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Truth, Understanding, and High-Cost Comsumer Credit: The Historical Context of the Truth in Lending Act

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TRUTH, UNDERSTANDING, AND HIGH-COST CONSUMER CREDIT: THE HISTORICAL CONTEXT OF THE TRUTH IN LENDING ACT

*Christopher L. Peterson**

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I. INTRODUCTION

Consumer credit is older than money.[1] The practice of exchanging things of value in return for the obligation of future repayment is, paradoxically, one of humanity's most useful and dangerous social inventions. The earliest form of credit was probably a version of "you scratch my back and I'll scratch yours." The creditor was "in effect a gift giver who merely expect[ed] a 'delayed' reciprocal gift from the recipient."[2] Historians and archeologists speculate that interest itself probably originated some time during the late Paleolithic or early Mesolithic ages between, about 8000 and 5000 B.C.E.[3] With farming, the accumulation of capital in the form of livestock, tools, and seed took on an

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1. SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 3, 17 (3d ed. 1996). "Credit long antedated industry, banking, and even coinage; it probably antedated primitive forms of money." *Id.* at 3. Paul Einzig further explains:

> Deferred payments played an important part in the life of primitive communities from a very early stage. . . . Credit existed on a fairly extensive scale before the stage of money economy was reached. There are many ethnographic instances of credit in kind in communities where no trace of any medium of exchange or even standard value has been discovered . . . . Even during the most primitive phase of barter when the exchange of goods assumed the form of reciprocal presents or services, there was often a discrepancy between the time of making the original payment or rendering the original service and that of the reciprocation. In a sense, it is therefore true to say that credit existed from the very earliest phases of economic activity, even before the evolution of barter proper.

PAUL EINZIG, PRIMITIVE MONEY IN ITS ETHNOLOGICAL, HISTORICAL AND ECONOMIC ASPECTS 362-63 (1966).

2. WILLIAM CHESTER JORDAN, WOMEN AND CREDIT IN PRE-INDUSTRIAL AND DEVELOPING SOCIETIES 13 (1993).

3. HOMER & SYLLA, *supra* note 1, at 19.

importance likely unfamiliar to the nomadic hunter-gatherers of earlier eras.[4] This desire to collect capital probably gave impetus to more clearly define the terms of previously ambiguous credit.[5] Loans were usually payable in either grain, animals, or metal.[6] The earliest historic interest rates ranged from 20-50% per annum, later stabilizing at 33% for loans on grain, and 20-25% for loans of silver.[7] Loans were made to invest in future production as well as for "nonproductive" purposes, the latter being accurately characterized as consumer credit.[8] There is, of course, no reason to suspect that greed, or, more charitably, the desire to successfully compete in a world of scarce resources, was any less a motive at the dawn of civilization than it is today.[9] Because creditors often lent to those in desperate need of food or shelter, the relative bargaining position of debtors often placed them at a significant disadvantage.[10] Also, in the absence of standard currencies, ambiguity over what constituted acceptable payment of a debt left wide latitude for abuse.[11] Thus, "[h]uman nature being what it is, trouble must have developed quickly. The rich extracted

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4. *See id.* at 18-20; EINZIG, *supra* note 1, at 362-63.

5. James M. Ackerman, Note, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 63; *see also* A. LEO OPPENHEIM, INTRODUCTION TO LETTERS FROM MESOPOTAMIA: OFFICIAL BUSINESS, AND PRIVATE LETTERS ON CLAY TABLETS FROM TWO MILLENIA 4-5 (A. Leo Oppenheim trans., 1967) (noting the importance of records in a "storage economy").

6. *See* HOMER & SYLLA, *supra* note 1, at 21.

7. *Id.* at 21, 29.

8. *Id.* at 18; *see also* CHARLES O. HARDY ET AL., CONSUMER CREDIT AND ITS USES 4-5 (1938) ("For the most part loans were not made to persons who, because they borrowed, were able to increase their own earning power and through this increase repay their debts."); Ackerman, *supra* note 5, at 63 ("The earliest loans were probably extended to people in immediate difficulty—what we would call personal or consumer loans.").

9. HOMER & SYLLA, *supra* note 1, at 21 ("Along with the early development of money and credit there also grew up abuses and prejudices. Some have continued to this day.").

10. *See* ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 584 (8th ed. 1949).

11. The Babylonian Code of Hammurabi attempted to address this problem by asserting that debts may be tendered in various types of goods. Ostensibly this prevented some abuses by creditors by preventing creditors from requiring payment in some rare or out-of-season good. *See* THE OLDEST CODE OF LAWS IN THE WORLD: THE CODE OF LAWS PROMULGATED BY HAMMURABI, KING OF BABYLON B.C.E. 2285-2242, at 59 (C.H.W. Johns trans., 1905) [hereinafter THE OLDEST CODE].

> If a man has to pay, in money or corn, but has not money or corn to pay with, but has goods, whatever is in his hands, before witnesses, according to what he has brought, he shall give to his merchant. The merchant shall not object, he shall receive it.

Id. Historians no longer believe that the Code of Hammurabi is the oldest code of laws in the world. Since Johns' book was published, a number of important archeological discoveries have outdated his title. Nevertheless, Johns' translation and index to the Code are accessible and user friendly. A more scholarly but less convenient translation is G.R. DRIVER & JOHN C. MILES, 2 THE BABYLONIAN LAWS (1955).

hard bargains and grew richer; the poor fell into perpetual debt and forfeited their meager possessions."[12] Consumer credit was one of the earliest tools of forced poverty, social oppression, and enslavement.[13]

Thousands of years later consumer credit has played a similar role in United States history. With credit taking the form of indentured servitude, many of the earliest European colonizers borrowed their way to America using their bodies as security and often paying with their lives.[14] After a constitutional crisis and civil war won freedom for African-American slaves, the landed white Southern gentry turned to the high-cost credit system of share cropping as the next best substitute for whips and chains.[15] At the beginning of the twentieth century, entire generations of the working poor in large Eastern cities sacrificed their chances of joining the middle class to salary lenders.[16] At the beginning of the twenty-first century, "payday" lenders in almost every state have partnered with banks to avoid regulation and sold the same credit products as salary-lending loan sharks did a hundred years earlier.[17] These and other lenders—variously called

12. Ackerman, *supra* note 5, at 63.

13. HARDY, *supra* note 8, at 4-5; H.W.F. SAGGS, BABYLONIANS: PEOPLES OF THE PAST 97 (1995); Ackerman, *supra* note 5, at 63-4.

14. *See* HOWARD ZINN, A PEOPLE'S HISTORY OF THE UNITED STATES: 1492-PRESENT 43 (Rvsd. ed., 1995) (arguing the profit to be had by purveyors of indentured servants, rather than the servants themselves, was among the most powerful forces leading to colonization); Vern Countryman, *Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 812-13 (1983) ("It is estimated that nearly half of our total white immigration came over under indenture.").

15. GERALD DAVID JAYNES, BRANCHES WITHOUT ROOTS: GENESIS OF THE BLACK WORKING CLASS IN THE AMERICAN SOUTH, 1862-1882, at 32 (1986); Donald G. Nieman, *Introduction* to FROM SLAVERY TO SHARECROPPING: WHITE LAND AND BLACK LABOR IN THE RURAL SOUTH 1865-1900, at *x-xi* (1994); James Smallwood, *Perpetuation of Caste: Black Agricultural Workers in Reconstruction Texas*, *in* AFRICAN AMERICAN LIFE, 1861-1900: FROM SLAVERY TO SHARECROPPING 227, 229 (Donald G. Nieman ed., 1994); HAROLD D. WOODMAN, KING COTTON AND HIS RETAINERS: FINANCING AND MARKETING THE COTTON CROP OF THE SOUTH, 1800-1925, at 310-11 (1968); C. VANN WOODWARD, ORIGINS OF THE NEW SOUTH, 1877-1913, at 207 (1951).

16. These creditors were known as the first "loan sharks." LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 49-52 (1999); LOUIS N. ROBINSON & MAUDE E. STEARNS, TEN THOUSAND SMALL LOANS: FACTS ABOUT BORROWERS IN 109 CITIES IN 17 STATES 11 (1930); CLARENCE W. WASSAM, THE SALARY LOAN BUSINESS IN NEW YORK CITY 26 (1908); Mark H. Haller & John V. Alviti, *Loansharking in American Cities: Historical Analysis of a Marginal Enterprise*, 21 AM. J. LEGAL HIST. 125, 133-34 (1977); Peter R. Shergold, *The Loanshark: The Small Loan Business in Early Twentieth-Century Pittsburgh*, 45 PENN. HIST. 200, 202 (1978).

17. Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 605 (2000); Jean Ann Fox, *Safe Harbor for Usury: Recent Developments in Payday Lending*, CONSUMER FEDERATION OF AMERICA REPORT 9-10 (1999); Scott Andrew Schaaf, Note, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. BANKING INST. 339, 357 (2001); *see* James J. White, *The Usury Trompe*

predatory lenders, sub-prime lenders, fringe bankers, but more conveniently and equitably termed "high-cost" lenders—continue to extract the same hard bargains from the ignorant and desperate poor as their progenitors did five thousand years ago.[18]

Today a debate claiming such notable expositors as Hammurabi, Moses, Plato, Dante, Shakespeare, Hai Jui, and Benjamin Franklin has been forged anew. From the late 1970s through the mid-1980s, many states eliminated or relaxed their regulation of consumer credit.[19] This was in response to factors such as the high market equilibrium interest rates of the

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l'Oleil, 51 S.C. L. REV. 445, 445 (2000). Turn of the century salary lenders and today's post-dated check payday lenders both lend at interest rates typically around 10% per week—or 520% per annum. Christopher L. Peterson, Comment, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV 543, 548-49.

18. The term "high-cost credit" has grown in popularity since 1994 when the Home Ownership and Equity Protection Act (HOEPA) established enhanced disclosure rules and some substantive regulations for home mortgages exceeding price threshold triggers. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, § 151, 108 Stat. 2190 (1994). The relevant regulatory provision itself is entitled "Requirements for certain closed-end home mortgages." 12 C.F.R. § 226.32 (2002). However, courts, along with most commentators, have adopted the more convenient term "high-cost" to reference loans subject to HOEPA. *See, e.g.*, Williams v. Gelt Fin. Corp. (*In re* Williams), 232 B.R. 629, 636 (Bankr. E.D. Pa. 1999) ("HOEPA thus placed new restrictions on lenders dealing in so called 'high-cost' mortgages by establishing additional 'advance look' disclosure requirements and imposing limits on some potentially abusive substantive terms."). Some litigants and courts also use the description in non-HOEPA contexts. *See, e.g.*, DeBerry v. First Gov't Mortgage & Investors Corp., 170 F.3d 1105, 1107 (D.C. Cir. 1999). The convenient term has also found its way into recent state laws. *See* Am. Fin. Servs. Ass'n v. Burke, 169 F. Supp. 2d 62, 64, 67-69 (D. Conn. 2001) (granting an injunction against Connecticut Banking Commissioner blocking enforcement of state law prohibiting mandatory arbitration clauses in "high-cost home loan[s]"); *see also* Alvin C. Harrell, *Subprime Lending Developments with Implications for Creditors and Consumers*, 52 CONSUMER FIN. L. Q. REP. 238, 245 (1998); Kathleen E. Keest et al., *Interest Rate Regulation Developments: High-Cost Mortgages, Rent-to-Own Transactions, and Unconscionability*, 50 BUS. LAW. 1081, 1084 (1995); Deborah Goldstein, Note, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 232 (2000). For purposes of this Article, the term "high-cost" is one of convenience, aimed at describing the upper end of consumer credit usually extended to the poor and those with risky credit records. Admittedly, at what point credit should be considered high-cost is open to debate. Some would say all consumer loans have high-costs in comparison to commercial loans, while others would argue no loan has a high cost if the borrower willingly agrees to it. This Article does not explore at what particular point a loan should be considered "high-cost." Certainly, an 800% annual percentage rate (APR) "payday" loan qualifies. A 6.7% APR thirty-year, fixed-rate mortgage with low points and fair contractual terms does not. Whether a 29% APR revolving credit card contract qualifies as high-cost is an open question.

19. PAUL R. BEARES, CONSUMER LENDING 12 (2d ed. 1992); KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES 54-55 (1995); Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 201 (1986).

period (which raised depository lender's costs of funds to the point that profitable lending was difficult within interest rate caps)[20] and the Supreme Court's decision allowing banks to export their home state's usury law to consumers in other states.[21] Since then the relatively low-priced consumer credit supplied to the middle class has continued to grow, financing consumer spending. In the wake of deregulation, however, markets for much higher priced loans extended to the financially vulnerable lower middle class, the working poor, and the desperate have seen comparably enormous growth.[22] Sensing widespread abuse, the nation's newsprint media has complained vitriolically, touching off a timely national discussion of an ancient topic.[23] For our society, like civilizations before

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20. BEARES, *supra* note 19, at 12.

21. Marquette Nat'l Bank v. First Omaha Serv. Corp., 439 U.S. 299 (1978); DeMuth, *supra* note 19, at 215-16.

22. JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 139 (1994) [hereinafter FRINGE BANKING] ("Over the 1980s, the number of pawnshops and check-cashing outlets nationwide more than doubled."); JOHN P. CASKEY, LOWER INCOME AMERICANS, HIGHER COST FINANCIAL SERVICES 59 (1997) ("It is also argued that reaching out to these households is a good business proposition, since the number of households using the alternative financial sector is large and growing."); KEEST, *supra* note 19, at 59 (stating that, "[Credit costs] may not be a problem for most consumers, who typically use credit cards or retail charge accounts for small-sum, short-term credit. But for other consumers, a variety of alternate sources with effective rates that would make a loan shark jealous have sprung up."); Michael Hudson, *The Poverty Industry, Introduction* to MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY 2 (Michael Hudson ed., 1996) ("Big companies are fueling the expansion and 'incorporation' of the poverty industry by pouring in growth capital and providing the sheen of brand-name respectability to transactions that Main Street and Wall Street once viewed with distaste.").

23. *See, e.g.*, Paul Beckett, *Clashing Interest: Why Patricia Heaton Could Cause Problems for a GE-Owned Bank*, WALL ST. J., Mar. 30, 2001, at A1 ("At stake is whether . . . the GE-owned bank . . . can skirt consumer-protection laws in states such as Louisiana by basing its operations in Georgia, which has relatively permissive rules on interest rates."); Ulysses Currie, *Maryland's Legal Loan Sharks*, WASH. POST, Nov. 21, 1999, at B08 ("Maryland should . . . prohibit the practice of the payday loan, which preys upon our state's poor and financially desperate."); Dean Foust, *Easy Money: Subprime Lenders Make a Killing Catering to Poorer Americans. Now Wall Street is Getting in on the Act*, BUS. WK., Apr. 24, 2000, at 107 ("[W]hat is new is the invasion of mainstream financiers into what was once the sole province of check cashers, pawnshops, and the like."); Adam Geller, *Payday Lenders Find Ways Around Restrictions*, CHI. TRIB., Mar. 6, 2001 ("In all, [a customer] says she paid $1800—an annual interest rate of nearly 800 percent—and still owed every penny of her original loan."); Molly Ivins, *Feeding Off the Bottom*, NEWS & OBSERVER (Raleigh, N.C.), Apr. 12, 2000, at A19 ("Another form of legal robbery is 'payday lending,' a practice that makes mob loan sharks look good."); Mary Kane, *Subprime Mortgage Loans Raise Concerns; High Rates, Fees Leave Little Equity, Lots of Risk*, NEW ORLEANS TIMES-PICAYUNE, Apr. 9, 2000, at F1 ("In a record economy . . . it might seem odd for anyone to worry about home ownership problems. But the growth of subprime lending—high rate, high-fee loans—along with loans that require no down payments or allow for huge debts, is raising concern."); Peter T. Kilborn, *New Lenders With Huge Fees Thrive on Workers With Debts*, N.Y. TIMES, June 18, 1999, at A1 ("[A]s borrowers amass loans, taking new ones to pay the fees on the others, the fastest way

it, the central quandary in high-cost credit policy has been balancing the need to protect the vulnerable with the need to facilitate economically and socially useful trade in credit.

This Article does not purport to resolve so dense an impasse. Instead it hopes to serve two more modest but related goals. The first is to provide a new conceptual tool for organizing discussions of consumer credit in general, and high-cost consumer credit in particular. The world's past civilizations have employed only relatively few types of strategies for addressing this fundamental dilemma. Unfortunately, historians—and in turn policymakers and legal practitioners—have not recognized the similarities between these strategies because most historical treatments focus either on one culture or on one strategy. When we step back and paint with the broader brush strokes of historical case studies, patterns of common social responses to consumer credit problems emerge. These patterns are important both because they provide a new way of organizing discussions about consumer credit policy and because they shed contextual light on the limitations of our current strategies. Sadly, most of our current consumer credit policies have histories of failure dating back hundreds or

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to payday becomes a fast way, too, to garnished wages and bankruptcy."); Paul Muolo, *Be Careful, Fannie and Freddie, Subprime Land Mines Lie Ahead*, 4 MORTGAGE SERVICING NEWS 5, 5 (2000) ("As any mortgage pro knows, subprime lenders these days are akin to 'predatory' lenders. A predatory lender is a dressed up word for 'loan shark.'"); Jane Bryant Quinn, *Little Loans Come at Staggering Cost*, WASH. POST, June 13, 1999, at H02 ("A payday loan can help someone out of a tight spot, provided that he or she borrows only once. But the lenders work hard at turning new borrowers into repeat customers, paying fees again and again."); Terence Samuel, *Support Grows for Controls on "Predatory Lending,"* ST. LOUIS POST-DISPATCH, Apr. 16, 2000, at A12 ("[C]oncern is growing in many quarters that as that sub-prime lending market booms, many people, particularly the elderly and the poor, are being savaged by unscrupulous operators who prey on their ignorance, inexperience or desperation."); Edmund Sanders, *Ameriquest Defends Loan Practices; Mortgage: Sub-Prime Lender Says It Has Been Fair, But Activists See Examples of Predatory Lending. The Two Sides Are Meeting to Resolve Their Differences*, L.A. TIMES, Apr. 9, 2000, at C1 ("Scores of Protestors stormed into an Ameriquest Mortgage Co. office . . . chanting slogans like 'No more loan sharks!' and 'People over profits!'"); Gwyneth K. Shaw, *Battle Looms Over High-Interest Payday Loans*, ORLANDO SENTINEL, Mar. 26, 2000, at A1 ("A survey of 34 payday lenders [in Florida] showed interest rates average 400 percent for a two-week loan, and can go up to more than 600 percent."); Kirsten Stewart, *Survey Finds Tactics of Some Lenders Questionable; Compliance with Disclosure Laws Lacking, Law Student Says*, SALT LAKE TRIB., Apr. 24, 2001, at E1 ("A University of Utah law student's random survey of check-cashing centers in the Salt Lake area found that a majority don't fully comply with state and federal disclosure laws designed to protect consumers from unfair lending practices."); *Borrowing Trouble: How Can Legislators Not Be Offended by Payday-Advance Businesses that Charge Outrageous Fees to Cash-Strapped Consumers? Leaders, Step Forward*, ORLANDO SENTINEL, Apr. 17, 2000, at A10 ("Florida ought not to be a haven for people who prey on others in financial distress."); *Senator Seeking Input on Subprime Loans; Meeting to Target Predatory Lending*, DALLAS MORNING NEWS, Apr. 20, 2000, at 1C ("The subprime market increased from $20 billion in 1993 to more than $150 billion in 1998."); *Time to Restore Loan-Sharking Laws*, SANTA FE NEW MEXICAN, Apr. 9, 2000, at F-8 ("[F]or the moment, nothing can be done about this traffic in human misery.").

even thousands of years. Policymakers must be re-apprised of these failures.

