Repayment*, *supra* note 356, at 279–87.

[358] SUZANNE METTLER, DEGREES OF INEQUALITY: HOW THE POLITICS OF HIGHER EDUCATION SABOTAGED THE AMERICAN DREAM (2014).

[359] *See id.*

[360] *See, e.g.*, *id.*; Brooks, *Repayment*, *supra* note 356, at 230–31; Herrine, *supra* note 1; Dalié Jiménez & Jonathan D. Glater, *Student Debt Is a Civil Rights Issue: The Case for Debt Relief and Higher Education Reform*, 55 HARV. CIV. RTS. - CIV. LIBERTIES L. REV. 131, 133–34 (2020); Jonathan D. Glater, *Student Debt and Higher Education Risk*, 103 CALIF. L. REV. 1561 (2015).

You can see traces of this shift in antitrust, consumer protection, energy law, and banking.[361] Although this article does not offer a thick account of how fringe financial markets are publicly constructed and governed,[362] it highlights how the law shapes supply and demand in this market. As discussed below, the policy implications of surfacing these issues are contested and a bit unclear. But my hope is that a pivot towards distribution can help us engage with the ways the law shapes supply and demand in consumer financial markets as opposed to merely viewing consumer law as a gap-filling layer on top of private law.

IV. IN DEFENSE OF SOCIAL PROVISION PLURALISM

This Article focuses on the primary argument in the legal literature against redistribution outside tax-and-transfer. In this Part, I consider a different objection to redistribution through the financial system: path dependency.[363] A central puzzle in comparative political economy is why there is more poverty in America than in other advanced industrial nations.[364] One answer is that America features a minimal state with a largely unregulated market.[365] In her history of twentieth-century American political economy, Prasad contends that this popular account has it squarely backward.[366]

---

[361] *See, e.g.*, William Boyd, *Ways of Price Making and the Challenge of Market Governance in U.S. Energy Law*, 105 MINN. L. REV. 739 (2020); Sanjukta Paul, *Antitrust as Allocator of Coordination Rights*, 67 UCLA L. REV. 378 (2020); Nathan Tankus & Luke Herrine, *Competition Law as Collective Bargaining Law*, *in* LABOUR IN COMPETITION LAW (forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3847377 [https://perma.cc/3F4N-NWZA]; Luke Herrine, *What Is Consumer Protection For?*, LOY. CONSUMER L. REV. (forthcoming 2022); Sanjukta Paul, *Recovering the Moral Economy Foundations of the Sherman Act*, 131 YALE L. J. 175 (2021). Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017).

[362] I expand on these themes and attempt to offer a thicker account in forthcoming work. *See* Vijay Raghavan, *Shifting Burdens at the Fringe*, B.U. L. REV. (forthcoming 2022).

[363] Path dependency is certainly not the only objection one could raise. As noted in Part III, there are a number of complex design problems associated with redistributive policies. In addition, there is a rich literature on the limits of public-private efforts to redistribute wealth. *See, e.g.*, JACOB S. HACKER, THE DIVIDED WELFARE STATE: THE BATTLE OVER PUBLIC AND PRIVATE SOCIAL BENEFITS IN THE UNITED STATES (2002); SUZANNE METTLER, THE SUBMERGED STATE: HOW INVISIBLE GOVERNMENT POLICIES UNDERMINE AMERICAN DEMOCRACY (2011). By ignoring these issues, I do not mean to suggest they are unimportant. However, I avoid discussing these issues at length because I view them as mostly design issues that exist with any effort to redistribute income. By contrast, path dependency is an argument that is specific to the kind of non-tax redistribution I advocate here and one that, if correct, might imperil the entire project.

[364] *See* PRASAD, *supra* note 36, at xi.

[365] *Id.*

[366] *Id.* at xi–xii.

America does not feature a minimal state but a highly interventionist one with extensive taxation and regulation.[367] Per Prasad, the modern regulatory state emerged as a result of a series of interventions in the late nineteenth and early twentieth century.[368] These interventions were the product of tension between America's productive capacity and extensive poverty and a unique agrarian political economy.[369] Agrarian populists pushed for the breakup of concentrated capital and subsidization of consumption, which culminated in antimonopoly legislation, the progressive income tax, decentralization of finance, and extensive federal interventions in financial markets.[370]

American interventions were different than European interventions, which featured regressive consumption taxes and social welfare.[371] Prasad argues that this difference helps explain the neoliberal turn in the 1970s and 1980s.[372] Progressive income taxes and extensive regulation gave rise to a deregulatory backlash during the economic crisis of the 1970s.[373] Financial deregulation and the liberalization of credit were the products of this neoliberal backlash.[374] As a result, today, we rely on private credit to provide social provision, and this arrangement has proved much less effective at fighting poverty than European social welfare.[375]