The second insight of this Article is that, from a historical perspective, consumer credit price disclosure rules, such as the Truth in Lending Act (TILA),[24] are a unique and relatively recent strategy for protecting vulnerable consumers from abuse by predatory lenders. In the mid-1950s policymakers and scholars came to realize that the middle class, which was borrowing in greater numbers than ever before, was unable to compare the prices of credit.[25] Because creditors calculated interest rates in many different ways, quoted prices bore no meaningful relation to each other.[26] Following Massachusetts,[27] Congress passed the Truth in Lending Act in 1968[28] which required lenders to use uniform annual percentage rate (APR) terminology, as well as disclose many other aspects of credit contracts.[29] The hope was that with uniformly disclosed prices, consumers would be able to shop for the best deal, thus better protecting themselves and forcing creditors to offer lower prices.[30] Despite these hopes, in recent years credit disclosure rules have fallen from the favor of consumer advocates, legal service attorneys, and scholars bent on protecting working and lower middle class consumers. Where thirty years ago critics of disclosure were likely to be banking industry lobbyists, today's critics are more likely to be non-profit consumer activists. These activists complain that watered down disclosure laws are too complex, come too late in negotiations, and are not accurate enough.[31] Even worse, consumer activists complain the industry

24. 15 U.S.C. §§ 1601-1667e (2002).

25. KATHLEEN E. KEEST & GARY KLEIN, NATIONAL CONSUMER LAW CENTER TRUTH IN LENDING 31 (3d ed. 1995).

26. *Id.*

27. Act of May 16, 1966 Mass. Acts 284; Act of Aug. 31, 1966 Mass. Acts 587 (codified as amended at MASS. GEN. LAWS ANN. ch. 140C, §§ 1-13 (West 1974), *repealed by* Act of Dec. 24, 1981, 1981 Mass. Acts 733 § 1); *see also* Edward L. Rubin, *Legislative Methodology: Some Lessons From the Truth-in-Lending Act*, 80 GEO. L.J. 233, 252-53 (1991) (discussing effect of Massachusetts disclosure laws on later federal law).

28. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified in 15 U.S.C. §§ 1601-1667e).

29. *Id.* The 1968 Act, entitled the Consumer Credit Protection Act, included provisions in addition to the Truth in Lending disclosure rules. *Id.* The Truth in Lending Act has since come to refer to the disclosure provisions of the Consumer Credit Protection Act. *See* Rubin, *supra* note 27, at 262. Because this Article is concerned primarily with disclosure, the phrase "Truth in Lending" is used.

30. KEEST & KLEIN, *supra* note 25, at 31.

31. Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1029-30 (1996); Jeffrey Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841 (1977); Elwin Griffith, *Truth in Lending—The Right of Rescission, Disclosure of the Finance Charge, and Itemization of the Amount Financed in Closedend Transactions*, 6 GEO. MASON L. REV. 191 (1998); Jonathan M. Landers, *Some Reflections on Truth in Lending*, 1977 U. ILL. L. F. 669; Jonathan M. Landers &

uses meaningless disclosure rules to deflect legislative pressure for more substantive consumer protections such as interest rate caps and generous bankruptcy discharge provisions.[32] While not denying these and other arguments, this Article suggests the problems of Truth in Lending may be those of a troubled adolescence rather than inherent limitations of the strategy itself. Unlike virtually all other consumer credit policies, disclosure is relatively untried. Having used disclosure regulations in earnest for only less than half a century, we may not have yet learned how to exploit their full potential. With aggressive and practical reform, Truth in Lending may blossom into a much more effective strategy than those which predate it by hundreds or even thousands of years.

Part II presents a new method of organizing consumer credit policy based on six traditional policy strategies and relying on examples from world history. Part III gives a chronological overview of consumer credit history in the United States. Part IV deals with the innovation and theoretical advantages of price disclosure as a seventh strategy. Lastly, conclusions are drawn for policymakers, scholars, and law practitioners.

II. ORGANIZING THE PROBLEM: A SURVEY OF SIGNIFICANT DEBTOR PROTECTION STRATEGIES IN WORLD HISTORY

American consumer credit law is preposterously unorganized. "Upon first exposure to the subject of credit regulation, the impression of the average attorney might be that the field is a maze, if not a mess, and probably both."[33] One recent commentator, smelling something more sinister, suggests the confusing character of consumer credit law remains entrenched because it provides a mirage of debtor protection which subverts more aggressive reform.[34] Requiring some conceptual method of organizing credit policy, legislatures, courts, attorneys, and scholars have fumbled, seemingly at random, for a system of categorization to begin thinking about credit law and policy. Thus, a wide variety of artificial categories have developed which break up credit policy into conceptual parts. For example, the Truth in Lending Act divides rules between open-

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Ralph J. Rohner, *A Functional Analysis of Truth in Lending*, 26 UCLA L. REV. 711 (1979); Rubin, *supra* note 27; *see also* Symposium, *A Symposium on Truth in Lending*, 9 OKLA. CITY U. L. REV. 1 (1984) (providing several additional examples); Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums* (Jan. 8, 2002), *available at* http://www.law.harvard.edu/faculty/hjackson/jacksonberry0108.pdf (last visited Apr. 19, 2002).

32. *See, e.g.*, Kathleen Keest, *Whither Now? Truth in Lending in Transition Again*, 49 CONSUMER FIN. L. Q. REP. 360, 360 (1995) ("[Truth in Lending] was never intended or designed to substitute for substantive consumer protection. Yet, without any real thought or open debate, it has apparently come to stand in that role.").

33. KEEST, *supra* note 19, at 36.

34. White, *supra* note 17, at 445.

and closed-end credit.[35] Some classify policies as either market-controlling or market-perfecting.[36] Others rely on the classic distinction between procedural and substantive rules.[37] Sometimes statutes and courts classify based on the distinction between retail and non-retail lenders.[38] The bankruptcy code makes much of whether credit is secured or unsecured.[39] Some creditors are depository institutions while others are not.[40] Finally, some statutes are "general" usury laws, while others are "special" usury laws.[41] Different rules, and in turn exceptions to those rules, exist for each of these different categories in each different conceptual scheme. When combined with simultaneous federal, state, and local regulation, these intersecting vertices create an impossibly complex jumble of meaningless distinctions. The result is not only that beginners have difficulty understanding the law, but also that legislatures and courts have difficulty designing rules which promote justice because these rules are based on arbitrary classifications.

This Part suggests a more natural way of approaching consumer credit policy based on the conceptual similarities between historical strategies. While many scholars have provided a rich history of consumer credit, none appear to have categorized the basic policy responses employed in history.[42] There have been six basic strategies for addressing the social

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35. *Compare* 15 U.S.C. § 1637, *with* 15 U.S.C. § 1638.

36. Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 157 n.22 (1988).

37. Truth in Lending's disclosure requirements are often described as a procedural, where interest rate caps are seen as substantive. KEEST, *supra* note 19, at 53.

38. *Id.* at 43.

39. *See generally* 11 U.S.C. §§ 506-507 (2002) (setting out rules for determination of secured status and debt priority). *See also* KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 57-59, 64 (1999) (providing simple summary of the effect of security status in bankruptcy proceedings).

40. Depository lenders usually include banks, credit unions, and savings and loan associations. KEEST, *supra* note 19, at 41-43. Non-depository lenders include finance companies and retailers. *Id.* at 41-44.

41. *Id.* at 37-38.

42. *See, e.g.*, ARTHUR BIRNIE, THE HISTORY AND ETHICS OF INTEREST (1952); HUGH BARTY-KING, THE WORST POVERTY: A HISTORY OF DEBT AND DEBTORS (1997); J.W. BLYDENBURGH, A TREATISE ON THE LAW OF USURY (1844); ROBERT BUCKLEY, A TREATISE ON THE LAW OF USURY (1817); RAYMOND DEROOVER, MONEY, BANKING AND CREDIT IN MEDIAEVAL BRUGES (1948); ROSA-MARIA GELPI & FRANCOIS JULIEN-LABRUYERE, THE HISTORY OF CONSUMER CREDIT: DOCTRINES AND PRACTICES (2000); HOMER & SYLLA, *supra* note 1; JORDAN, *supra* note 2; ODD LANGHOLM, THE ARISTOTELIAN ANALYSIS OF USURY (1984); CAROL BRESNAHAN MENNING, CHARITY AND STATE IN LATE RENAISSANCE ITALY: THE MONTE DI PIETA OF FLORENCE (1993); PAUL MILLETT, LENDING AND BORROWING IN ANCIENT ATHENS (1991); J.B.C. MURRAY, THE HISTORY OF USURY (1866); BENJAMIN NELSON, THE IDEA OF USURY: FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD (2d ed. 1969); JOHN T. NOONAN, THE SCHOLASTIC ANALYSIS OF USURY (1957); MARK ORD, AN ESSAY ON THE LAW OF USURY (3d ed. 1809); FRANKLIN W. RYAN, USURY

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problems endemic to consumer credit (plus one more recent addition) that retain significant relevance for contemporary American policymakers.[43] An exposition relying on historical examples sheds light on these strategies.

A. *Debtor Amnesty: The Deceptively Simple Solution*

Humanity's first conceptually distinct and enduring strategy designed to protect vulnerable debtors from creditor abuse was to issue government decrees forgiving, or at least ameliorating, debts. The Sumerians, generally considered the world's first civilization, occupied the southernmost segment of Mesopotamia between the Tigris and Euphrates rivers stretching roughly from modern Baghdad to the Persian Gulf.[44] Eventually supplanted by the Babylonians, Sumerian civilization is credited with developing the world's first wheeled vehicles, the first ox-drawn plows, the first city-states, and the first system of writing.[45] Alongside other trade practices, including pottery, weaving, metalwork, and masonry, was trade in credit.[46] Many documents dealing with credit have survived showing a system which carefully recorded and commonly extended loans.[47]

Nevertheless, even in these first civilizations the harmful social side effects to otherwise beneficial lending developed early on. The principal

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AND USURY LAWS (1924); MELANIE TEBBUTT, MAKING ENDS MEET: PAWNBROKING AND WORKING-CLASS CREDIT (1983); Ackerman, *supra* note 5; James G. Frierson, *Changing Concepts on Usury: Ancient Times Through the Time of John Calvin*, 7 AM. BUS. L.J. 115 (1969).

43. There are other strategies which are beyond the scope of this Article because they do not suggest relevant insight for contemporary United States policy makers. Foremost among these untreated strategies are laws banning interest altogether. The first example of a civil interest ban was Charlemagne's *Admonito Generalis*. GELPI & JULIEN-LABRUYERE, *supra* note 42, at 22-25. And, although Islam provides for many alternative forms of banking, *Shari'ah* law prohibits the taking of interest or *riba*. *See generally* Aidit bin Haji Ghazali, *Consumer Credit from the Islamic Viewpoint*, 17 J. OF CONSUMER POL'Y 443, 449 (1994) (providing a useful introduction to Islamic credit practices). Another example might include the complex shell currency and credit system of South Pacific Islander society on Rossel Island. In this society certain types of shells were valid tender only for certain types of transactions. *See* ENZIG, *supra* note 1, at 61-64. Currency traders developed, borrowing from those who did not want a particular type of shell and lending to those who did. *Id.* Interestingly, beliefs about magic of the currency traders, rather than laws, enforced the consumer credit system. *Id.* Similarly, the credit policies of totalitarian regimes such as Stalin's U.S.S.R. and Mao's China are probably distinguishable, but hold little relevance for contemporary America.

44. THOMAS H. GREER & GAVIN LEWIS, A BRIEF HISTORY OF THE WESTERN WORLD 15-17 (6th ed. 1992).

45. *Id.*; M.E.L. MALLOWAN, EARLY MESOPOTAMIA AND IRAN 59-61 (1965); MARC VAN DE MIEROOP, CUNEIFORM TEXTS AND THE WRITING OF HISTORY 9-11 (1999); OPPENHEIM, *supra* note 5, at 8-9.

46. GREER & LEWIS, *supra* note 44, at 18; P.R.S. MOOREY, ANCIENT MESOPOTAMIAN MATERIALS AND INDUSTRIES: THE ARCHEOLOGICAL EVIDENCE *passim* (1994).

47. HOMER & SYLLA, *supra* note 1, at 26; *see also* MIEROOP, *supra* note 45, at 19 ("The loan is probably the most common private business transaction we find in the textual record . . . .").

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problem then, as now, was how to deal with those debtors who could not or would not repay their obligations. The normal penalties for default were severe.[48] Free males, as the heads of households, were entitled to send their wives, servants, or children into forced servitude to pay off debts.[49] If the head of the household could not produce a working dependant, he was often enslaved or imprisoned.[50] Creditors who seized the human assets of a debtor were essentially free to do with the slave whatever the creditor chose.[51] The treatment of debt slaves was harsh indeed, often including gouging out the slave's eyes to prevent escape, and only providing enough food to sustain life.[52] Creditors sold a significant portion of the Sumerian population into debt slavery to live alongside prisoners of war.[53]

This treatment, at times apparently offending even the ancient sense of social decency, led many Sumerian and Babylonian kings to "make justice."[54] This claim, coming down in the form of aristocratic boasting, "referred to the cancellation by royal decree of certain debts, such as any which had forced free people to sell themselves or their families into slavery."[55] For example, one of the earliest recorded legal codes, dating from about 2350 B.C.E., includes relief aimed at controlling abuses

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48. Ackerman, *supra* note 5, at 63, 66.

49. SAMUEL NOAH KRAMER, THE SUMERIANS: THEIR HISTORY, CULTURE, AND CHARACTER 78-80 (1963); C. LEONARD WOOLLEY, THE SUMERIANS 99, 102, 104 (1928). One loan contract from this era translates:

> Bakšišum has received [x] shekels of silver from Mannum-ki-iliya. He has placed his son as pledge. If Bakšišum (wishes to redeem[?]) his son, he shall pay the silver together with its interest. If (the son) dies or escapes, he will take his silver from Bakšišum. (7 witnesses, including a smith.).

J.N. POSTGATE, EARLY MESOPOTAMIA: SOCIETY AND ECONOMY AT THE DAWN OF HISTORY 194 (1992).

50. HOMER & SYLLA, *supra* note 1, at 27.

51. KRAMER, *supra* note 49, at 78.

52. *Cf. id.* (stating that slaves were usually well treated).

53. GREER & LEWIS, *supra* note 44, at 18; POSTGATE, *supra* note 49, at 194.

54. JAMES G. MACQUEEN, BABYLON 56-57 (1964); SAGGS, *supra* note 13, at 97.

55. SAGGS, *supra* note 13, at 97; *see also* POSTGATE, *supra* note 49, at 194-95 (describing the Sumerian notion of *amar-gi*, "which meant 'return to mother,' and referred to the liberation of members of a family enslaved for debt"). Enmetena, a King from the city of Lagaš, inscribed these words on the face of a building:

> Enmetena annulled debts for Lagaš, restoring mother to child and restoring child to mother. He annulled grain loan debts. He annulled debts for the sons of Uruk, of Larsa, and Bad-tibira, restoring them to the hands of Inanna at Uruk, to the hands of Utu at Larsa, and to the hands of Lugal-Emuš at the Emuš.

Id. at 196.

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associated with debt.[56] Urukagina, a Sumerian King who promulgated the rules, included in his reforms amnesty for all persons imprisoned for failure to repay debts.[57] Similarly, Ammisaduqa (1646-1626 B.C.E.), a later Babylonian King, also canceled the debts of enslaved former citizens.[58]

Although the details of these royal decrees of amnesty are sparse, they begin to sketch the outlines of problems that have plagued similar strategies ever since. Initially, forgiving some debts did not solve the real problem, only treating its symptoms after the fact. Debtors would still borrow, creditors would still lend, and in the absence of state intervention, default and its attendant problems still developed. Moreover, each decree was a limited one-time treatment rather than a permanent systemic reform. Executive pardons did nothing for those not lucky enough to fall under their limited jurisdiction. The conundrum of whether a creditor or debtor should bear the losses associated with default still existed. All that amnesty decrees could do was temporarily reverse fortunes of those who managed to capture the attention of fickle authority.

Nevertheless, as a social strategy, granting debtors amnesty from their obligations persisted. Then, as now, creditors tended to advocate harsh penalties to deter default on loans. In 1531, during his reign of Holland, Charles V of Spain passed a characteristic edict later described as the first specific bankruptcy statute in the Netherlands.[59] In its preamble, the law justified itself as attempting to remedy the expense connected with lawsuits and to provide for a pure administration of justice which would deal equally with the rich and poor.[60] Hoping to deter debtor default, the law provided that "all persons who absented themselves from their ordinary residences with the object of defrauding their creditors were to be regarded as common thieves, and if caught might be summarily dealt with and publicly hanged."[61] Ironically, the Spanish Crown consistently defaulted on its own debts, finding itself bankrupt on *six* subsequent occasions during the sixteenth century alone.[62]

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56. KRAMER, *supra* note 49, at 79.
57. *See id.*; MACQUEEN, *supra* note 54, at 21-22.
58. SAGGS, *supra* note 13, at 97.
59. Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 246 (1917).
60. *Id.*
61. *Id.*
62. HOMER & SYLLA, *supra* note 1, at 115. Credit as a social and economic institution survived through the middle ages and into the enlightenment even in the face of staunch medieval Catholic prejudices against interest. Ackerman, *supra* note 5, at 72-73; GELPI & JULIEN-LABRUYERE, *supra* note 42, at 38. Gelpi and Julien-Labruyere explain that "interest-bearing loans were practiced throughout society at large, by princes, merchants, simple folk, and the church itself. It was a hypocritical society, trying to disguise the forbidden practice, condemning it publically but

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Similar to Sumerian and Babylonian kings, Europe's princes also issued decrees canceling debts. The crucial difference, however, was that European princes usually canceled only their own loans or the loans of their closest allies and associates. For example,

> Philip the Fair (IV) of France, 1285-1314, borrowed heavily at unstated rates, but instead of repaying his bankers he banished them, canceled his own debts and decreed that the principal of all other debts must be paid to the Crown. His principal creditor, the Order of Knights Templar, which had become largely a banking organization, was utterly destroyed. Edward III of England, 1312-1377, likewise repudiated his debts . . . and ruined his Florentine bankers.[63]

Nobles were also known to orchestrate the cancellation of their debts by availing themselves to lingering church doctrines prohibiting interest, especially against foreigners.[64] While consumer and commercial debtors alike faced severe punishments such as summary public hangings, the deliberate and fraudulent default of royalty "could be punished only by the sanction of a future denial of credit."[65] Such royal "amnesty" was common enough to have market effect. Interest rates offered to nobility were much higher than those to towns and commercial ventures since repayment by nobles was relatively uncertain.[66] This aristocratic abuse of power demonstrates a central limitation of forgiving debt as a policy strategy: it is difficult to devise fair and efficient rules determining who deserves amnesty. Too often, those who receive discharge of their debts are those who least merit it. As we shall see, it is precisely this difficulty which more than any other afflicts the contemporary United States bankruptcy system.

B. *Separating "Good" Credit from "Bad" Credit: Interest Rate Caps and Other Loan Contract Restrictions*

Mesopotamian societies were not content with market anarchy and occasional capricious amnesty of their kings. The next great innovation in consumer credit policy is best exemplified in the famous Babylonian Code

having to recourse to it privately, turning away from those who practiced it, yet tolerating them." GELPI & JULIEN-LABRUYERE, *supra* note 42, at 38 (citation omitted); *see also* HOMER & SYLLA, *supra* note 1, at 106-11 (cataloging interest rates of late medieval era); NELSON, *supra* note 42, at 29-72 (discussing in detail religious thinkers evolution toward acceptance of interest in the late medieval era).

63. HOMER & SYLLA, *supra* note 1, at 99.

64. *Id.* at 112.

65. *Id.* at 94.

66. *Id.*

of Hammurabi written in 1750 B.C.E.[67] Legend tells us the Babylonian King Hammurabi ascended a mountain where Shamash, the God of Justice, gave him a divinely inspired code of law.[68] Under the rule of Hammurabi, Babylon developed from an insignificant city to the national capital of probably the most complex society of its time.[69] Following Hammurabi, Babylon remained the capital of the entire region for around 1500 years.[70] The Code set out over two hundred laws addressing social problems ranging from divorce to theft.[71] Audaciously, it attempted to create a comprehensive and timeless set of laws to govern Babylonian society. Hammurabi's laws included several distinct controls on the lending market designed to protect debtors.[72] Foremost was the world's first recorded maximum allowable interest rate cap, which limited rates to about 20% per annum for loans on silver and 33% on loans of grain.[73] The text of the code bears a remarkable similarity to interest rate caps adopted thousands of years later and which are still in force in many areas. The Code states: "If a merchant has given corn on loan, he may take 100 SILA of corn as interest on 1 GUR; if he has given silver on loan, he may take 1/6 shekel 6 grains interest on 1 shekel of silver."[74]

A central insight behind interest rate caps is the recognition that while some loans are useful social agreements, others cause more harm than good. For early Babylonians, the central difference between acceptable and unacceptable loans was price. Thus, loans at interest rates in excess of the statutory caps were banned. However, the Code also prohibited dangerous loan characteristics not directly related to price. For instance, recognizing loans may have dangerous consequences not only for individuals but for whole families, the Code required both a husband and a wife to sign loan contracts encumbering joint property.[75] Other rules included a maximum allowable three years that a wife, servant, or child of a debtor could spend in slavery to pay off a man's debt.[76] Creditors could not take payments by force without the consent of the debtor.[77] Debts of either a woman or a man incurred before marriage were not binding on the other spouse after marriage.[78] Moreover, to prevent violations, Hammurabi's Code required

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67. Ackerman, *supra* note 5, at 66.
68. GREER & LEWIS, *supra* note 44, at 24.
69. *Id.*
70. *Id.*
71. *Id.* at 24-25.
72. THE OLDEST CODE, *supra* note 11, at 68.
73. HOMER & SYLLA, *supra* note 1, at 30.
74. DRIVER & MILES, *supra* note 11, at 39.
75. HOMER & SYLLA, *supra* note 1, at 27; THE OLDEST CODE, *supra* note 11, at 21-22.
76. THE OLDEST CODE, *supra* note 11, at 21-22.
77. *Id.* at 20-21.
78. *Id.* at 30.

creditors and debtors make their loan contracts in the presence of an official and witnesses.[79]

Hammurabi's interest rate cap, along with its other lending format restrictions proved remarkably durable. The rate cap remained intact as law for 1200 years—well over an entire millennium. In 2000 years the only significant change was to equalize the maximum allowable rate of grain to match that of silver.[80] It is nonetheless unlikely the interest rate cap and other provisions were consistently enforced.[81] Records still exist documenting loans at 400% per annum during the period.[82] Still, the enduring legacy of this approach testifies to the success of the law as compared to what must have come before. Nevertheless, for a closer look at potential cracks in the construction of this impressive regulatory feat, we must turn to later civilizations with a more complete historical record.

Ancient Rome also set maximum allowable interest rate caps. High-cost debt played a crucial and volatile role in Roman politics from the earliest stages.[83] In the fifth century B.C.E., Romans were only one of several ethnic groups present in Italy, and were still far away from domination of the Mediterranean.[84] Class struggle, which would reemerge in centuries to come, manifested itself dramatically.[85] In 494 B.C.E., a violent civil revolt took place.[86] A large number of poor plebeians withdrew from the city and gathered on a hill overlooking the Tiber River where they preceded to elect their own shadow legislature, officials, and tribunes, essentially seceding from the Roman republic.[87] The revolt has since come to be known as the first secession.[88] The outcome of this revolt and many others like it during the period is historically unclear. However,

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79. HOMER & SYLLA, *supra* note 1, at 27. Hammurabi's Code also formalized some standards for granting debtor amnesty. For instance, the Code abated debts where debtors could not pay due to natural disasters such as drought or flood. THE OLDEST CODE, *supra* note 11, at 12-13.

80. HOMER & SYLLA, *supra* note 1, at 27.

81. M.I. FINLEY, ECONOMY AND SOCIETY IN ANCIENT GREECE 162 (1981).

82. Edward L. Glaeser & Jose Scheinkman, *Neither a Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws*, 41 J. L. & ECON. 1, 20 n.37 (1998) (relying on C.H.W. JOHNS, BABYLONIAN AND ASSYRIAN LAWS, CONTRACTS AND LETTERS (1904)).

83. KARL CHRIST, THE ROMANS: AN INTRODUCTION TO THEIR HISTORY AND CIVILISATION 13 (Christopher Holme trans., 1984); STEPHEN L. DYSON, COMMUNITY AND SOCIETY IN ROMAN ITALY 78 (1992).

84. *See generally* MICHAEL CRAWFORD, THE ROMAN REPUBLIC 31-42 (2d ed. 1993) (relating brief history of the Roman conquest of Italy); CHESTER G. STARR, JR., THE EMERGENCE OF ROME AS RULER OF THE WESTERN WORLD 7-13, 16 (1953).

85. CHRIST, *supra* note 83, at 12-15; STARR, *supra* note 84, at 22.

86. CHRIST, supra note 83, at 12-13.

87. *Id.* at 12-15.

88. *Id.* at 13; T.J. CORNELL, THE BEGINNINGS OF ROME: ITALY AND ROME FROM THE BRONZE AGE TO THE PUNIC WARS (C. 1000-264 BC) 256-57 (1995).

the cause of the revolt is not: "[b]y all accounts the principal cause of the first secession was a debt crisis."[89]

The situation facing poor Romans of the period should by now come as no surprise to readers.[90] Many historians, both modern and ancient, have focused on one uncannily familiar story which may have lit the fire.[91] Apparently, a war veteran's farm was destroyed during a battle with a rival tribe.[92] The loss of his farm, combined with government tax demands, forced the veteran to borrow money at dangerously high rates.[93] When he was unable to pay, his creditor imprisoned and tortured him.[94] Eventually, the veteran appeared in the city Forum where those who heard his story were so enraged they took to the streets rioting.[95]

The first major codification of Roman law, called the Twelve Tables, was in part a response to the debt crisis of the first secession.[96] For reasons undoubtedly similar to those the Babylonians relied upon, the Twelve Tables included an interest rate cap and some basic provisions to enforce it.[97] Under the Twelve Tables the legal maximum interest rate was set by weight at one ounce per pound per year, which amounts to 8 1/3% per annum.[98] Creditors found contracting for greater rates were liable in Roman courts for fourfold damages.[99] This basic legislative approach

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89. *Id.* at 266; *see also* CHRIST, *supra* note 83, at 13 ("In almost all the social disturbances of the Graeco-Roman cultural world, land distribution and the cancellation of debt were primary demands.").

90. One historian explains:

> Debt provided the rural elite with another form of sociolegal control, binding free rustics to them in a manner similar to that of slaves and freedmen. Roman law was not kind to debtors. The rural ruling class could use the threat of prosecution laws as a major instrument of control. This rural indebtedness apparently increased during the second and third centuries [C.E.] and contributed to the protofeudal system of the late Empire.

DYSON, *supra* note 83, at 134.

91. *See, e.g.*, F.R. COWELL, THE REVOLUTIONS OF ANCIENT ROME 31, 39-40 (1962) ("There was at first no limit to the interest that might be demanded on loans, so those in desperate want were forced to accept any terms. Moneylenders in ancient times were notorious for their harsh, grasping greed and, left uncontrolled as they were, they demanded thirty, fifty, a hundred percent interest and more.").

92. *Id.* at 40 (quoting Livy).

93. *Id.*

94. *Id.*

95. *Id.*

96. STARR, *supra* note 84, at 23.

97. HOMER & SYLLA, *supra* note 1, at 45.

98. *Id.*

99. *Id.*

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remained intact for the duration of the Roman Republic and the Empire, although the legal maximum varied with political tides. During the third century B.C.E. the maximum legal rate was lowered for a short time to 4 1/6%.[100] In 88 B.C.E., Sulla raised the interest rate cap to 12% per annum.[101] This rate remained the legal limit for centuries and was adopted by the later Empire and the Byzantine Empire.[102]

Although interest rate caps provided some protection for Romans, they were poorly enforced throughout Roman history.[103] Pawn shops and other lenders that catered to the higher-risk poor consistently charged three to ten times the legal maximum.[104] The rate caps also proved too inflexible in comparison to the volatile Roman economy. In particular, the availability of gold and silver from mining and foreign conquest dramatically affected market prices for the use of money.[105] Moreover, both the Republic and the Empire faced the persistent problem of rich currency hoarders, who would hide away vast fortunes in coins, thus decreasing the available supply of cash and raising prices for the use of money.[106] When the supply of money was low, interest rate caps were probably all but ignored, thus affording almost no protection to debtors.

The problems with interest rate caps were not limited to Rome. Around 2000 years later on the other side of the globe, fundamentally analogous problems plagued China during the late Ming dynasty. Following a hundred years of foreign domination by Mongolians with the clan of Ghengis Kahn at their head, the famous Chinese leader Chu Yuan-chang (later referred to as the Hung-wu emperor) solidified control over many competing factions and succeeded in driving the Mongolians out of Northern China.[107] In 1368, Chu Yuan-chang founded the Ming dynasty, which would last for the terms of fifteen succeeding emperors until its overthrow by Manchurian invaders in 1644.[108] By the late sixteenth century, the Chinese government suffered from inept administration of rural agrarian masses by a literary bureaucracy.[109] Prevailing Chinese law

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100. *Id.* at 45, 52.

101. *Id.* at 52.

102. *Id.*

103. The "rapacious *faeneratores*, or moneylenders" are a staple in ancient Roman history and culture. DYSON, *supra* note 83, at 78.

104. HOMER & SYLLA, *supra* note 1, at 59.

105. *Id.* at 38-39, 48.

106. *Id.* at 48.

107. F.W. MOTE, IMPERIAL CHINA, 900-1800, at 474, 549 (1999).

108. *Id.* at 564, 776; FRANZ MICHAEL, THE ORIGIN OF MANCHU RULE IN CHINA: FRONTIER AND BUREAUCRACY AS INTERACTING FORCES IN THE CHINESE EMPIRE 1 (1972).

109. RAY HUANG, 1587: A YEAR OF NO SIGNIFICANCE: THE MING DYNASTY IN DECLINE 131 (1981).

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fixed a maximum allowable interest rate for loans at 36% per annum.[110] The statutes also forbade the collection of interest at amounts greater than the original principal.[111] Hoarding of coin wealth, supply limitations, and failed attempts to introduce paper currency made cash a rare and expensive commodity.[112] Nevertheless, lending for consumption purposes appears to have been widespread.[113] In 1587, over 20,000 pawn shops operated in China.[114] Once again, the interest rate cap was poorly enforced. Wealthy families commonly lent money to poor farmers at illegal interest rates.[115] Foreclosures on the homes of poor rural farmers undercut, on an enormous scale, the ability of the poor to survive.[116] As one historian explains:

> Agrarian exploitation of the poor . . . was far from limited to . . . isolated incidents. It affected all walks of life and was carried out on a large and small scale without surcease generation after generation. Essentially, such exploitation was the economic basis of the bureaucracy as an institution. Official families, who collected rents from landholdings and interest from the moneylending business, were an integral part of the rural economy.[117]

When subsistence farmers fell behind on payments, wealthy creditors hired local "roughnecks" to collect.[118]

The story of one eccentric civil servant explicitly shows the entrenched role of high-cost lending at this time in China.[119] Hai Jui was a civil servant who worked his way up the Chinese bureaucracy with a maverick attitude extremely rare in the Confucian ordered civil service.[120] Hai Jui achieved notoriety with the Chinese masses early in his career by remonstrating the son of a powerful dignitary for financially abusing his position.[121] Having attained fame for an unostentatious lifestyle, Hai Jui did the unthinkable by openly criticizing the emperor Chia-ching.[122] Hai Jui wrote the emperor

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110. HOMER & SYLLA, *supra* note 1, at 614.

111. HUANG, *supra* note 109, at 138 (noting a 3% monthly statutory maximum) (relying on *Ta-Ming Hui-tien*, at 163.14, 164.25).

112. *Id.* at 146-47.

113. *Id.* at 140, 144.

114. *Id.* at 144.

115. *Id.* at 145-46.

116. *Id.* at 138, 140.

117. *Id.* at 145.

118. *Id.* at 138.

119. *See id.* at 130-55.

120. *Id.*

121. *Id.* at 132.

122. *Id.* at 135-36.

a letter describing him as "vain, cruel, selfish, suspicious, and foolish."[123] Reportedly, Hai Jui purchased a coffin and said goodbye to his family before sending the letter.[124] Chia-ching was deeply disturbed by the reproach, and sentenced Hai Jui to death for insolence.[125] Before the sentence was carried out, Chia-ching passed away and Lung-ch'ing ascended to the throne in 1567.[126] Lung-ch'ing commuted the sentence, and Hai Jui emerged from prison more prestigious than ever.[127] Eventually, Hai Jui attained the rank of governor over the richest and most developed prefecture in the entire empire.[128]

But for Hai Jui, challenging endemic high-cost lending proved more politically dangerous than even challenging an emperor. As governor, Hai Jui attempted to enforce previously ignored credit laws and stretched procedural rules in order to prevent poor farmers from losing their homes.[129] In doing so he confronted the richest landowners in the province who profited from money lending, and thereby created enemies who would eventually erode his power.[130] When the poor learned the governor had personally heard the complaints of dispossessed landowners, his offices were flooded with as many as three to four thousand petitions a day.[131] Other civil servants, possibly linked to lending interests, accused Hai Jui of "encourag[ing] hoards of riffraff to make false charges against men of substance."[132] These accusations, fueled by otherwise impotent claims of personal impropriety, cost Hai Jui his post and forced him into early retirement from which he never politically recovered.[133] All this was in spite of Hai Jui's formidable contribution of organizing the dredging of two commercially important rivers.[134]

Perhaps Ming society would have done well to incorporate the lending reforms Hai Jui attempted to establish. Within fifty years Ming society entered a period of peasant rebellions hastening the overthrow of the dynasty by Manchurian invaders from the North.[135] Hai Jui probably would

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123. *Id.* at 145.
124. *Id.* at 135.
125. *Id.* at 136.
126. *Id.*
127. *Id.*
128. *Id.* at 137.
129. *Id.* at 138-39.
130. *Id.* at 139.
131. *Id.*
132. *Id.* at 140.
133. *Id.* at 141.
134. *Id.* at 138.
135. JAMES BUNYAN PARSONS, THE PEASANT REBELLIONS OF THE LATE MING DYNASTY, at xiii (1970); MOTE, *supra* note 107, at 795-96.

not be surprised by the incident which one Chinese source attributes as the cause of the first rebellions:

> The incident involved four soldiers and an oppressive moneylender, appropriately named Ch'ien (money). The moneylender bribed the commander of the garrison to join him in a plot to force the soldiers to repay much more money than they had actually borrowed. This piece of chicanery prompted the soldiers to mutiny and organize local famine victims to ally with them in rebellion.[136]

This story should not surprise us, given its remarkable similarity to the war veteran thought to have provoked the first secession in Rome.

There can be little doubt that interest rate caps were a significant improvement over the violent and chaotic markets of our earliest civilizations. As a social policymaking strategy, interest rate caps combined with other lending format restrictions have endured at least since the Code of Hammurabi and are still in effect throughout much of the United States and the modern world. Nevertheless, the experiences of Rome and China begin to show the limitations of the policy. Interest rate caps and other lending format restrictions presume to prevent mutually agreeable contracts. Effective policing of these rules requires more resources than most societies are willing to spend. Although extremely different societies have chosen the "oldest continuous form of commercial regulation[,]" interest rate caps and similar format restrictions have traditionally garnered limited success in curbing harmful consequences of high cost lending.[137] The policy has also cultivated black-market cultures which have come to threaten the very foundations of otherwise successful dynasties.

C. *Separating "Us" from "Them": Selective Protection Strategies*

While some societies have attempted to separate harmful loans from beneficial credit, others have attempted to separate individuals "deserving" of protection from those who are not. This strategy of selective protection is as old as that of interest rate caps. The best example of its evolution is

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136. PARSONS, *supra* note 135, at 5 n.* (discussing CHI LIU-CH'I, MING CHI PEI LUEH 4/11a-b). Parsons asserts, without citing evidence, that Chi Liu-ch'i's attribution of the soldier's story as the cause of the rebellion is "undoubtedly an exaggeration." *Id.* He is probably right. The single incident, if it happened at all, would alone not be enough to start a revolution. But, whether the incident itself actually happened is irrelevant. What is important is that many people, including a Chi Liu-ch'i, probably thought it did. The story points to the charged atmosphere surrounding high cost lending which is indicative of the wide despair of debtors at the time. *Id.*

137. Robin A. Morris, *Consumer Debt and Usury: A New Rationale For Usury*, 15 PEPP. L. REV. 151, 151 (1988).

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found not far from Babylon in ancient Israel. Unlike Babylon to the East, which had a long tradition of monarchy, the Hebrew culture was tribally organized prior to roughly the first millennium B.C.E.[138] The Hebrew people were seminomadic in small ranges near towns, relying on herding domesticated animals and occasional farming.[139] They lived both in tents and in houses.[140] Having settled on the land bridge between Africa and Asia, the Hebrew culture was subject to invasion from many directions and by many peoples.[141] From early on, Hebrew culture developed a strong sense of tribal unity and cooperation in order to compete with outside threats.[142]

The early Hebrew laws concerning high-cost lending reflect this sense of tribal unity, by extending legal protection only to other Hebrews. *Deuteronomy*, which describes Yahweh's laws as delivered by Moses (probably around the 13th century B.C.E.), states:

> You shall not charge interest on anything you lend to a fellow-country-man [*l'ahika*], money or food or anything else on which interest can be charged. You may charge interest on a loan to a foreigner [*nokri*] but not on a loan to a fellow-country-man, for then the LORD your God will bless you in all you undertake in the land which you are entering to occupy.[143]

Thus, the Hebrews took action to prevent corrosion of community bonds and to provide at least some outlet for the wealthy to lend excess capital. Protection against the dangers of owing interest to rival outsiders was probably an added benefit in the competitive inter-tribal anarchy which characterized the ancient East Mediterranean coast. Moreover, by simply banning interest within the Hebrew community, the rule probably had lower administrative costs than those legal systems forced to distinguish between legal and illegal loans on the basis of interest rate caps. Recently two economists described the likely role of the Hebrew

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138. *See* B.S.J. ISSERLIN, THE ISRAELITES (1998).

139. *See id.*

140. *Id.* at 61.

141. *Id.* at 21-24.

142. *Id.* at 49-50, 59-64; JAMES C. VANDERKAM, AN INTRODUCTION TO EARLY JUDAISM 5-6 (2001); Niels Peter Lemche, *The Relevance of Working with the Concept of Class in the Study of Israelite Society in the Iron Age*, *in* CONCEPTS OF CLASS IN ANCIENT ISRAEL 89, 94-95 (Mark R. Sneed ed., 1999).

143. *Deut.* 23:19-20 (Oxford Study ed., 1976) (emphasis added); *see also* NELSON, *supra* note 42, at xix-xxii (discussing the linguistic roots of ancient Hebrew terms for foreigner and clan member). The Hebrews also had a few other ancillary rules. For instance, *The Bible* prohibits holding clothing as collateral. *See Exod.* 22:26. Also, the Jubilee Year rule established a crude debtor amnesty system which required returning of property sold under duress to the original owner every fifty years. *See* Glaeser & Scheinkman, *supra* note 82, at 20 n.37.

rules as trying "to make sure that individuals did not reduce themselves to a level of poverty, where they would be burdens on the community."[144]

Not surprisingly, the Hebrew injunction against charging any interest to other Hebrews was followed infrequently.[145] The story of Nehemiah is enlightening in this regard. By the 5th century B.C.E. the Persian empire dominated Israel.[146] During the reign of Artaxerxes I (464- 424 B.C.E.), Nehemiah, a Jewish cup bearer to the King, was appointed governor of Jerusalem.[147] Nehemiah tells his own story in his rare, first person dictated book in the Old Testament.[148] Apparently arriving in 445 B.C.E. from the Persian capital of Susa, Nehemiah organized the rebuilding of the walls around Jerusalem.[149] Nehemiah instituted a number of reforms directed at high-cost lending:[150]

> There came a time when the common people, both men and women, raised a great outcry against their fellow-Jews. Some complained that they were giving their sons and daughters as pledges for food to keep themselves alive; others that they were mortgaging their fields, vineyards, and houses to buy corn in famine; others again that they were borrowing money on their fields and vineyards to pay the king's tax. "But," they said, "our bodily needs are the same as other people's, our children are as good as theirs; yet here we are, forcing our sons and daughters to become slaves. . . ." I was very angry when I heard their outcry and the story they told. I mastered my feelings and reasoned with the nobles and the magistrates. I said to them, "You are holding your fellow-Jews as pledges for debt." I rebuked them severely and said, "As far as we have been able, we have brought back our fellow-Jews who had been sold to other nations; but you are now selling your own fellow-countrymen, and they will have to be bought back by us!" . . . "What you are doing is wrong . . . . Let us give up this taking of persons as pledges for debt. Give back today to your debtors their fields and vineyards, their olive-groves and houses, as well as the income in money, and in corn, new wine and oil." "We will give them back," they promised, "and exact nothing more. We will do what you say." So,

144. Glaeser & Scheinkman, *supra* note 82, at 21.

145. Norman K. Gottwald, *The Expropriated and the Expropriators in Nehemiah 5*, *in* CONCEPTS OF CLASS IN ANCIENT ISRAEL 1, 7 (Mark R. Sneed ed., 1999).