Prasad does not suggest that market regulation was deliberately pursued to undermine the development of a robust welfare state. Anne Fleming, however, suggests there is some evidence that regulation was pursued to prevent the expansion of the welfare state.[376] In particular, Fleming explains that a key argument of early consumer advocates was that consumer credit regulation would "prevent pauperism and thereby reduce spending on public welfare."[377] Fleming suggests there is a throughline between early twentieth-century "anti-pauperist" arguments and present calls for greater consumer financial regulation.[378]

If Prasad and Fleming are correct and there is a trade-off between credit and public welfare, is that necessarily a bad thing? Abbye Atkinson suggests we should have serious concerns about credit as our exclusive form of social provision.[379] Atkinson identifies two important problems with credit as social provision. The first

---

[367] *Id.* at 253–54.
[368] *Id.*
[369] *Id.*
[370] *See* PRASAD, *supra* note 36, at 253–54.
[371] *Id.* at 253–55.
[372] *Id.* at 255–56.
[373] *Id.*
[374] *Id.*
[375] The most notorious example of which is the Organization for Economic Co-Operation and Development's ("OECD") poverty rate measure. Data, *Poverty Rate*, OECD, https://data.oecd.org/inequality/poverty-rate.htm#indicator-chart [https://perma.cc/2USX-BRSB] (last visited Sept. 12, 2021) (finding the United States poverty rate second highest amongst all OECD nations in between Romania and Costa Rica).
[376] Fleming, *supra* note 40.
[377] *Id.* at 162.
[378] *Id.* at 178–79.
[379] Atkinson, *Rethinking*, *supra* note 15.

is that credit is an intertemporal transfer of wealth, shifting "an individual's future capital to facilitate present consumption."[380] If there is no interperiod redistribution, credit can only work as a social provision if the borrower's economic standing improves between when the debt is incurred and must be repaid.[381] And there is little evidence that private credit facilitates this economic transformation. The second issue is that credit that cannot be repaid becomes debt, which has often functioned as a mechanism to subordinate socioeconomically marginalized groups.[382] And Pamela Foohey raises a third and important issue: credit may encourage undesirable consumption.[383]

There are a few reasons to doubt the strongest version of the path dependency argument. First, it is not entirely clear that there is a trade-off between social provision through the financial system and traditional social welfare.[384] Prasad herself makes clear that the events that led to the development of the modern American financial system were the product of multiple factors.[385] New Deal era interventions did not necessarily preclude other interventions. And it is not obvious that pursuing more redistributive policies in consumer law will "crowd out" other forms of redistribution.

Second, whether credit functions as social provision turns less on the mechanics of credit as an abstract notion and more on the concrete set of legal obligations tied to the credit relationship. In fact, much of the modern criticism of private credit is tied to deregulatory moves that made both the costs of credit and the damage of debt more severe at a time when credit markets opened to historically marginalized groups.[386] That is not to suggest that repairing the New Deal architecture is sufficient. Credit absolutely cannot function as our only form of social provision. But credit markets can function better than they presently do.[387]

Finally, it is not clear that ignoring distributional issues in consumer law will necessarily yield good outcomes. There is very little evidence that a lack of redistribution in law results in more redistribution through tax-and-transfer.[388] Moreover, there are good reasons to think that private credit may remain a problem

---

[380] *Id.* at 1098.

[381] *Id.* at 1098–99.

[382] Atkinson, *Borrowing*, *supra* note 44.

[383] *See* Foohey, *Auto*, *supra* note 353, at 2217, 2226–30.

[384] Indeed, our present experience suggests the opposite. We are witnessing one of the most dramatic expansions in our social safety net in fifty years coupled with more robust financial regulation and enforcement.

[385] *See* PRASAD, *supra* note 36, at 251 (suggesting weak path dependence between New Deal interventions and the neoliberal backlash in the 1970s and '80s).

[386] *See* Atkinson, *Borrowing*, *supra* note 44; Baradaran, *Jim Crow*, *supra* note 348, at 910. For an extensive treatment of reverse redlining as a result of Nixon-era housing policy, see KEEANGA-YAMAHTTA TAYLOR, RACE FOR PROFIT: HOW BANKS AND THE REAL ESTATE INDUSTRY UNDERMINED BLACK HOMEOWNERSHIP (2019).

[387] On the modern promise of policy levers with a checkered past *see* Monica Prasad, *Histories of Hammers*, JUST MONEY (Aug. 26, 2021), https://justmoney.org/m-prasad-histories-of-hammers/ [https://perma.cc/BC8Y-LV8A].

[388] *See supra* Section I.C.

even with robust social welfare.[389] Thus, we should not expect that the availability of social welfare or public options will eliminate or necessarily diminish demand for potentially exploitative private credit. If that is true, it is unclear what pursuing a suboptimal policy in consumer law achieves.

WHY NOT CONSUMER LAW?