146. H. Tadmor, *The Period of the First Temple, the Babylonian Exile and the Restoration*, *in* A HISTORY OF THE JEWISH PEOPLE 91, 175 (H.H. Ben-Sasson ed., 1976).

147. *Id.* at 175-76.

148. *Id.* at 176.

149. *Id.*

150. *Id.*

> summoning the priests, I put the offenders on oath to do as they promised. . . . And they did as they had promised.[151]

There is no independently corroborating evidence of Nehemiah's actions.[152] One historian interprets Nehemiah's credit reforms as similar to earlier acts of Sumerian and Babylonian Kings who granted amnesty to those sold into slavery for debt.[153] Although Nehemiah's reforms did not fundamentally change the Hebrew rule in *Deuteronomy*, they do shed light on its social operation. It would seem that, without strong leadership, early Hebrews lent and borrowed from one another with serious social consequences in spite of the injunction in *Deuteronomy*.[154] Moreover, from a contemporary American perspective, the racial orientation of the strategy is unadaptable to a democratic society committed to equal protection. Historically, it is unclear whether the moneylenders' new-found filial charity derived from Nehemiah's exhortations had any enduring effect. Most scholars doubt that the situation facing Hebrew debtors significantly changed for at least another three hundred years.[155] Their lot probably only improved when the Hebrew Hasmonean state expanded, making foreign poor people a suitable substitute for religiously protected Hebrews.[156]

Many other cultures have used formal and informal mechanisms to protect favored groups from the consequences of high-cost debt. For instance, the Indian *Dharmasastras* provides for different interest rates varying with the caste of the debtor.[157] Under the rule, lenders provide much lower rates to Brahmins than other caste members, without regard to the personal credit history of the individual.[158] While selective protection strategies may have some success for protected group members, they also

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151. *Neh.* 5:1-13 (Oxford Study ed., 1976).

152. Tadmor, *supra* note 146, at 175.

153. *Id.* at 176; *see also* KRAMER, *supra* note 49, at 82 (discussing reforms of Urukagina of Lagash in Sumeria); SAGGS, *supra* note 13, at 97 (discussing reforms of Ammisaduqa in Babylon); Gottwald, *supra* note 145, at 8 (comparing Nehemiah's reforms to Solon's).

154. *See* Gottwald, *supra* note 145, at 7 ("We are basically left with the wider biblical attestation that in spite of numerous measures to combat impoverishment through debt, none seems to have been effective over any great length of time.").

155. FINLEY, *supra* note 81, at 163; Gottwald, *supra* note 145, at 9.

156. FINLEY, *supra* note 81, at 163; see NAOMI PASACHOFF & ROBERT J. LITTMAN, JEWISH HISTORY IN 100 NUTSHELLS 56-58 (1995) (for a convenient description of the Hasmonean kingdom).

157. K.V. RANGASWAMI AIYANGAR, ASPECTS OF ANCIENT INDIAN ECONOMIC THOUGHT 108 (1934).

158. *Id.* Ancient Mesopotamiam cultures may have had social norms which led to similar, albeit less formal outcomes. One letter from the city of Ugarit reads, "[g]ive [in the meantime] the 140 shekels which are still outstanding from your own money but do not charge interest between us—we are both gentlemen!" A. LEO OPPENHEIM, ANCIENT MESOPOTAMIA: PORTRAIT OF A DEAD CIVILIZATION 88 (1977).

probably encourage class division and racism. Despite egalitarian pretensions of the United States, as we shall see, this strategy too was later imported to the new world.

D. *Everyone for Themselves: Self-Help Free Markets*

While the earliest high-cost credit policy strategies attempted to prevent or remedy undesirable credit outcomes through government or religious rules, later strategies began, in one way or another, to harness market forces. While microeconomic theory as we currently recognize it did not begin to develop until the eighteenth century, social and governmental strategies for mitigating the problems associated with high-cost debt began to recognize the benefits of relying on market forces much earlier. Reforms adopted in the surprisingly liberal society of ancient Athens are illustrative. At the zenith of its power and cultural sophistication, ancient Athens had "no law restricting the rate of interest."[159] Foreshadowing the economic arguments of thinkers such as Adam Smith, Jeremy Bentham, and David Ricardo, Athenian culture focused on individualism, personal responsibility, and balance in determining economic outcomes.[160]

The story of how Athenians arrived at this approach probably starts around the beginning of the 6th century B.C.E. At this time, Athenian society had intensely polarized. Recent advances in trading throughout the Mediterranean, the growing use of coined money, and competition from free slave labor had put pressure on subsistence farmers around Athens.[161] Credit was already common and took on many different forms: some credit was secured by land, but often it was secured by the freedom of the debtor where, similar to other early civilizations, default meant slavery.[162] The gap between rich and poor became so wide that revolution threatened.[163] Although this situation was complex, early writers are universal in their agreement that the primary cause of the crisis was high-cost debt.[164] One historian summarizes the situation thus:

> Solon tells us plainly of the overt abuses in his own day. A large part of the soil of Attica had come into the possession or at least under the control of the rich; many Athenians were

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159. MILLETT, *supra* note 42, at 181.

160. GREER & LEWIS, *supra* note 44, at 63.

161. Ackerman, *supra* note 5, at 68; *see also* 1 FRITZ M. HEICHELHEIM, AN ANCIENT ECONOMIC HISTORY: FROM THE PALEOLITHIC AGE TO THE MIGRATIONS OF THE GERMANIC, SLAVIC AND ARABIC NATIONS 281-82 (Joyce Stevens, trans. 2d ed. 1958) (giving a more thorough account of the causes of the Solonic crisis).

162. HOMER & SYLLA, *supra* note 1, at 34, 36.

163. Ivan M. Linforth, *Solon the Athenian*, *in* CLASSICAL PHILOLOGY 52 (1919).

164. FINLEY, *supra* note 81, at 156.

> suffering under a load of debt; some of these debtors, helpless to relieve themselves, had been forced into exile and had been living so long abroad that they had forgotten the good Attic speech; others, free-born though they were, had become slaves; and of these many had been sold into slavery abroad and so were in the worst case of all. Broadly speaking, the land and the greatest part of its products belonged to the rich; and the poor were constrained to toil for them as their slaves without mercy or redress. Here were causes enough for bitterness and discontent. While the rich enjoyed their ease and all the luxuries and comforts that the times afforded, the poor were condemned to a life of hopeless drudgery at home or the worst of evils in the ancient world, exile in a foreign land.[165]

To stave off collapse of the city-state, the community appointed the poet and orator Solon, later called the father of Athenian law, to unilaterally rehabilitate its government.[166] The situation must have been very grave judging by the radical character of Solon's reforms and their acceptance.[167] Solon took several one-time measures to stabilize the situation including canceling or reducing many debts, freeing all enslaved for debt, and repurchasing those sold abroad for debt at state expense.[168] Solon also permanently outlawed enslaving defaulting debtors.[169] But this relief came at a price, for Solon is attributed to the law, "[m]oney is to be placed out at whatever rate the lender may want."[170]

Solon's deregulation encouraged Athenians to rely on their own judgment.[171] Unregulated interest rates reflected Athenian commercially-oriented values.[172] Historians speculate it was this deregulation which helped creditors accept Solon's reforms.[173] In any case, the changes appear to have had a lasting and generally positive effect on the Athenian society. Unregulated credit prices proved effective in encouraging the finance of maritime trade.[174] "Bottomry loans," where a creditor advanced maritime traders the value of the ship's cargo before a voyage and assumed the risk

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165. Linforth, *supra* note 163, at 48-49 (citations omitted).

166. Ackerman, *supra* note 5, at 68; HOMER & SYLLA, *supra* note 1, at 34; GREER & LEWIS, *supra* note 44, at 58-59.

167. HOMER & SYLLA, *supra* note 1, at 34-35.

168. *Id.* at 34; *see also* FINLEY, *supra* note 81, at 157 (discussing the linguistic meaning of Solon's reforms).

169. HOMER & SYLLA, *supra* note 1, at 34.

170. MILLETT, *supra* note 42, at 50 (alterations omitted).

171. Linforth, *supra* note 163, at 67-68.

172. HOMER & SYLLA, *supra* note 1, at 38-39.

173. *Id.* at 34-35.

174. Ackerman, *supra* note 5, at 68.

of shipwreck, played a vital role in Athenian trade.[175] Lenders could invest in shipping loans at whatever price the risks of the voyage demanded.[176] Merchants engaging in risky, long distance trade could shop for high-priced loans from respectable law abiding creditors, rather than black market money lenders.[177] One scholar emphasizes that in Athens, credit was more often used to the mutual benefit of people in similar economic situations, as opposed to lending by the rich to the poor—common in most of the ancient world.[178] Athens developed a banking system which "changed money, received deposits, made loans to individuals and states, made foreign remittances, collected revenues, issued letters of credit and money orders, honored checks, and kept complete books."[179] Although lending did not develop to modern standards of complexity, it nevertheless had its own kind of sophistication which was fundamental to sustaining the ancient Athenian lifestyle.[180]

But, for the poor and unwary, the historical record tells a different story indeed. Unregulated credit prices allowed unscrupulous lenders to charge the highest rates to those in extreme need.[181] In this period we find some of the most expensive loans in recorded history—as high as 9,000% per annum.[182] Borrowers probably intended these loans, like most high-cost loans, to be short term, but they were nevertheless often compounded over long periods of time.[183] Creditors were free to calculate interest in whatever way they chose, probably charging interest compounded at frequent intervals.[184] Because high-cost lending was so profitable, a class of creditors catering to the vulnerable poor and ignorant grew and thrived.[185] High-cost lenders became prevalent enough to create a deep and lasting influence on Greek drama and literature and an ancient variety of modern loan sharks became a typical character in Athenian plays.[186] Perhaps it was the dramatic social pain associated with expensive debt which induced contempt for lending by two of the world's greatest philosophers. We should not underestimate that both Plato and Aristotle, observing the effect of unregulated interest rates on their society, concluded that all interest

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175. HOMER & SYLLA, *supra* note 1, at 35-36.

176. *Id.*

177. *See id.*

178. MILLETT, *supra* note 42, at 219-20.

179. HOMER & SYLLA, *supra* note 1, at 38.

180. MILLETT, *supra* note 42, at 220-21.

181. HOMER & SYLLA, *supra* note 1, at 35-36.

182. *Id.* at 40 (relying on AUGUSTUS BOECKH, THE PUBLIC ECONOMY OF THE ATHENIANS 179 (Anthony Lamb trans., 1857)).

183. *Id.*

184. Ackerman, *supra* note 5, at 68-69.

185. HOMER & SYLLA, *supra* note 1, at 35.

186. *Id.* at 38.

should be banned.[187] Plato, for example, condemns lenders for "'planting their own stings into any fresh victim who offers them an opening to inject the poison of their money; and while they multiply their capital by usury, they are also multiplying . . . the paupers.'"[188]

The Athenian credit market is emblematic of the free market strategy for controlling the harmful consequences associated with high-cost lending. Moreover, it mirrors much of the debate concerning credit regulation today. Athens stands as an example that since ancient times unregulated interest rates (with basic limitations such as the elimination of debt slavery) could be socially and economically productive. Yet, modern advocates of free market lending should also stand warned that unrestricted interest rates left sophisticated lenders free to exact ruinous contracts on those in vulnerable bargaining positions.

E. *Give Them What They Want: Charitable Lending*

Even societies deeply committed to controlling credit markets have come to realize the benefits of harnessing market forces in designing social policy. A fifth strategy, still often used in contemporary America, looks to undercut high-cost lenders by offering cheaper, less dangerous loans subsidized by the charitable impulses of powerful social or government institutions. An early example of the use of this strategy to control the harmful consequences of high-cost debt evolved in late fifteenth-century Italy. Influenced by Aristotelian contempt for credit as well as the ancient Hebrew impulse to protect vulnerable group members, medieval Roman Catholic religious doctrine strongly condemned taking any interest.[189] Most historians agree that the prejudice fundamentally retarded commerce.[190] Merchants had difficulty devising strategies to finance business ventures.[191] Throughout the middle ages the poor were afflicted by extreme poverty, due in no small part to the lack of strong international and domestic trade.[192]

But toward the end of the fifteenth century, things began to change. The threat from the black death improved considerably.[193] Increased international and domestic trade invigorated the economy.[194] The printing press was invented.[195] Eventually the ideological grip of medieval

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187. Ackerman, *supra* note 5, at 69-70.
188. *Id.* at 69 (quoting PLATO, THE REPUBLIC 280 (F. Cornford trans., 1945)).
189. BARTY-KING, *supra* note 42, at 8; HOMER & SYLLA, *supra* note 1, at 70-71.
190. BARTY-KING, *supra* note 42, at 10-11; HOMER & SYLLA, *supra* note 1, at 71-72.
191. HOMER & SYLLA, *supra* note 1, at 71.
192. GREER & LEWIS, *supra* note 44, at 273; HOMER & SYLLA, *supra* note 1, at 98.
193. HOMER & SYLLA, *supra* note 1, at 104.
194. Ackerman, *supra* note 5, at 74; GREER & LEWIS, *supra* note 44, at 286-87.
195. GREER & LEWIS, *supra* note 44, at 346.

scholasticism finally began to loosen.[196] Questioning the wisdom of their outright interest ban, Italian religious and secular authorities began to search for new ways to alleviate the suffering of the poor. Black market money lenders and pawnshops catering to the desperate poor had long existed in spite of religious condemnation.[197] In this period many Italian leaders came to agree that small loans to the poor were inevitable and even necessary to save those in extreme need.[198]

As a result, religious leaders established charitable pawnshops which intended to charge only enough to cover costs of operation.[199] Called *mons pietatis*, such pawnshops met much controversy, but nevertheless found Papal approval at the Fifth Lateran Council in 1515.[200] The term translates literally as "mountain of piety."[201] Appropriately, the Latin word for mountain often carries a loose proverbial reference to making large promises followed by small performances.[202] Papal authorities reasoned that where the *montes pietatum* charged more than the original principal they were not receiving usury but, rather, contributions to defray operation costs.[203]

The *montes pietatum* offered key theoretical advantages which may explain their acceptance in the face of strong opposition from many Catholic thinkers. Rather than simply prohibiting certain types of loans, the *montes* required no one to do anything against their will, thereby eliminating the risk of motivating a black market.[204] By offering cheaper credit to the poor, the *montes* harnessed the market force of demand to put

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196. Ackerman, *supra* note 5, at 74; GREER & LEWIS, *supra* note 44, at 318-19.

197. HOMER & SYLLA, *supra* note 1, at 72.

198. *Id.* at 78-79, 104-06; JORDAN, *supra* note 2, at 15.

199. CASKEY, FRINGE BANKING, *supra* note 22, at 13-14; HOMER & SYLLA, *supra* note 1, at 78-79; JORDAN, *supra* note 2, at 37; M.R. NIEFELD, THE PERSONAL FINANCE BUSINESS 18-19 (1933); NELSON, *supra* note 42, at 19-22; TEBBUTT, *supra* note 42, at 108; Ackerman, *supra* note 5, at 76-77. A similar institution may have existed in the third century B.C.E. in Ptolemaic Egypt. There "directors of the government monopoly banks . . . would loan money upon silver vases or other articles of value deposited with them. . . . The interest charged was the legal one of that time, namely 2 percent per month." William Linn Westermann, *Warehousing and Trapezite Banking in Antiquity*, 3 J. ECON. & BUS. HIST. 30, 47 (1931). Buddhist monasteries in China also had a tradition of offering a small number of subsidized pawn loans at least as early as 200-300 A.D. HOMER & SYLLA, *supra* note 1, at 608. Monasteries also appear to have made pawn loans for profit as well.

200. NELSON, *supra* note 42, at 19-20.

201. CASSELL'S NEW LATIN DICTIONARY 379, 449 (1959). The *montes pietatum* are also commonly referred to by their Italian name, *monti di pieta*. *See, e.g.*, CASKEY, FRINGE BANKING, *supra* note 22, at 13.

202. CASSELL'S NEW LATIN DICTIONARY 379 (1959).

203. HOMER & SYLLA, *supra* note 1, at 79.

204. CASKEY, FRINGE BANKING, *supra* note 22, at 13-14.

private lenders out of business.[205] Debtors had no reason to pay the high prices of traditional pawnshops, since they could obtain money from a more trustworthy source at a lower price.[206] It is probably exactly these reasons which have fed charitable attempts to undercut private lending throughout history.

Harnessing these market forces, the *montes pietatum* did find some success. By 1509, eighty-seven of these pawnshops had been set up in the Italian peninsula.[207] Over the next two centuries the idea spread throughout the continent under sponsorship of the church, municipalities, and independent charities.[208] As the Catholic church lost influence, many of the *montes* failed, but others were taken over by municipal governments.[209] A few of the largest and strongest still exist today.[210]

Unfortunately, the *montes pietatum* and strategies like them have faced several drawbacks in spite of their visionary appeal. First, charitable attempts to undercut private lenders such as the *montes pietatum* are subject to the tides of ideological fashion, whereas private lending is supported by the inexorable and constant desire for profit. For instance, the most vocal advocates of the *montes* at their outset were the Franciscan Observant Order of Friars.[211] Their charitable motives where at least supplemented and possibly dominated by their demagogic antisemitism.[212] "Paced by Bernardino da Feltre (d. 1494), the Observantine preachers regurgitated the oft-discredited charges of ritual murder, incited mobs to attacks on Jewish life and property, and harangued the people and their magistrates to destroy the Jews . . . ."[213] The noble intentions of early administrators of the *montes* were polluted by the desire to drive Jewish pawnbrokers from business and from Italy itself.[214] Whether the *montes* would ever have grown from infancy without the fuel of racial hatred is unclear.

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205. *See* HOMER & SYLLA, *supra* note 1, at 106, 110 (comparing the 20% legal mazim for pawn loans in Florence with the 6% offered rate at montes pietatis).

206. *Id.*

207. NELSON, *supra* note 42, at 19.

208. CASKEY, FRINGE BANKING, *supra* note 22, at 13-14.

209. *Id.* at 14.

210. *See id.* at 13-15. Currently enduring municipal pawnshops include the "Dorotheum" in Vienna and the "Credit Municipal" in Paris. Mexico also has numerous municipal pawnshops. *Id.* at 14 n.3; John Dornberg, *Vienna's Dorotheum: A Singular Auction House and Hockshop*, 21 SMITHSONIAN 110, 110-20 (1990).

211. NELSON, *supra* note 42, at 19; NIEFELD, *supra* note 199, at 18.

212. NELSON, *supra* note 42, at 19.

213. *Id.* (footnote omitted).

214. *Id.* Similarly, vicious antisemitism existed throughout Europe. *See, e.g.*, BARTY-KING, *supra* note 42, at 10.

Charity is also easily corrupted on a much smaller level, and often with spoiling consequences. English attempts to institute charitable pawnshops in the early 1700s are illustrative. The first major charitable pawnshop to appear in England, the Charitable Corporation, was founded in 1699, and chartered in 1707.[215] It operated without incident for about thirty years "until rumors that huge amounts of money were being embezzled on the basis of fictitious pledges began to gain credence."[216] After Charitable Corporation officials fled the country, an enormous scandal ensued creating a long standing public mistrust against charitable alternatives to pawnbrokering in England.[217] Lamentably, in consumer credit as elsewhere, the motivation of charity is rarely more contagious than hate or greed.

A separate drawback to charitable attempts to displace private lenders derives from private lenders' desires not to be displaced. Obviously pawnbrokers resent attempts by government or charitable institutions to drive them out of business. This resentment may be more acute where the social reformers engage private lenders in subsidized competition, rather than instituting uniform command and control style rules such as interest rate caps. The former attack private lending at the root of its business—the demand for credit—whereas the latter merely regulates the way business may be conducted. Such private opposition to charitable lending often stifles charitable lending institutions in their infancy. A hundred years after the Charitable Corporation debacle, British reformers again tried to organize a charitable pawnshop, which again met with failure.[218] This time private lenders organized a strong resistance aimed at government, investment, and customer levels.[219] The opposition proved so effective as to convince one disgruntled ex-pawnbroker to state:

> A little more mature reflection convinced us that a few individuals with a limited fund could not hope to withstand for more than a very short period the opposition of a body so powerful their in number, their riches, and their union as the pawnbrokers of the Metropolis, and that if a successful competition should ever be established against them it must be by a body as numerous, as rich, and as united as themselves.[220]

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215. TEBBUTT, *supra* note 42, at 109.
216. *Id.*
217. *Id.*
218. *Id.* at 109-10.
219. *Id.*
220. *Id.* at 110.

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This opposition was not merely for the purpose of mobilizing support and resources for charitable lending projects. It is easy to imagine private pawnbrokers strategically engaging in marketing and price campaigns to drive vulnerable charitable lenders, who still required customers to pay overhead, out of business. But even where private lenders do not intentionally besiege charity credit, benevolent lenders usually advocate thrift and are unwilling to encourage indebtedness, thus carrying a much lower profile and in turn a smaller base of customers. Charitable lending strategies have historically lacked the profit-driven zeal to successfully compete with private lenders.

However, the most formidable obstacle faced by charitable lending regimes is mobilizing sufficient capital resources. This problem is also doubtlessly engendered by the opposition of private lenders, but is still a menacing limitation to the strategy in its own right. Even the earliest of the *montes pietatum*, founded at the headwaters of the social current creating the most successful of Europe's charitable pawnshops, often found accumulation of capital reserves for their non-profit venture prohibitive.[221] Wealthy Christians, despite the considerable religious pressure towards charity exerted by the fourteenth-century Italian Catholic church, were simply unlikely to invest in the *montes*.[222] Although some of the *montes* survived past infancy, quite simply, "many suffered or failed from undercapitalization."[223] Without profit there is little or no incentive to supply the necessary assets to conduct charitable lending on any meaningful scale.

Advocates of this strategy often turn to government to help mobilize the capital when they realize the support of private beneficiaries is inadequate. A noted British scholar has concluded, based on failed British attempts to establish charitable lending, that governmental support is a virtual prerequisite to any meaningful success.[224] However, successful governmental rent-seeking behavior is costly, inconsistent, and unpredictable, especially when opposed by powerful, organized private lobbies. While the supply of expensive capital for consumer lending has continued unabated for millennia, the supply of governmental subsidies for low-cost loans to the poor has been meager and sporadic.[225] Governments, almost always controlled by the society's power elite, face the same absence of incentive to provide charitable lending to the poor as private

221. JORDAN, *supra* note 2, at 37.

222. *Id.*

223. *Id.*

224. TEBBUTT, *supra* note 42, at 111.

225. *See, e.g.*, MENNING, *supra* note 42, at 259-60 (noting the lack of sufficiant capital in Florence's *mons pietatis* until the Medici family began using it to pay interest on deposits and lend large sums to a wealthy clientele).

citizens.[226] Additionally, government strategies are burdened in stimulating lower-priced loans by the costs of immobile bureaucracy and tax collection.[227]

The limitations of charitable attempts to undersell private lenders aside, this strategy nevertheless has retained advocates and limited successes for centuries—and for good reason. The strategy harnesses the demand for lower-price loans to extend protection to vulnerable debtors. Unfortunately, as the *montes pietatum* demonstrated, these successes are limited by serious structural problems, particularly supply problems, which have come to afflict similar American strategies in the twentieth century.

F. *Strength in Numbers: Cooperative Lending*

For thousands of years, families have extended low-cost and non-interest bearing loans to family members to insulate the family from the dangers of high-cost debt.[228] This informal cooperation can be an effective method of pooling a small and trusted group's resources to overcome short term deprivation and income shocks. However, the potency of this familial cooperation is limited by the size of the family's resource pool, as well as by the strength of the familial bonds tying the group together. In eighteenth- and nineteenth-century Europe, some groups began to expand and organize this cooperative lending strategy. The earliest formally organized cooperative lending groups were probably the British building societies. In the late eighteenth and early nineteenth century, Great Britain was in the nascent stages of industrialization and undergoing a revolution in financial markets.[229] A new class of urban salaried industrial workers was emerging.[230] Demographic shifts from rural agricultural work to urban industrial work contributed to widespread housing shortages.[231] The enlightenment fostered a new focus on self-help and entrepreneurialism.[232]

Seeking to cope with the industrial revolution, a small group in Birmingham innovated a new way of pooling resources to purchase homes.[233] In 1775, a small club, Ketley's Building Society, formed with the

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226. *Id.*

227. PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 462-63, 712, 716 (15th ed. 1995).

228. HOMER & SYLLA, *supra* note 1, at 17.

229. *Id.* at 153-54.

230. GREER & LEWIS, *supra* note 44, at 511-13; CHARLES FERGUSON & DONAL MCKILLOP, THE STRATEGIC DEVELOPMENT OF CREDIT UNIONS 15 (1997).

231. M. MANFRED FABRITIUS & WILLIAM BORGES, SAVING THE SAVINGS & LOAN: THE U.S. THRIFT INDUSTRY AND THE TEXAS EXPERIENCE 1950-1988, at 12 (1989).

232. MARK BOLEAT, THE BUILDING SOCIETY INDUSTRY 3 (1982); HOMER & SYLLA, *supra* note 1, at 153-54, 181-84.

233. FABRITIUS & BORGES, *supra* note 231, at 11-12.

purpose of pooling resources to purchase homes for members of the club.[234] None of the members alone were able to gather enough cash to cover the cost of building a new house.[235] In the newly formed club, members could contribute a specified amount each week into a common building fund.[236] As soon as enough resources were gathered, the club would purchase land and build a home for one of the members as determined by lot.[237] Members who had received their home were obligated to continue making their weekly contributions.[238] When the club had purchased a home for every member, the society was terminated.[239] Although the first Birmingham building society and the others which followed were limited to providing purchase money for home building, they nevertheless furnished their members with the ability to permanently acquire relatively inexpensive credit.[240] After a group member acquired a home, the member would have significant real property upon which to secure relatively low-cost loans to overcome short term needs or income shocks.[241] By establishing a building society, a group could insulate member families, and in turn entire neighborhoods, against financial predators.[242]

As Germany began to experience the same structural precedents which spurred British building societies, it too developed organized cooperative lending institutions. Unlike British building societies, German institutions did not limit themselves to financing homes.[243] Modern credit unions trace their genealogy to two upper-middle class German financial innovators.[244]

Herman Schulze, mayor of the town of Delitzsch, sought to create an institution which could lend capital to mechanics, tradesmen, and other local merchants.[245] After unsuccessfully pursuing charitable investments from wealthy benefactors, in 1850 Schulze turned to organizing cooperative societies which would pool resources.[246] These early Schulze-Delitzsch credit cooperatives sold shares, then lent the proceeds to

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234. BARTY-KING, *supra* note 42, at 165.

235. *Id.*; BOLEAT, *supra* note 232, at 3.

236. BARTY-KING, *supra* note 42, at 165.

237. BOLEAT, *supra* note 232, at 3.

238. *Id.*

239. *Id.*

240. HOMER & SYLLA, *supra* note 1, at 154.

241. *See* DALTON CONLEY, BEING BLACK, LIVING IN THE RED: RACE, WEALTH, AND SOCIAL POLICY IN AMERICA 60-61 (1999) (making a similar point in a contemporary context).

242. BARTY-KING, *supra* note 42, at 165-66; BOLEAT, *supra* note 232, at 3-5; FABRITIUS & BORGES, *supra* note 231, at 11-12.

243. JACK DUBLIN, CREDIT UNIONS: THEORY AND PRACTICE 143 (1971).

244. *Id.*

245. *Id.*

246. *Id.*

members who could demonstrate efficient operation and a likelihood of profit for their small businesses.[247] Members bought their share in the union on an installment plan, similar to British building societies' weekly investment requirement.[248] Because every member of the union shared equally in the risk that a borrowing member might default, Schulze-Delitzsch organizations excluded all but relatively stable small merchants from membership.[249]

Frederick William Raiffeisen, mayor of the village of Flammersfeld, organized similar cooperatives hoping to focus not on merchants, but on impoverished families.[250] After many failed ventures, Raffeisen forswore all charitable efforts and instead focused on self-sufficiency and mutual benefit.[251] Thereafter, he limited membership to individuals with unimpeachable character, widely vouched-for moral responsibility, and steady incomes, with successful results.[252] With careful management, both men organized credit unions which successfully loaned money not based on collateral, but upon the character of the borrower as judged by all other members of the union.[253] With widespread and growing demand for these basic financial services, the early German credit unions grew quickly.[254] By 1882, Germany boasted over 3,000 Schulze-Delitszch credit cooperatives.[255] By 1888, there were 425 Raffeisen credit unions.[256] Taking cue from British and German predecessors, cooperative credit organizations spread to Italy, Austria, France, Belgium, and then throughout Europe.[257] Organized cooperative lending spread across the Atlantic first into Quebec, Canada and then into the United States.[258] In the latter half of the nineteenth century and throughout the twentieth century, cooperative lending institutions grew rapidly both in variety and in number throughout the western world.[259]

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247. *Id.*; FERGUSON & MCKILLOP, *supra* note 230, at 15-16.

248. DUBLIN, *supra* note 243, at 143-44.

249. *Id.* at 143.

250. *Id.* at 144.

251. *Id.*

252. J. CARROLL MOODY & GILBERT C. FITE, THE CREDIT UNION MOVEMENT: ORIGINS & DEVELOPMENT 1850-1970, at 11 (1970).

253. *Id.*

254. FERGUSON & MCKILLOP, *supra* note 230, at 16.

255. *Id.*

256. *Id.*

257. *Id.* at 16-17.

258. DUBLIN, *supra* note 243, at 146; OLIN S. PUGH & F. JERRY INGRAM, CREDIT UNIONS: A MOVEMENT BECOMES AN INDUSTRY 2 (1984).

259. DUBLIN, *supra* note 243, at 46; FERGUSON & MCKILLOP, *supra* note 230, at 16-19 (1997); ROLF NUGENT, CONSUMER CREDIT AND ECONOMIC STABILITY 75-76 (1939); PUGH & INGRAM, *supra* note 258, at 1-2.

Nevertheless, when viewed as a strategy for providing protection against the dangers of high-cost debt, cooperative credit organizations have, like other social strategies, encountered significant structural limitations. For instance, vulnerability to fraud and incompetence tends to make cooperative lending institutions unstable. Cooperative credit organizations have a strong incentive to add more members, and thus pool more resources. More members mean each member suffers less loss upon loan default. But as the union's membership grows, losses may become more likely, since members are less capable of judging the credit worthiness of individual members applying for loans. Moreover, the larger the group, the more conflicting perspectives to accommodate.

Thus, as cooperative lending groups became larger, they were forced to adopt democratic ideals and management checks and balances in order to safeguard the common pool of funds. For instance, the New World's first credit union, the *Caisse Populare* in Quebec, organized trustees into different committees to oversee the operation of their credit union.[260] Some members were assigned to a *conseil d'administration* which watched over the day-to-day affairs of the union, while the *commission de surveillance* was responsible for guaranteeing the books were properly kept.[261] The spirit of cooperation was essential because those with oversight responsibilities were ineligible to receive loans in order to avoid conflicts of interest.[262] And, unlike commercial banks, trustees received no compensation.[263] While these policies and their natural outgrowths, such as salaried professional management, have made large-scale cooperative lending possible, they have not succeeded in eliminating the risks. As the 1980 savings and loan scandal made clear, cooperative lending may be as vulnerable to fraud and mismanagement today as it was two centuries ago.

But, perhaps more importantly, cooperative lending by its nature tends to exclude those who are in most desperate need of its advantages. From the beginning, organized cooperative lenders have rigorously limited their membership to those with common bonds and relatively stable financial backgrounds. The first British building societies confined membership to groups of no more than twenty close neighbors and friends.[264] Many German cooperatives required costly entrance fees which functionally excluded undesirable members.[265] Early Quebec credit unions excluded all but respected French speaking Catholics and garnered community support

260. DUBLIN, *supra* note 243, at 146.

261. RONALD RUDIN, IN WHOSE INTEREST? QUEBEC'S CAISSES POPULAIRES 1900-1945, at 13 (1990).

262. *Id.*

263. *Id.*

264. BOLEAT, *supra* note 232, at 3.

265. DUBLIN, *supra* note 243, at 143-44.

with anti-Semitic hate speech.[266] Moreover, many potential members who met the racial, religious, and character prerequisites of cooperative credit did not meet formal and informal financial requirements.[267] It took little time for cooperative lenders to recognize that impoverished applicants had nothing to offer other members in the way of mutual benefit.[268] These applicants sought not cooperation but charity, and were therefore excluded.

III. ECHOES OF THE PAST: HIGH-COST CONSUMER CREDIT POLICY IN THE UNITED STATES

The United States has permutated variations of each of these major high-cost consumer credit policy strategies. Debtor amnesty, interest rate caps and other contract restrictions, selective protection, deregulated free markets, charitable lending, and organized cooperative lending have all been used by American policymakers for at least a century. However, American high-cost consumer credit policy has materialized obedient to no logical pattern, instead tracking the twists and turns of history and cultural change. This Part briefly surveys this evolution by focusing on the recurrent strategic limitations which have plagued our imported high-cost credit policy strategies. This Part also discusses the radical cultural revolution in middle-class American values with respect to consumer credit.

A. *High-Cost Consumer Credit Policy Prior to 1900*

European colonies in North America established their first laws dealing with high-cost credit following the English system of the time.[269] The basis for most modern state usury laws comes from imported English interest rate cap statutes. In particular, the colonies applied the Statute of Anne, which set a maximum allowable interest rate of five percent per annum.[270] The Statute of Anne, passed in 1713, was deeply influenced by receding but still influential medieval predispositions against the taking of interest: "[t]he statute[] . . . bear[s] witness to the Church's continued prejudice against the practice of usury in any form."[271] Specifically, the statute forbade charging interest "above the value of five pounds for the

266. RUDIN, *supra* 261, at 5, 11.

267. *Id.* at 27.

268. PUGH & INGRAM, *supra* note 258, at 6.

269. HOMER & SYLLA, *supra* note 1, at 274 ("The colonists from England brought with them seventeenth-century English attitudes toward credit and interest.").

270. KEEST, *supra* note 19, at 37; Ackerman, *supra* note 5, at 85; Tracy A. Westen, *Usury in the Conflict of Laws: The Doctrine of the Lex Debitoris*, 55 CAL. L. REV. 123, 131 & n.45 (1967); Laurence M. Katz, Comment, *Usury Laws and the Corporate Exception*, 23 MD. L. REV. 51, 52 & n.11 (1962).

271. Katz, *supra* note 270, at 52.

forbearance of one hundred pounds for a year."[272] The statute attempted to send a strong message of deterrence by including a damages provision establishing a fine which was triple the amount lent for charging above the five percent cap.

> [A]ll and every person . . . which shall . . . receive . . . payment for one whole year, of and for their money or other thing, above the sum of five pounds for the forbearing of one hundred pounds for a year . . . shall forfeit . . . the treble value of the monies, wares, merchandizes, and other things so lent.[273]

The basic interest rate caps of the colonies and (after independence) the States, modeled on the Statute of Anne, formed the backbone of attempts to control harmful consequences of high-cost lending in the United States. The caps set interest rate ceilings at different levels ranging between four percent and ten percent.[274] After independence, most states set their maximum interest rates at six percent.[275] Many of these interest rate caps, now called "general usury laws," have survived in one form or another until today.[276] The colonies also fashioned debt enforcement laws in the English pattern, which strongly favored creditors.[277] States at times would raise or lower their ceilings.[278] In 1867, Massachusetts followed the lead of England and other European countries in abolishing its interest rate cap.[279] A few states in turn followed Massachusetts.[280] Nevertheless, the legislative approach of low interest rate caps was relatively stable, normally encountering only mild tampering. "With very few exceptions, general usury laws were the only statutes regulating credit costs in the United States prior to the twentieth century."[281] The simplicity and durability of the early State interest rate caps echos many historical precedents. Thus, the American "combination of rigorous enforcement of debt and legal maximum rates of interest comes down from Hammurabi

272. *Act to Reduce the Rate of Interest*, 12 Ann., c. 16 (1713), *reprinted in* Katz, *supra* note 270, at 52 n.11.

273. *Id.*

274. Ackerman, *supra* note 5, at 85.

275. *Id.*

276. KEEST, *supra* note 19, at 37.

277. Ackerman, *supra* note 5, at 85.

278. *Id.* at 85-86.

279. *Id.* at 86.

280. *Id.* at 86-87; Westen, *supra* note 270, at 133-34.

281. KEEST, *supra* note 19, at 37.

through Rome, through seventeenth-century England, to the modern United States."[282]

1. The American Thrift Ethic

Culturally, Americans viewed debt supporting commerce as necessary and enterprising, but conversely placed a large social stigma on borrowing for personal consumption purposes.[283] One author in 1838 explained widespread American comfort with commercial lending in terms of personal trust:

> As the credit system is the offspring of confidence, and as no man reposes confidence where he deems it likely to be abused, the existence of this extensive and universal system of credit may be taken as evidence of *a general belief* among those who have commodities for sale, that those who desire to obtain them, have the disposition, and will have the means of paying for them, in such manner and at such times as may be agreed upon.[284]

This focus on confidence is enlightening in regard to the reluctance of mainstream commercial lenders to extend credit for consumption purposes. Quite simply, unlike commercial debtors, consumption borrowers were not trusted.[285] The papers of Benjamin Franklin reveal popular thinking about individuals who borrowed for consumption purposes:

> Think what you do when you run in Debt; *You give to another Power over your Liberty*. If you cannot pay at the Time, you will be ashamed to see your Creditor; you will be in Fear when you speak to him; you will make poor pitiful sneaking Excuses, and by Degrees come to lose your Veracity, and sink into base downright lying; for, as Poor Richard says, *The second Vice is Lying, the first is running in Debt*. . . . Poverty often deprives a Man of all Spirit and Virtue: *Tis hard for an empty Bag to stand upright* . . . . *The Borrower is a Slave to the Lender, and the Debtor to the Creditor*, disdain the Chain, preserve your Freedom; and maintain your independency: Be *industrious* and *free*; be *frugal* and *free*.[286]

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282. HOMER & SYLLA, *supra* note 1, at 274.

283. CALDER, *supra* note 16, at 98; HOMER & SYLLA, *supra* note 1, at 274.

284. H.C. CAREY, THE CREDIT SYSTEM IN FRANCE, GREAT BRITAIN, AND THE UNITED STATES 25 (1838).

285. CALDER, *supra* note 16, at 91-104 (providing extensive historical discussion of Victorian American moral attitudes towards personal consumption debt).

286. DAVID M. TUCKER, THE DECLINE OF THRIFT IN AMERICA: OUR CULTURAL SHIFT FROM

But in spite of strong social messages against personal debt, especially debt at high prices, "[h]igh rates no doubt existed in commercial and personal transactions. But high interest rates were vigorously opposed by colonial law and custom and were therefore negotiated secretly . . . ."[287] Low interest rate caps reflected this cultural norm.[288] It was not possible for lenders to make a profit from short term loans of small amounts without charging rates in excess of the legal limits.[289] Accordingly, normal citizens generally could not purchase the use of money from legal lenders.[290] In this way, the law acted as an agent of socialization against all borrowing for consumptive purposes.