What I have attempted to show in this Article is that background legal conditions shape demand in consumer markets in a way that makes it difficult to regulate markets without the tools to change those background conditions. But considering the events of the last few years, is there anyone who really doubts that is true? The simple answer is yes. As the student debt relief debate highlights, there are plenty of people who object to redistribution outside tax-and-transfer on the grounds that it is inefficient, regressive, and will crowd out other forms of redistribution. But even if that were not the case, there is still the issue of how to allocate redistributive authority.

The distributive levers that I explore in this Article are not new. Many other scholars have explored similar themes. Yet few have suggested that this redistributive authority should be located within consumer law or with a consumer regulator. I have been somewhat vague about what redistributive consumer law might look like in practice. I will end by briefly sketching out one possible future.

One way to understand my push for more redistribution in consumer law is an attempt to deliver on the promise of reform in 2007. Scholars and policymakers advocated for a new federal regulator for several reasons. One reason was that existing authority over consumer financial regulation was fragmented and inconsistently applied.[390] But a second and equally important reason was that prudential regulators largely believed their primary mandate was to protect financial institutions.[391] And during the Trump Administration, regulators reclaimed their mantle as the guardians of finance.[392]

---

[389] *See* Kiel & Ernsthausen, *supra* note 13 (discussing how Americans used stimulus money to service existing debts); *cf.* Matthew A. Bruckner, *Debtor-Creditor Issues with Basic Income Guarantees*, 29 AM. BANKR. INST. L. REV. 171 (2021) (arguing that basic income guarantees could leave Americans worse off without consumer protections against debt collectors).

[390] *See, e.g.*, Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY J. IDEAS, https://democracyjournal.org/magazine/5/unsafe-at-any-rate/ [https://perma.cc/Q4H8-FYVY] (last visited Sept. 12, 2021).

[391] *Id.* ("[Prudential regulators believe] their main mission is to protect the financial stability of banks and other financial institutions, not to protect consumers. As a result, they focus intently on bank profitability and far less the financial impact on customers of many of the products the banks sell.").

[392] *See* Permissible Interest on Loans that Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pt. 7, 160); National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68,742 (Oct. 30, 2020) (to be codified at 12 C.F.R. pt. 7).

Finance affects the lives of millions of ordinary Americans. Consumer advocates wanted consumers to have a seat at the table. They got their desired agency, but there were important limits. The CFPB has some prudential-like powers: it can supervise and examine financial institutions. But the CFPB lacks the tools to coordinate economic activity.[393]

The CFPB cannot directly restrict rates, and its general unfairness authority is subject to a cost-benefit standard. Moreover, the CFPB likely lacks the authority to use all the distributional levers discussed in this Article. The CFPB likely has the power to redistribute some income pursuant to its general UDAAP authority. But the CFPB presently lacks the ability to broadly implement this Article's prescriptions.

One simple implication of this Article then is that we should reconsider the compromise struck in Dodd-Frank and grant the CFPB broader authority to coordinate economic activity. For some, this may seem misguided. Many scholars recognize that Dodd-Frank was an incomplete solution to the problems that ailed consumer financial markets. For these scholars, the solutions generally lie outside consumer law.[394] While I am broadly sympathetic to these reform efforts, I believe consumer law can play a role in the broader effort to democratize finance.

There are other good reasons why it may not be wise to pursue legislation that expands the CFPB's authority. Such an effort would inevitably lead to a discussion about its overall structure. But that fight might be worth engaging in if it resulted in the CFPB having tools to regulate not only the supply of credit but also the demand for credit.[395]

---

[393] Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VAND. L. REV. 951 (2021) (discussing bank agency coordination authority and specifically distinguishing the CFPB). Adam Tooze suggests this may have been by design. ADAM TOOZE, CRASHED: HOW A DECADE OF FINANCIAL CRISIS CHANGED THE WORLD 304–07 (2018) (describing how, in negotiating the language of Dodd-Frank, Ben Bernake and Timothy Geithner used the CFPB "as a pawn sacrifice" to neuter the "'populist fury' of the 'atonement agenda,'" which included the push to nationalize banks: "[the creation of the CFPB] allowed the reform campaign to claim a major win" but "was largely irrelevant to the vision of systemic stabilization that Geithner and Bernake were pursuing").

[394] *See* Saule T. Omarova, *The People's Ledger: How to Democratize Money and Finance the Economy*, 74 VAND. L. REV. 1231 (2021); Saule T. Omarova, *Why We Need a National Investment Authority* (Apr. 20, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566462 [https://perma.cc/ZG9B-PLWS]; John Crawford, Lev Menand & Morgan Ricks, *FedAccounts: Digital Dollars*, 89 GEO. WASH. L. REV. 113, 116–19 (2021).

[395] *See* PRASAD, *supra* note 36, at 260–61 (discussing the need to focus on the supply and demand for consumer credit).