The American thrift ethic stifled development of debtor amnesty policies. Defaulting debtors, particularly consumer debtors, found little public sympathy.[291] In addition to interest rate caps, colonists also imported English debtor prisons.[292] Imprisonment for debt was surprisingly common in the eighteenth and early nineteenth centuries:

> Thus, in 1830, there were in Massachusetts, Maryland, New York, and Pennsylvania three to five times as many persons imprisoned for debt as for crime. The Suffolk County Jail in Boston alone for the decade 1820-1830 contained 11,818 imprisoned debtors from a total population ranging from 43,000 to 63,000.[293]

Although some states pushed for reform in the 1830s, debt peonage was not federally outlawed until after the Civil War.[294] Northern states only felt compelled to outlaw debtor prisons when Southern whites began circumventing emancipation with debt peonage.[295]

Gradually, the bankruptcy system evolved to become the primary mechanism of providing American debtor amnesty. Throughout Europe, the earliest bankruptcy rules were exclusively creditor collection remedies which provided virtually no protection for debtors.[296] It was not until 1706

SAVING TO SPENDING 9-10 (1991); 7 THE PAPERS OF BENJAMIN FRANKLIN 342-49 (Leonard W. Labaree ed., 1963).

287. HOMER & SYLLA, *supra* note 1, at 275.

288. CALDER, *supra* note 16, at 112.

289. Haller & Alviti, *supra* note 16, at 127.

290. CALDER, *supra* note 16, at 112.

291. Countryman, *supra* note 14, at 812-13.

292. *Id.* at 813.

293. *Id.* at 814.

294. *Id.* at 816.

295. *Id.*

296. *Id.* at 809-10; John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163, 164, 181 (1996); Charles Jordan Tabb, *The History*

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that short-lived English bankruptcy law included discharge of a limited number of debts for a limited number of debtors.[297] Nearly a century later in 1800, the United States adopted its first bankruptcy law.[298] Like early American interest rate caps, debtor amnesty provisions included in early American bankruptcy laws bear a surprising resemblance to their ancient Mesopotamian predecessors. Like the occasional Sumerian and Babylonian royal decrees forgiving debts for favored subjects, nineteenth century American bankruptcy debtor amnesty rules responded to financial crises, were short lived, and were capriciously limited in scope.[299] For example, a financial panic spurred the 1800 Bankruptcy Act, which was repealed in only three years.[300] While the act included narrow provisions providing for discharge of some debts, only merchants were eligible.[301] And, while the law allowed release from debtor prison for those obtaining discharge, there is some evidence that only the relatively influential consistently acquired this amnesty.[302] For instance, Robert Morris, a member of the Constitutional Convention and a prominent financier, managed to liberate himself from a Pennsylvania debtor prison.[303] Those without such prominence were not so lucky.[304]

Our second and third bankruptcy rules were similarly inconsistent in providing amnesty for imprisoned and defaulting debtors. The Bankruptcy Act of 1841, which became effective in 1842, was promptly repealed in 1843.[305] Perhaps contributing to its short life was the controversial innovation of extending limited debt discharge rights to non-merchant debtors.[306] The post-Civil War economic crisis spawned the relatively enduring Bankruptcy Act of 1867.[307] It also provided limited debt discharge rights, but survived for less than a decade.[308]

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of the Bankruptcy Laws in the United States, 3 AM. BANKR. INST. L. REV. 5, 7-8 (1995).

297. McCoid, *supra* note 296, at 163-65.

298. Tabb, *supra* note 296, at 6-7.

299. Both British and American bankruptcy laws have consistently suffered from inconsistency. Both have exhibited a "pattern of lapse [and] revival." McCoid, *supra* note 296, at 181.

300. Countryman, *supra* note 14, at 813.

301. *Id.* at 811-13.

302. *Id.* at 813.

303. *Id.*; Tabb, *supra* note 296, at 15.

304. *See* Countryman, *supra* note 14, at 813; Tabb, *supra* note 296, at 14-15.

305. Countryman, *supra* note 14, at 814-15.

306. *See id.*

307. *Id.*

308. CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 13-20 (1935); Countryman, *supra* note 14, at 815-16; Tabb, *supra* note 296, at 14, 18-22.

2. The Origin of American Selective Protection: Our Tradition of Credit Discrimination

The American credit culture prior to the twentieth century only can be understood against a backdrop of formal and informal discrimination against non-European races and women. This fact is easily overlooked given the stark absence of treatment of race and gender in most financial and credit histories. For example, a discussion about credit for African-Americans prior to the Civil War can only be dominated by the institution of slavery. Rather than asking whether credit was available to slaves, scholarship often focuses on how slaves were used to secure credit for their European captors.[309] It is naive to suspect that after emancipation equal access to inexpensive credit became easily available for African-Americans. At the end of the Civil War, over ninety percent of blacks lived in the South, where the white elite was determined to preserve as many of the economic aspects of slavery as possible.[310] African-Americans usually had no resource to provide for themselves besides their own labor.[311] High-cost credit played an important role in perpetuating the power of white elites. A large portion of the black population found sustenance in sharecropping, which relied on a cycle of poverty and debt to enforce the subordination of black workers.[312] Sharecroppers received no pay for their work until the sale of the crop at harvest time.[313] With no available cash source, black agricultural workers were forced to turn to high-cost credit to survive.[314] Interest rates on supplies and money loaned to Southern blacks were high, often exceeding fifty percent.[315] When the farming season ended and black workers sold their share of the crop, there were rarely enough proceeds to cover debts from the previous season.[316] Thus, sharecroppers were forced to borrow again year after year, each time

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309. *See, e.g.*, RICHARD HOLCOMBE KILBOURNE, JR., DEBT, INVESTMENT, SLAVES: CREDIT RELATIONS IN EAST FELICIANA PARISH, LOUISIANA 1825-1885 (1995) (conducting a systematic historical study of the role of slave property in securing credit contracts).

310. Nieman, *supra* note 15, at vii-viii.

311. Smallwood, *supra* note 15, at 227.

312. For general discussions of sharecropping in the nineteenth-century South, see WILLIAM COHEN, AT FREEDOM'S EDGE: BLACK MOBILITY AND THE SOUTHERN WHITE QUEST FOR RACIAL CONTROL, 1861-1915 (1991); RONALD L.F. DAVIS, GOOD AND FAITHFUL LABOR: FROM SLAVERY TO SHARECROPPING IN THE NATCHEZ DISTRICT, 1860-1890 (1982); JAYNES, *supra* note 15; ROGER L. RANSOM & RICHARD SUTCH, ONE KIND OF FREEDOM: THE ECONOMIC CONSEQUENCES OF EMANCIPATION (2d ed. 1977); JAMES L. ROARK, MASTERS WITHOUT SLAVES: SOUTHERN PLANTERS IN THE CIVIL WAR AND RECONSTRUCTION (1977); CRANDALL A. SHIFFLETT, PATRONAGE AND POVERTY IN THE TOBACCO SOUTH: LOUISA COUNTY, VIRGINIA, 1860-1900 (1982).

313. Smallwood, *supra* note 15, at 238-39.

314. *Id.* at 229.

315. Nieman, *supra* note 15, at x.

316. Smallwood, *supra* note 15, at 229.

hoping that the next crop would allow them to pay off their debt and perhaps save a little extra money. Moreover, white landowners and creditors often cheated black workers. In Texas, for example, the widespread practice of shutting out black workers without compensation immediately before harvest, after they had farmed the entire agricultural season, found judicial sanction in the courts.[317] Very few African-Americans were resourceful enough to gather enough cash and credit to purchase their own farms, hence almost all black agricultural workers faced lives of gripping poverty exacerbated and entrenched by high-cost lending.[318]

Similarly, it is somewhat futile to speak of access to credit when women had neither governmentally recognized, protected property rights, nor the right to vote. In American history, access to credit for women was often a function of their relationships to men.[319] The ability to borrow requires a creditor's trust that the debtor will be able to raise and turn over the amount loaned plus interest. Because women were excluded from the basic mechanisms of the market economy, they could not consistently guarantee repayment without enlisting in some way the cooperation of a male. Where women did try to borrow, their exclusion from lower-priced lenders forced them to turn to pawnbrokers or other high-cost lenders, often with "devastating effects upon a family's real income."[320] The story of one New York single mother is illustrative:

> Mrs. Zulinsky . . . one day found that her entire life's savings of six hundred dollars had been stolen from her mattress. Charity could not support three children, so Mrs. Zulinsky was forced to become, in the slang of the day, "a furniture dealer." Her table, her two beds, all her chairs, and "even the marble clock surmounted by a bronze horseman armed with a spear" were hauled down to the pawnshop and "put up the spout." When night fell, Mrs. Zulinsky's family was "sitting on boxes and sleeping on the floor," but the immediate emergency had been bridged.[321]

Throughout the nineteenth century approximately three quarters of pawnbroker customers were women, usually borrowing at rates around 300% per annum.[322]

317. *Id.* at 238-39.

318. *Id.* at 229.

319. *See, e.g.*, TEBBUTT, *supra* note 42, at 1.

320. *Id.*

321. CALDER, *supra* note 16, at 43; *see also* ELIZABETH EWEN, IMMIGRANT WOMEN IN THE LAND OF DOLLARS 159 (1985).

322. CALDER, *supra* note 16, at 47-48.

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3. The Rise of Salary Lending

High-cost consumer debt was by no means limited to ethnic minorities and women. By the latter half of the nineteenth century, there was an upsurge in lenders catering to a clientele of married, working class, white men with steady jobs.[323] These creditors, known as salary lenders,[324] were the precursor to today's payday lenders. Their borrowers "were frequently regular employees of large organizations: government civil servants, railroad workers, streetcar motormen, and clerks in firms such as insurance companies."[325] Such workers, often recent immigrants or former agricultural laborers, formed the foundation of the emerging lower middle class of urban American society.[326] For the lender, they represented good credit risks. These men usually borrowed to meet unexpected needs such as family illness or moving expenses.[327] Nevertheless, they held steady jobs and had family obligations which prevented them from skipping town.[328] High-cost lenders targeted such workers because they had a steady supply of disposable income which made them likely to repay.[329] Moreover, frequent minor income shocks made the workers likely to borrow.[330]

It was these high-cost lenders whom working class people in the Eastern U.S. cities first came to describe as "loan sharks."[331] Although the term was new, the tactics of the lenders were not. Initially, these loan sharks charged very high interest rates.[332] In fact, rates in excess of one thousand percent annually were common.[333] Reminiscent of high-cost loans in ancient Athens, principal amounts were generally small, and due in a short period of time.[334] But, very often the loans would end up compounding over great periods of time.[335] The records of one salary lender in New York City showed that out of approximately 400 debtors, 163 had been making payments on the loans for over two years.[336] Nor was the length of these loans merely a result of the debtor's unwillingness or

323. Haller & Alviti, *supra* note 16, at 127-28.
324. *Id.*
325. *Id.* at 128.
326. *Id.* at 127, 129.
327. *Id.* at 128.
328. *Id.* at 128-29.
329. *See, e.g.*, Ackerman, *supra* note 5, at 89.
330. *Id.*; Robert W. Kelso, *Social and Economic Background of the Small Loan Problem*, 8 LAW & CONTEMP. PROBS. 14, 15-20 (1941).
331. Haller & Alviti, *supra* note 16, at 125-26.
332. HOMER & SYLLA, *supra* note 1, at 428.
333. *Id.*
334. *Id.*
335. Haller & Alviti, *supra* note 16, at 133.
336. *Id.*

inability to pay. The most essential characteristic of these early salary lenders, and perhaps all loan sharks in general, was the tendency to manipulate loans into "chain debt."[337] This was accomplished by a broad variety of means. The first and perhaps most important were late fees, which were often assessed even where the creditor was only minutes or hours late.[338] Commonly, creditors "deliberately maneuvered a borrower into a late payment, by falsely suggesting that a late payment would be overlooked or by claiming that a payment sent by mail arrived after the payment deadline."[339] It is easy to imagine the incentive a salary lender might have in closing shop early on a Friday afternoon when working customers might rush in to make a last minute payment. Sometimes, individual late fees were nearly as much as the principal itself.[340] We can expect that other tactics reflected those used throughout history, including "creative" calculations of the interest, a broad assortment of other fees (such as origination fees, collection fees, broker fees, pledge storage fees, and insurance fees), and refinancing induced by balloon payments. The key in chain debt is for the lender to collect the most money while reducing the amount owed to as little as possible.[341]

In a typical transaction, a debtor would borrow five dollars on Monday, and repay six on Friday.[342] This 20% per week loan translates into a 1040% per annum rate.[343] African-Americans borrowing in the South were often charged rates twice as high in the same type of transaction, where a loan of five dollars was repaid with seven at the end of the week.[344] The charge of one or two dollars itself seems fairly innocuous for any one given week. But, when a debtor lost a job, was not paid for his work, became ill, had a family member become ill, or was prevented from paying for any other reason, the simple transaction rapidly swelled into an enormous drain on an already strained budget.

Profits from extended-term salary lending fueled the late nineteenth-century upsurge in high-cost lending.[345] As the industry grew, so too did the horror stories, often the only circulated evidence of what was becoming a crisis. Moreover, the surge in high-cost lending would significantly contribute to a transformation in American culture:

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337. *Id.*
338. *Id.*
339. *Id.*
340. *Id.*
341. *Id.*
342. HOMER & SYLLA, *supra* note 1, at 428.
343. *Id.*
344. *Id.*
345. PETER W. HERZOG, THE MORRIS PLAN OF INDUSTRIAL BANKING 5-6 (1928); KEEST, *supra* note 19, at 38-39; Haller & Alviti, *supra* note 16, at 125.

> There was, for example, the employee of a New York publishing house who supported a large family on a salary of $22.50 per week and had been paying $5 per week to a salary lender for several years, until he had paid more than ten times the original loan. Or the case of a Chicagoan who borrowed $15, paid back $1.50 per month for three years before fleeing the city to escape the debt. Or the case of a streetcar motorman who, in 1912, had seventeen Chicago loan companies attempting to collect $307 on an original loan of $50 after he had already paid $360. Or the claim of another Chicago borrower that he had borrowed $15, ten years later had repaid $2,153 and still owed the original $15.[346]

In this period, pawnbrokers also grew quickly alongside salary lenders. In 1812, New York City had ten licensed pawnbrokers, but by 1897 the number had grown more than ten times to 134 licensed pawnbrokers.[347] Similarly, San Francisco, where there were no state usury laws, was home to 243 pawnshops by 1897.[348] Moreover, credible turn of the century studies estimated one in five American workers owed money to salary lenders.[349] Although individuals indebted to salary lenders and pawnbrokers could not have known it, their stories bore remarkable similarity to those told for thousands of years.

Unfortunately, as in Babylon, Rome, and Ming China, government interest rate caps provided little or no protection for those in the grips of such high-cost lending.[350] First, many lenders evaded usury caps by phrasing the contract as a purchase or assignment of future wages, rather than a loan.[351] Second, lenders could easily take advantage of the time-price doctrine to avoid interest rate caps.[352] Under this doctrine, where a physical good was purchased over time on installments, it was not considered a loan under English law for purposes of a statutory interest rate cap.[353] Because American general usury laws were modeled on their English predecessors, U.S. courts almost invariably considered purchases of physical products over time as exempt from usury laws.[354] This led some

346. Haller & Alviti, *supra* note 16, at 133-34.

347. CALDER, *supra* note 16, at 46.

348. *Id.*

349. *See id.* at 52 n.39 (relying on ARTHUR H. HAM, THE CAMPAIGN AGAINST THE LOAN SHARK 1 (1912); Shergold, *supra* note 16, at 202).

350. *See, e.g.*, DAVID J. GALLERT ET AL., SMALL LOAN LEGISLATION: A HISTORY OF THE REGULATION OF THE BUSINESS OF LENDING SMALL SUMS 17 (1932) (characterizing early interest rate caps and their enforcement provisions as "piecemeal" and prone to "frequent failure").

351. *Id.* at 180; CALDER, *supra* note 16, at 50.

352. KEEST, *supra* note 19, at 38.

353. *Id.* at 37-38.

354. *Id.* at 37.

lenders to avoid interest rate caps by, for example, requiring the debtor to "purchase" a worthless oil painting at the time the loan contract was signed.[355] The debtor would owe the same amount of money, and could immediately throw the painting away, but the transaction would be at least superficially legal.[356] Third, statutes indicating the interest rate cap often did not clearly describe how interest was to be calculated under the cap, leaving wide ambiguity over the actual amount legally chargeable.[357] Some lenders would engage in "note shaving," where a loan would be offered at a legal rate, but additional mandatory fees would create a true price well above that contemplated by legislators.[358] Other lenders would charge interest on money already repaid by the debtor, thus dramatically increasing the overall amount the debtor would have to repay.[359] Fourth, lenders would also require debtors to sign forms when taking out the loan which granted the creditor power of attorney long before any payment dispute arose.[360] When and if the debtor tried to challenge the contract in the judicial system, he might find out he had already waived his right to do so.[361] Whether or not this was in fact legal, power of attorney forms no doubt deterred many debtors from trying to contest the contract.[362] Even if the debtor was not dissuaded, the creditor could, without the debtor's knowledge, appear before a court and confess judgment on an unpaid debt, thus enlisting the power of the state to help in collection.[363] Fifth, some state court systems were structured such that the income of lower justices of the peace and magistrates was provided for through court fees.[364] Thus, "[j]ustices who found for salary lenders could often attract a good deal of business and thus earn tidy sums, so that it was in the economic interest of justices to look with favor upon suits by lenders."[365] Sixth, even where there was no economic incentive, lenders still retained the formidable advantage of initiating suits.[366] Pleadings, choice of venue, and choice of jurisdiction could all offer litigation savvy lenders the ability to shape

355. CALDER, *supra* note 16, at 50.

356. *See, e.g.*, *id.*

357. *See, e.g.*, Act to Reduce the Rate of Interest, 12 Ann., c.16 (1713), *reprinted in* Katz, *supra* note 270, at 52 n.11.

358. CALDER, *supra* note 16, at 116.

359. These lenders were commonly called Morris Plan Banks. EVANS CLARK, FINANCING THE CONSUMER 69 (1930); HARDY ET AL., *supra* note 8, at 32; KEEST, *supra* note 19, at 39; *see also* HERZOG, *supra* note 345, *passim* (providing detailed if somewhat generous description of Morris Plan lending).

360. Haller & Alviti, *supra* note 16, at 134.

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.* at 135.

365. *Id.*

366. *Id.* at 134.

lawsuits to their advantage.[367] For example, we can expect lenders would know when to bluff and when to sue simply because they had inside information about the personal views of various judges. Seventh, loans made above interest rate caps prior to the turn of the century must have made their way to the courts for adjudication relatively infrequently.[368] This is not to say that there were no cases where courts found loans above the statutory limit.[369] But, compared to the number of illegal loans that were made, we can expect only a very few of these cases ever made it to court. After all, anyone who had the money to hire an attorney to sort through salary lenders' complex legal contracts would use that money to pay off the debt. Eighth, public prosecutors would very rarely take the initiative to seek out those lending in excess of legal limits.[370] Outside of New York, there was not one state officer specifically charged with enforcement of usury laws.[371] This meant that the complex and time consuming business of enforcing interest rate caps was easy for officials to ignore. In this way, generations of lenders offered and collected upon loans which violated certainly the spirit, if not the letter, of general usury laws. Moreover, high-cost lenders' legal ingenuity helped them to maintain at least a thin veil of legality throughout much of the nineteenth century.

Even without resorting to the judicial system, creditors could place enormous pressure on debtors. A nineteenth-century creditor was free to confront the friends and family of a debtor who had already paid the principal of a loan thrice over, subjecting the borrower to terrible social embarrassment.[372] A common tactic was

> to employ a "bawler-out"—usually a woman with a stentorian voice and rich vocabulary. The bawler-out went to the borrower's place of work or neighborhood and, in a loud voice, denounced him for his dishonesty in refusing to repay the loan. To avoid further embarrassment or the possibility of being fired, the borrower might well seek a settlement.[373]

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367. *Id.* at 134-35.

368. For example, the number of reported cases is paltry in comparison to the number of salary lenders openly operating in violation of general usury limits. The Russell Sage Foundation estimated about 300 lenders were doing business in New York City alone around the turn of the century. GLENN ET AL., 1 RUSSELL SAGE FOUNDATION, 1907-1946, at 138. Although Russell Sage advocates attempted to investigate and find attorneys to deal with the large volume of illegal lending, it is clear their efforts were an exception to the norm. *Id.*

369. *See, e.g.*, State v. Halburt, 72 A. 1079, 1080 (Conn. 1909) (holding salary wage assignment invalid under state interest rate cap).

370. GALLERT ET AL., *supra* note 350, at 53-54.

371. *Id.*

372. *See, e.g.*, Haller & Alviti, *supra* note 16, at 134 n.14.

373. *Id.* (citing FOREST HALSEY, THE BAWLEROUT (1912); Frank M. White, *The Story of a Debt*, *in* WORLD WORK 346 (Jan. 1912)); *see also* CALDER, *supra* note 16, at 54 (providing a

The lender could also threaten to garnish the wages of the debtor, which in the social climate of the time was tantamount to threatening the debtor with unemployment.[374]

Lingering Victorian condemnation of personal debt created a culture of silence which masked the increasingly pervasive indebtedness of the working and lower-middle class.[375] With debtor prisons only recently outlawed, debtors kept their obligations private. Although there are a number of surviving records of commercial lending at legal or nearly legal rates, there is very little surviving documentation of higher-priced illegal loans.[376] In the late 1880s, Congress became concerned enough to direct the census of 1890 to estimate the total amount of private debt.[377]

> Robert Porter, the census superintendent, "feared that the people regarded their debt . . . as a part of their private affairs, and that they would resent any inquiries in regard to it." The image was not a pleasant one: unarmed census workers thrown out of the homes of angry debtors resentful of governmental prying into their personal affairs. Porter concluded that any attempt to ask the people about their debts would cause collateral damage to the rest of the survey, enough to wreck the entire 1890 census.[378]

Realizing the citizenry would never reveal the extent of their personal debts, census officials relented and instead tried to estimate private debts on the basis of public records.[379]

4. Policy Responses to the Late Nineteenth Century High-Cost Credit Boom

The social havoc associated with late nineteenth-century salary lenders and pawnbrokers forced American credit policy into a period of dramatic evolution. Elites, as well as the working and still vulnerable middle class, united to adopt a variety of policies new to America, but not to world

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similar description).

374. *In re* Home Disc. Co., 147 F. 538, 546 (N.D. Ala. 1906) ("Railroad companies, owners of furnaces and mills, and other large employers of labor, made and enforced rules, for their own protection, that employes [sic] who had unsettled disputes about an assignment of their wages should be laid off, and if the dispute were long-continued, should be discharged.").

375. CALDER, *supra* note 16, at 19.

376. HOMER & SYLLA, *supra* note 1, at 275.

377. CALDER, *supra* note 16, at 39-40.

378. *Id.* at 40 (quoting Robert Porter, *Public and Private Debts*, 153 N. AM. REV. 610-12 (1891)).

379. *See id.*

history. For instance, many Americans searched for redress in the philanthropy of the rich.[380] Social elites founded several charitable lending institutions in the late 1800s.[381] Following the European *mons pietatis* and later municipal pawnshops, a group of wealthy Boston citizens organized a philanthropic pawnshop called the Collateral Loan Company in 1859.[382] Like its European predecessors, the Collateral Loan Company aimed to provide relatively inexpensive pawn loans to poor clients in need of emergency credit.[383] If loans were not repaid, the pawned security was sold at public auction.[384] A board of directors chosen by shareholders who had invested capital in the company, as well as the mayor of Boston and the governor of Massachusetts, led the company.[385] Shareholders would receive limited dividends on their capital investment, but the real appeal of the business was almost certainly charitable.[386]

Other institutions, both in Boston and elsewhere, emulated the Collateral Loan Company.[387] In 1888, Massachusetts expanded charitable lending beyond philanthropic pawn loans by incorporating the Workingmen's Loan Association in Boston.[388] The Massachusetts state legislature acted to create a business "for the purpose of loaning money upon pledge or mortgage of goods and chattels or of safe securities of every kind or upon mortgage of real estate."[389] The most prominent example of a charitable lending company in the United States is the Provident Loan Society of New York, founded in 1894.[390] Key charitable investors included J. Pierpont Morgan, Percy Rockefeller, and Cornelius Vanderbilt.[391] Similar to the Italian *mons pietatis*, the charitable pawnshop charged rates that were low compared to commercial pawn shops, but still "high enough to cover all costs of operation . . . and to allow an accumulation of a surplus—which could be used only for expansion of the business or for gifts to charitable organizations, not to increase the return to contributors of capital."[392] The society's founders feared that personal financial problems exacerbated by high unemployment rates following the

380. *See* CASKEY, FRINGE BANKING, *supra* note 22, at 23.
381. *See id.*
382. *Id.*
383. *Id.*
384. *Id.*
385. *Id.*
386. *See generally id.* (providing a brief historical discussion of the Collateral Loan Company).
387. *Id.*
388. CALDER, *supra* note 16, at 120.
389. 1888 Mass Acts ch. 100.
390. CALDER, *supra* note 16, at 120-21.
391. CASKEY, FRINGE BANKING, *supra* note 22, at 23-24.
392. GLENN ET AL., *supra* note 368, at 66 n.2.

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recession of the early 1890s were causing "deterioration in the social conditions of the working class."[393]

Widespread high-cost lending also spurred the middle class to more aggressively organize cooperative lending associations in order to insulate themselves from the risks of high-cost debt. The first American building society, modeled after earlier British counterparts, was formed in 1831, and by the late nineteenth century savings and loan associations became entrenched.[394] By 1893, thirteen states—California, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, Missouri, New Jersey, New York, Ohio, Pennsylvania, and Tennessee—boasted more than 100 savings and loan associations.[395] While the first credit unions modeled on German and then Canadian institutions did not appear in the Untied States until 1909, they thereafter quickly followed on the heels of British modeled societies.[396]

Finally, the rise of the loan sharks along with the financial panic of 1893, created momentum to once again attempt to pass a federal bankruptcy law.[397] Opposition to a federal bankruptcy law by Western and Southern representatives fearing Northern bias stalled the law until 1898, when numerous amendments favorable to debtors secured its passage.[398] Growing middle class access to credit, as well as increasing sympathy for the plight of non-commercial debtors who had been preyed upon by unscrupulous lenders, brought about a fundamental change in the purpose of American bankruptcy law.[399] While previous laws were primarily creditor collection devices with parsimonious discharge provisions meant only to ease temporary financial crises, the 1898 Act aimed to give bankrupts a "fresh start."[400] Although the focus of Congressional debates was still upon commercial transactions,[401] under the new law, consumers and merchants alike were free to voluntarily enter bankruptcy.[402] Discharge was no longer contingent upon creditor consent.[403] The list of restrictions on the right of discharge was significantly narrowed and, in fact, only a few debts were exempted from discharge.[404] And, perhaps to limit the use of bankruptcy as a salary loan collection device, creditors could no longer

393. CASKEY, FRINGE BANKING, *supra* note 22, at 24.

394. FABRITIUS & BORGES, *supra* note 231, at 12-13.

395. *Id.* at 16, tbl. 2.1.

396. DUBLIN, *supra* note 243, at 146; FERGUSON & MCKILLOP, *supra* note 230, at 18-20; NUGENT, *supra* note 259, at 75-76; PUGH & INGRAM, *supra* note 258, at 2.

397. *See* Tabb, *supra* note 296, at 23.

398. *Id.*

399. *See* Countryman, *supra* note 14, at 817.

400. *Id.* at 817-18.

401. Tabb, *supra* note 296, at 24.

402. *See* Countryman, *supra* note 14, at 817.

403. *Id.* at 818.

404. *Id.* at 818-19.

force wage earners into involuntary bankruptcy proceedings.[405] Thus, the 1898 law was not only a device to secure an equitable division of property among creditors, but also a device to deal out discharge of debts to deserving debtors.[406]

With more generous discharge provisions came increasingly complex and costly procedural rules for administering bankrupt estates. "At least seventy percent of the [1898] Bankruptcy Act, if not more, was procedural."[407] The process soon became so complex that a specialized sub-discipline of law practice emerged.[408] Creditors elected a trustee, and organized into a creditors' committee.[409] Although venue was in federal district courts, it was necessary to appoint "referees in bankruptcy."[410] Federal district court judges delegated almost all of the judicial and administrative duties to referees, who eventually evolved into today's bankruptcy judges.[411] The subject of bankruptcy policy debate switched from whether to grant discharge to the best way to grant it, thus charging the courts with a whole new system of commercial administration.[412] After 1898, bankruptcy debates became contests between efficient formalistic rules versus justice-oriented discretionary standards.[413] Despite these complexities, the law became America's first non-transitory bankruptcy law, and although it was often amended, it remained in force for eighty years.[414]

B. *High-Cost Consumer Credit Policy from 1900 to the End of World War II*

The progressive new bankruptcy law, combined with interest rate caps and fledgling charitable and cooperative lending efforts, proved incapable of stemming the growing and dangerous tide of late nineteenth century high-cost credit. As the twentieth century began, the number of high-cost

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405. *Id.* at 818.

406. Bankruptcy Act of 1898, ch. 541, § 4, 30 Stat. 544-547; Countryman, *supra*, note 14, at 817-18; David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 312-14 (1999); Tabb, *supra* note 296, at 23-26.

407. Lawrence P. King, *The History and Development of the Bankruptcy Rules*, 70 AM. BANKR. L.J. 217, 218 (1996).

408. Tabb, *supra* note 296, at 25-26.

409. *Id.* at 25.

410. *Id.*

411. *Id.*

412. *Id.* at 24.

413. Robert Weisberg, *Commercial Morality, The Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 5 (1986).

414. Moss & Johnson, *supra* note 406, at 312-14; Tabb, *supra* note 296, at 23-26; Weisberg, *supra* note 413, at 5.

creditors and debtors continued to grow.[415] By 1907, 90% of the employees of New York's largest transportation company made weekly payments to salary lenders.[416] An influential study estimated one in five American workers owed money to a salary lender.[417] Others have argued, based on analysis of data from Pittsburgh, that this ratio actually underestimated the number of debtors obligated to turn-of-the-century "loan sharks."[418] While rates ranging from 20% to 300% were normal, rates well in excess of 1,000% were also still common.[419] The situation of many of the nation's poor was becoming so acute that socially sensitive elites could no longer ignore it.[420] Newspapers around the country ran exposés and aggressive editorial campaigns on the evils of loan sharks, with headlines indistinguishable from those found today.[421] Even the slow-to-change judiciary began to respond with a smattering of harshly worded opinions.[422] One federal judge characterized a high-cost lender as having "brought on conditions which were yearly reducing hundreds of laborers and other small wage-earners to a condition of serfdom in all but name."[423]

For the first time in American history, significant numbers of wage earning consumer debtors began to seek amnesty from their creditors by declaring bankruptcy under the 1898 law. But salary lending and other forms of high-cost credit persisted. Prior to becoming Attorney General, Charles D. Thatcher noted many consumer debtors only declared bankruptcy after a struggle to pay off their debts, which often included turning to salary lenders as a last resort.[424] Borrowers would often attempt to negotiate a repayment plan to satisfy their obligations.[425] Using aggressive collection tactics, salary lenders would undermine the effectiveness of these informal work-out plans by crowding out other

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415. CLARK, *supra* note 359, at 7-8.

416. CALDER, *supra* note 16, at 52.

417. *Id.* at 1 (relying on ARTHUR H. HAM, THE CAMPAIGN AGAINST THE LOAN SHARK 1 (1912)).

418. *Id.* at 52.

419. *Id.* at 50; GALLERT ET AL., *supra* note 350, at 54; HOMER & SYLLA, *supra* note 1, at 428.

420. KEEST, *supra* note 19, at 38-39.

421. CALDER, *supra* note 16, at 120.

422. *See, e.g.*, Willson v. Fisher, 75 Misc. 383, 387 (N.Y. 1912) ("I do not see how any one can look at this transaction as a whole and escape from the conclusion that it is not only usurious, but that plaintiff has been fully paid, and more."); State v. Hurlburt, 72 A. 1079, 1080 (Conn. 1909) ("[T]o allow loans at a rate of interest exceeding 15 percent, a year, where the lender disguises the true nature of the transaction by exacting an absolute conveyance, would frustrate the main object of the enactment, which was to protect borrowers from extortion."). *See also* GALLERT ET AL., *supra* note 350, at 54 (listing additional cases).

423. *In re* Home Disc. Co., 147 F. 538, 546 (N.D. Ala. 1906); *see also* GALLERT ET AL., *supra* note 350, at 54 (demonstrating scholarly perception of these changes by 1932).

424. Moss & Johnson, *supra* note 406, at 318-19.

425. *Id.* at 318.

creditors.[426] Salary lenders often served as a final weight breaking a wage earner's back and forcing him into bankruptcy.[427]

Charitable and cooperative lending societies grew in response to wider perception of high-cost lending problems. In 1909, fifteen philanthropic lending societies existed throughout the United States.[428] By 1915, this number more than doubled to thirty-eight.[429] Moreover, cooperative lending institutions also grew quickly between the turn of the century and the stock market crash of 1928.[430] While these charitable and cooperative endeavors helped many people, they were not nearly large enough to deal with the magnitude of problems associated with high-cost lending.[431] Much like their European predecessors, inadequate capital and staying power bedeviled United States charitable lenders.[432] Of the early charitable lending societies, almost all failed due to years of operating losses, either falling to the wayside of history or reverting to regular commercial pawnshop operations.[433] Early twentieth-century scholars explained:

> Important as the service has been which these remedial loan societies have rendered, their facilities are not adequate to the need and cannot be used by the poorer type of borrower. It must be remembered that these societies were organized as, and for the most part remain, semi-philanthropic in purpose. Though their capital has grown, it has not kept pace with the needs of the borrowers.[434]

The notable exception was the Provident Loan Society of New York. It survived by commanding greater charitable capital from its fabulously wealthy benefactors, deriving a unique advantage from New York City's unusual population density, more than doubling its original interest rate of twelve percent, and by highly underestimating the value of security in comparison to normal pawnbrokers.[435] But, even this most rare charitable organization failed to displace traditional commercial pawnbrokers in New

426. *Id.* at 318-19.

427. *Id.*

428. GALLERT ET AL., *supra* note 350, at 54.

429. *Id.* at 55.

430. PUGH & INGRAM, *supra* note 258, at 2-3; NUGENT, *supra* note 259, at 76.

431. GALLERT ET AL., *supra* note 350, at 13.

432. *See* CASKEY, FRINGE BANKING, *supra* note 22, at 24.

433. *See id.*

434. GALLERT ET AL., *supra* note 350, at 13.

435. CASKEY, FRINGE BANKING, *supra* note 22, at 24 ("The Provident Loan Society probably survived when the others did not because it was the largest and best capitalized of the remedial loan societies, enabling it to weather years with operating losses. It also undoubtably gained from the dense population of New York City . . . .").

York City.[436] Ultimately, charitable lenders suffering from haphazard management and undercapitalization "were no more effective in solving the problem of illegal lending than the publicity campaigns run by the newspapers . . . their loans amounted to a drop in the bucket."[437]

Although cooperative lenders were becoming more important for the upper-middle class, the vulnerable working and lower-middle class were still excluded. Almost a full century after the first American building societies appeared, a scholar complained:

> Not even the savings institutions, which are commonly thought of as workingmen's banks, have served the masses with credit. While the average savings banks have accepted deposits from people of small means, they have not, except in the rarest instances, been willing to make them loans. Unlike the commercial banks, they have offered only a small part of the traditional banking services to their customers.[438]

Like their British counterparts, cooperative lenders could only function by limiting cooperation to relatively small, homogeneous, and stable groups. Those who most needed the benefits of cooperation were precisely those who were excluded.

1. The Small Loan Laws

The failure of non-governmental responses to the problems of high-cost loans contributed to a growing dissatisfaction with state general usury laws. Before the Great Depression, Americans, distrustful of government, were not yet ready to ask it to help provide credit for the disadvantaged. Instead, reformers hoped to raise interest rate caps in order to attract legal private capital to markets for consumer loans.[439] The intellectual roots of this position were not new. Classical economists consistently argued that legislating interest rates only forces the high-risk loan market underground, thus requiring the borrower to pay a premium to the lender against the risk of being caught.[440] By making a special exception to general usury laws

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436. *See id.* at 26.

437. CALDER, *supra* note 16, at 121-22.

438. CLARK, *supra* note 359, at 6.

439. *See* KEEST, *supra* note 19, at 39.

440. Adam Smith explained:

> When the law prohibits interest altogether, it does not prevent it. Many people must borrow, and nobody will lend without such a consideration for the use of their money as is suitable, not only to what can be made by the use of it, but to the difficulty and danger of evading the law.

allowing higher rates for small loans, reformers hoped to make consumer lending profitable to banks and other commercial creditors.[441] Honest, respectable private lenders would flow into the market for costly consumer loans, creating healthy competition and driving the dishonest loan sharks out of business.[442] Thus was born the first of what are now commonly called "special usury statutes." Special usury laws provided certain specified lenders licenses to lend at rates in excess of a state's general interest rate cap.[443] At the time, these first special usury laws were commonly called small loan laws. The new statutes allowed lenders—who would agree to licensing, bookkeeping, security interest, and collection practice rules—to lend less than $300 at between thirty-six and forty-two percent per year.[444]

The primary advocates of the small loan special usury laws were scholars and business persons associated with the Russell Sage Foundation, a charity fund established by the wife of a railroad tycoon.[445] The foundation sponsored several groundbreaking studies and organized lobbying efforts to raise interest rates for small personal loans.[446] Most importantly, the foundation drafted uniform small loan laws, which many states relied on in passing their own legislation.[447] Many small loan lenders saw themselves as performing an important social service in lending at reasonable terms to disadvantaged people in need.[448]

The passage of the small loan laws was a watershed event in both the law and culture of American high-cost credit. The small loan laws opened the door for states to amend the hitherto untouched general usury laws that descended from the Statute of Anne. A wide variety of different creditor organizations began lobbying for their own exceptions to state general usury laws. One state legislature and one interest group at a time, a simple and common body of law transformed into an obscure and arcane patchwork of legal exceptions, restrictions, fees, limitations, and

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ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 97-98 (Richard F. Teichgraeber, III ed., Random House 1985). Hervé Moulin has recalled the same point more recently. *See* HERVÉ MOULIN, COOPERATIVE MICROECONOMICS: A GAME-THEORETIC INTRODUCTION 7 (1995) ("[T]here is the concern that a well-intentioned politician who invokes ethical principles to interfere with the market process . . . is likely to be countereffective . . . illegal usury is more expensive because the borrower must pay a premium to insure the lender against the risk of being caught . . . .").

441. KEEST, *supra* note 19, at 39.

442. *See id.* at 48.

443. *See id.*

444. GALLERT ET AL., *supra* note 350, at 89; KEEST, *supra* note 19, at 48.

445. CALDER, *supra* note 16, at 124-25; KEEST, *supra* note 19, at 48.

446. CALDER, *supra* note 16, at 125-27.

447. KEEST, *supra* note 19, at 48.

448. CALDER, *supra* note 16, at 150.

definitions. State legislatures passed a hodgepodge of industrial loan laws, installment loan laws, retail installment sales acts, insurance premium finance regulations, and home equity loan laws.[449] Each state cultivated its own unique regulatory environment.

Culturally, the act of governmental approval of licensed high-cost lenders dramatically changed the social symbols and discourse Americans had used to refer to high-cost lenders for over two centuries. After passage of the small loan laws, high-cost creditors began a steady march toward legitimization. Small loan legislation, along with the Bankruptcy Act of 1898, began a process of erasing the government-sponsored line of stigma which had separated commercial and consumer lending in Western culture for centuries. These were the first steps in what has since been described as a "credit revolution."[450]

2. The Credit Revolution: Financing the Middle Class

From the 1920s through the Great Depression, the business of lending under the small loan laws boomed.[451] The ranks of lenders seeking to earn a profit lending at rates below the special usury interest rate caps of between thirty-six and forty-two percent swelled.[452] These lenders aggressively worked to distance themselves from the salary lending "loan sharks" which dominated turn-of-the century consumer financing.[453] Many small loan lenders called themselves "personal finance" companies, hoping to call up images of respected commercial banks rather than neighborhood pawnshops.[454] Reflecting the optimistic expansion of the industry, one personal finance executive went so far as to say, "I think I can confidently predict that within a very brief period of time we will no longer be thought of as 'moneylenders' but as financial physicians to the American family."[455] Nevertheless, an increasingly overshadowed class of illegal or marginally-legal lenders persisted, borrowing and collecting from the most desperate debtors. While the numbers of debtors increased in the Great Depression (probably due to cautious lending based on fear of default), indebtedness was less severe than one might expect.

Of more lasting influence was the new era of accepted middle class durable consumer good financing. Many commentators have pointed to this era as a turning point when the culture of thrift and rugged

449. *Id.* at 49.

450. *Id.* at 156.

451. CALDER, *supra* note 16, at 147; CLARK, *supra* note 359, at 45, 191-92.

452. CALDER, *supra* note 16, at 147; KEEST, *supra* note 19, at 48.

453. CALDER, *supra* note 16, at 147.

454. *Id.*

455. *Id.* at 153 (quoting Burr Blackburn, *Financial Consultation Services*, 16 PERS. FIN. NEWS 22 (1932)).

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individualism of early America gave way to one of consumerism and personal debt.[456] Beginning roughly in the 1920s, businesses began to realize the advantages of not merely advertising products, but promoting new ideas and ways of life.[457] "Through newspapers, magazines, billboards, radios, and motion pictures, advertising invaded the countryside as well as the city—pushing new ideas, habits and tastes."[458] Led by automobile dealers looking to expand their market, installment lenders charged rates in excess of the old general usury laws, but still far below what turn-of-the-century salary lenders expected. This new class of creditor used installment loans to finance home furnishings, sewing machines, pianos, washing machines, vacuum cleaners, phonographs, and jewelry.[459] Unlike the shady, back door, fly-by-night loan sharks, these lenders included many of the nation's most respected businesses. Although the older, more dangerous high-cost lenders were still around, they were more than happy to let the new, brash, and well-capitalized middle class corporate financiers take the spotlight. High-cost lenders had always preferred relative anonymity. It was in this era that names like General Motors, Sears, Singer, Montgomery Ward, and Steinway & Sons changed forever the way middle class America viewed debt.[460]

C. *High-Cost Consumer Credit Policy after World War II*

By the time America hit the economic boom following the Second World War, consumer credit had already become a culturally and morally accepted part of life. However, the depth of the "credit revolution" had only just begun. A leading cultural historian on the subject of consumer credit summarized the entire postwar period with one word: "more."[461] More installment lending, more lending from cooperative lenders such as credit unions and mutual saving banks, more lending from retailers, and even more lending from the biggest and last player to embrace consumer credit—large banks.[462] A movement to the suburbs created demand for

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456. *See* LOREN BARITZ, THE GOOD LIFE: THE MEANING OF SUCCESS FOR THE AMERICAN MIDDLE CLASS 64 (1989); DANIEL BELL, THE CULTURAL CONTRADICTIONS OF CAPITALISM 21, 69-70 (1976); THOMAS C. COCHRAN, CHALLENGES TO AMERICAN VALUES: SOCIETY, BUSINESS, AND RELIGION 86 (1985); JOHN KENNETH GALBRAITH, THE AFFLUENT SOCIETY 170-72 (2d ed. 1969); CHRISTOPHER LASCH, THE CULTURE OF NARCISSISM: AMERICAN LIFE IN AN AGE OF DIMINISHING EXPECTATIONS 53 (1978); WILLIAM E. LEUCHTENBURG, THE PERILS OF PROSPERITY, 1914-1932, at 197 (2d ed. 1993); TUCKER, *supra* note 286, at 114-15; Haller & Alviti, *supra* note 16, at 140-42.

457. *See* GALBRAITH, *supra* note 456, at 171; LEUCHTENBURG, *supra* note 456, at 197; TUCKER, *supra* note 286, at 115.

458. TUCKER, *supra* note 286, at 115; *see also* BARITZ, *supra* note 456, at 64.

459. BARITZ, *supra* note 456, at 80.

460. *See id.* at 64, 80; CALDER, *supra* note 16, at 164-65; GALBRAITH, *supra* note 456, at 171.

461. CALDER, *supra* note 16, at 291.

462. *See id.* at 291-92.

housing, automobiles, and household furnishings. The cultural trend away from early American thrift became even more pronounced as themes like "be the first on your block to own" were pushed by advertisers and accepted by millions.[463] Middle-class Americans took on previously unheard of levels of debt and gradually paid it back without unmanageable difficulties.[464]

The social acceptance of consumer debt in America became unbreakable with the coming of the credit card. Retailers as early as 1914 had issued charge cards specific to their stores to encourage loyalty in their most wealthy customers.[465] Gasoline suppliers and airlines made similar efforts beginning in the 1930s.[466] The first "third-party universal" card which has become the contemporary norm was issued by Diner's Club in 1949.[467] The credit issuer acted as broker between customers and firms (usually restaurants). Customers gained the convenience of not carrying cash, and the ability to borrow money over a short term. Sellers gained access to market share by catering to a card carrying clientele. In spite of early growing pains, credit cards steadily gained in popularity, growing into the currently recognizable industry by the late 1960s.[468] Eventually backed by the capital of the nation's largest banks, the credit card industry solicited business through advertisements to consumers in every media. In 1971, half of all American families used at least one credit card.[469] In subsequent years, by sending out billions upon billions of mailed solicitations, credit card companies succeeded in making third party consumer credit almost a medium of currency unto itself.[470] By 1995, credit cards had "outstripped coins and folding money as the payment of choice for consumer transactions."[471]

1. Echoes: Modern Credit Policy with Ancient Mistakes

American credit policymakers have scrambled to keep up with sweeping cultural change. Late twentieth-century consumer credit policy has become an astonishingly complex patchwork of federal, state, and local

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463. BEARES, *supra* note 19, at 11.

464. CALDER, *supra* note 16, at 291, 302-03.

465. SCOTT B. MACDONALD & ALBERT L. GASTMAN, A HISTORY OF CREDIT AND POWER IN THE WESTERN WORLD 227 (2001); LEWIS MANDELL, THE CREDIT CARD INDUSTRY: A HISTORY XII-XIII, at 23 (1990).

466. MACDONALD & GASTMAN, *supra* note 465, at 227.

467. *Id.*

468. MANDELL, *supra* note 465, at xv.

469. LEWIS MANDELL, CREDIT CARD USE IN THE UNITED STATES 1 (1972).

470. MACDONALD & GASTMAN, *supra* note 465, at 227-30; MANDELL, *supra* note 465, at 1, 2, 4, 22-23.

471. TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 108 (2000).

laws. While our policy directed at controlling the excesses of the credit market has evolved to accommodate millions of new middle class borrowers, its underlying nature echoes the strategies of the past.

Debtor amnesty rules, best exemplified by debt discharge in bankruptcy, have continued to provide an important safety valve, but have been unable to prevent the latest upsurge in high-cost lending. While bankruptcy laws retained the underlying structure of the 1893 Act until 1978, the protection afforded to consumer debtors lurched back and forth often depending on little more than the mood of Congress, the influence of creditor lobbyists, and the economic circumstances of the day.[472] For instance, Depression era legislation focused on debtor rehabilitation and placed significant restraints on the ability of creditors to seize collateral.[473] The Chandler Act in 1938 presumed to make the administration of bankruptcies more fair and efficient.[474] It included a revision of Chapter 13 which dealt with wage earner reorganization plans.[475] In 1946, Congress changed the compensation of Bankruptcy referees from hourly fees to a full time salary.[476] In 1960, Congress created a committee on bankruptcy rules to explore ways to simplify the complex and inefficient system of sorting through bankrupt estates.[477] During the pro-consumer Johnson era, bankruptcy reform efforts culminated in amendments that made discharge self-executing rather than an affirmative defense.[478] In 1973, bankruptcy referees were renamed bankruptcy judges.[479] After a decade of study, Congress adopted a new bankruptcy code in 1973 which substantially expanded the jurisdiction of bankruptcy judges.[480] A 1978 Act created a pilot program, later adopted throughout the country, dividing labor between bankruptcy judges and newly created bankruptcy trustees.[481] Trustees handled the administrative work, allowing judges to focus on adjudication.[482] Soon after the new code was in operation, Congress, at the instigation of creditors, passed a series of laws making many different types of debt unsusceptible to discharge. In 1984, the United States Supreme Court forced Congress to clarify the constitutional status of

472. *See* Tabb, *supra* note 296, at 26-27.
473. *Id.* at 28.
474. *See id.* at 29-30.
475. *Id.*
476. *Id.* at 31.
477. *See* King, *supra* note 407, at 218-19; Tabb, *supra* note 296, at 31.
478. Tabb, *supra* note 296, at 32.
479. *Id.* at 31-32.
480. *Id.* at 34.
481. *Id.* at 35.
482. King, *supra* note 407, at 236; Tabb, *supra* note 296, at 35.

bankruptcy judges, which created an opportunity for the credit industry to once again significantly narrow available consumer credit protections.[483]

All these changes occurred against the backdrop of growing personal bankruptcy filings. Diagnosing the cause of increased filings has been a subject of much dispute. The credit industry and its patrons have consistently complained of the decreasing stigma associated with personal bankruptcy.[484] For nearly a hundred years, they have attributed growth in bankruptcy rates to this "loss of shame."[485] Others argue bankruptcy filings have simply tracked the rapid increases in consumer borrowing.[486] By all accounts, mainstream credit card debt has become the type of credit most likely to send consumers into bankruptcy.[487] Yet, in the last two decades the growth of high-cost second-tier fringe debt has played a more important role, concurrent with a sharp decline in the median income of bankrupt families. Because bankruptcy only provides an after-the-fact safety valve, it has not, and cannot, prevent problematic high-cost debt situations before they arise. Obviously, an amnesty law so widespread as to cure the debt ills of all troubled debtors would ruin the credit industry to everyone's detriment. The discharge provisions of our costly and complex bankruptcy system have doubtlessly improved on the capriciousness of Mesopotamian royal decrees of amnesty. But like their ancient Mespotamian forbears, bankruptcy discharge only provides a lucky and sometimes undeserving few relief at the expense of their creditors—and by driving up interest rates at the expense of fellow debtors. In at least one respect, Mesopotamian amnesty decrees may have been better than our current system. The Sumerians and Babylonians did not sponsor bankruptcy professionals and services with costly taxpayer investments.

In the Post-War Era, Americans also experimented with laws and programs that explicitly selected white Europeans for protection unavailable to other ethnic groups. An important example of such a selective protection strategy had its roots in Roosevelt's New Deal. In 1933, Congress created the Home Owners Loan Corporation (HOLC), a federal agency which sought to stimulate economic growth through home building and to provide financial assistance for those who might not otherwise be able to purchase a home.[488] The agency innovated long-term,

483. N. Pipeline Constr. Co. v. Marathon Pipe Line, 458 U.S. 50 (1982); Tabb, *supra* note 296, at 38-39.

484. *See* Moss & Johnson, *supra* note 406, at 311.

485. *See id.* at 311-14.

486. *See id.* at 312.

487. SULLIVAN ET AL., *supra* note 471, at 140.

488. KENNETH T. JACKSON, CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES 195 (1985).

self-amortizing mortgage loans with uniform payments over the duration of the loan.[489] However, the agency also took the lead in developing racially discriminatory appraisal practices.[490] For the agency, "[r]acial homogeneity was explicitly identified as a criterion for evaluating properties; but it was clear that not all homogeneous neighborhoods were equally valued."[491] For example, the agency appraised a St. Louis County neighborhood as having "little or no value today, having suffered a tremendous decline in values due to the colored element now controlling the district."[492] Perhaps more importantly, in 1934 Congress and FDR created the Federal Housing Administration, which facilitated inexpensive home purchase financing by offering federal insurance for mortgage loans.[493] By insuring lenders against the risk of default, creditors could offer a greater number of lower-priced home loans.[494] Unfortunately, this valuable federal program was reserved almost exclusively for the use of white Americans with European ancestry.[495] The FHA's underwriting manual stated:

> Areas surrounding a location are to be investigated to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the location being invaded by such groups. If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values.[496]

These policies created a legacy of discriminatory home financing which extended well past the Second World War and, many argue, continues today. For example, although from 1934 to 1959 the FHA financed sixty percent of home purchases in the United States, from the mid-40s through the mid-50s, less than two percent of the FHA's loans went to African-Americans.[497] For middle-class Americans in the twentieth century, family

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489. *Id.* at 196.

490. *See* Gregory D. Squires, *Community Reinvestment: An Emerging Social Movement, in* FROM REDLINING TO REINVESTMENT: COMMUNITY RESPONSES TO URBAN DISINVESTMENT 1, 4 (Gregory D. Squires ed., 1992).

491. *Id.*

492. JACKSON, *supra* note 488, at 200; Squires, *supra* note 490, at 4.

493. JACKSON, *supra* note 488, at 203; R. ALLEN HAYS, THE FEDERAL GOVERNMENT AND URBAN HOUSING 85 (2d ed. 1995).

494. Squires, *supra* note 490, at 5.

495. *See id.*

496. *Id.* (quoting U.S. FEDERAL HOUSING ADMINISTRATION, UNDERWRITING MANUAL ¶ 937 (1938)).

497. *Id.* at 6.

homes have been the most important source of security for purchasing inexpensive credit.[498] The difficulty black families had in finding cheap financing for home purchases was an important factor preventing their migration to the suburbs along with white Americans.[499] Relegated to the decaying inner cities, a disproportionate number of black families rented their homes instead of buying them.[500] Because home equity is the most important security by which middle and lower income families can obtain long term inexpensive credit, discriminatory mortgage insurance policies in the mid-twentieth century may well have significantly contributed to a greater African-American vulnerability to high-cost lenders in the latter twentieth century. By selectively protecting only European Americans, early federal home financing policies helped create a tradition of excluding racial minorities from access to the means to procure cheap credit.[501]

Charitable lending efforts also have continued to suffer from their historic limitations despite later twentieth century attempts to morph them. For instance, in 1977 Congress tried to reinvent charitable lending as community reinvestment. The Community Reinvestment Act (CRA) is premised upon the notion that financial institutions should have a duty to provide for the credit needs of members in their local community.[502] The law requires banks to identify their service area and indicate how they are meeting the credit needs of low and moderate income groups within their area.[503] If a lender does not adequately extend credit to its low and moderate income customers, then federal regulatory agencies are authorized to deny applications of the lender for deposit insurance, charters, establishment of branch offices, or other similar transactions.[504]

Although the law has helped some low-income communities, especially where activist and community watchdog groups have vocally sought enforcement of the law, the CRA's impact has generally been limited. Unfortunately, "federal regulatory agencies have rarely initiated any action on the basis of a CRA evaluation."[505] While some fair lending advocates insist the approach holds promise, community reinvestment suffers from the same problems as earlier charitable lending efforts. The motivation for creditors to lend to low-income neighborhoods is based on the fear of enforcement efforts of federal regulators. The motivation of federal

498. *See generally* CONLEY, *supra* note 241, at 1-4, 32-42, 121-22, 150-52 (1999) (discussing historical importance of home ownership as a factor in the relative wealth of African-Americans).

499. Squires, *supra* note 490, at 6-7.

500. CONLEY, *supra* note 241, at 37-42.

501. *Id.*

502. *See generally* 12 U.S.C.A. §§ 2901-2905 (West 2002).

503. *See id.*

504. *See generally id.*

505. Squires, *supra* note 490, at 11.

regulators is based on the charitable ambitions of Congress. Despite Congressional goodwill, lenders have little incentive to lend and regulators have little incentive to find violations.[506] In 1989, one befuddled Senator questioned the lack of regulatory enforcement:

> I think it to be somewhat incredible that the substance of the testimony is mostly that you haven't found any violations when the evidence is pretty clear out there that a lot of violations have to be taking place . . . . [W]e have incredible testimony . . . . I'm not trying to pick on anybody, but I want to suggest that I find it pretty close to remarkable that we never find any violations.[507]

Another Congressman went even further saying "[t]he Community Reinvestment Act . . . has become monument to regulatory inaction."[508]

The incentive structure behind community reinvestment does not harness the profit motives of lenders. The result is chronic under-capitalization. Morever, where community reinvestment lending does occur, it tends to devolve into simple profit-seeking behavior. For instance, in recent years consumer watchdog groups have complained that banks have turned to purchasing predatory mortgage loans from shady brokers in order to satisfy their reinvestment requirements. Recalling the supply problems of the *mons pietatis* as well as late nineteenth-century American cooperative lending societies, the recent comments of a community reinvestment advocate would have been as applicable centuries ago as they are today: "[t]he present state of access to capital in low-income communities is improving but nevertheless very inadequate. Although there have been major improvements with new institutions and instruments, there are still huge gaps."[509] Community reinvestment has not provided enough low-cost funds to displace aggressive profit seeking high-cost lenders in significant numbers. Although today the federal government has filled in where the captains of industry left off, whether community

506. Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement Is Needed*, 20 FORDHAM URB. L.J. 293, 296 (1993); Stephen A. Fuchs, *Discriminatory Lending Practices: Recent Developments, Causes and Solutions*, 10 ANN. REV. BANKING L. 461, 479-80 (1991); Richard D. Marisco, *Fighting Poverty Through Community Empowerment and Economic Development: The Role of the Community Reinvestment and Home Mortgage Disclosure Acts*, 12 N.Y.L. SCH. J. HUM. RTS. 281, 282 (1995).

507. *Discrimination in Home Mortgage Lending Hearing Before the Subcomm. on Consumer and Regulatory Affairs of the Committee on Banking, Hous., and Urban Affairs, U.S. Senate*, 101st Cong. 118 (1989) (statement of Senator Alan J. Dixon).

508. *Discriminatory Mortgage Lending Patterns, Field Hearing Before the House Committee on Banking, Finance, and Urban Affairs*, 101st Cong. 2 (1989) (statement of Chairman Gonzales).

509. Daniel M. Leibsohn, *Financial Services Innovation in Community Development*, 8 J. AFFORDABLE HOUSING & COM. DEV. L. 122, 128 (Winter, 1999).

reinvestment will succeed in the future depends on the ability of regulators and advocates to overcome competitive market forces in a way charitable lenders of previous centuries could not.

In the Post-War Era, credit unions became the prototypical American cooperative lending institutions. Drawing on war and depression-hardened leaders, as well as responsible yet credit hungry consumers, in the two decades after 1945 the number of credit unions grew 155.2% and the number of credit union members grew 489.4%.[510] Government and employer sponsorship facilitated the gains.[511] Credit unions retained the significant advantage of freedom from taxation.[512] The groups that provided the common bond for credit union membership also tended to provide free or subsidized management assistance, overhead, and a ready pool of potential members.[513] In 1970, Congress created the Federal Credit Union Administration and insured credit union deposits with federal funds, further stabilizing the industry.[514] In terms of credit sales, credit unions have used their production cost advantages to generally offer below market interest rates for similar credit products. During the Post-War Era, the staple loan for most credit unions became automobile financing.[515] In the late 1970s and early 1980s, almost half of all credit union loans financed car purchases, and these loans in turn constituted a little less than twenty percent of all car loans nationwide.[516] For millions of Americans, there can be no doubt credit union membership has provided an invaluable and socially constructive source of financial services and inexpensive credit.[517]

However, as in past ages, credit unions and other cooperative lenders have not significantly altered the financial destinies of the most vulnerable debtors. Despite the originating spirit of cooperative idealism, two noted credit union scholars conceded

> credit union leaders had to confront the fact that the nature of the movement had changed greatly and that they were serving members with different patterns of employment and needs. Adequate savings could not be derived from the lower income groups and the very poor were not good credit risks. The ultimate effect was that the credit union movement developed more of a middle income orientation than one devoted to lower-income groups. Thus, . . . the main thrust of

510. PUGH & INGRAM, *supra* note 258, at 13.
511. *See id.* at 12-13.
512. *See id.* at 12.
513. *Id.* at 33-34.
514. *Id.* at 6.
515. *Id.* at 25.
516. *Id.*
517. DUBLIN, *supra* note 243, at 166; PUGH & INGRAM, *supra* note 258, at 12-13, 25, 34-35.

> management became one of establishing sound management practices designed to stabilize the individual units while permitting steady growth.[518]

Although the common bond requirements for credit union membership loosened around the country, management practices and economies of scale pushed the credit union industry toward a smaller number of larger credit unions.[519] Beginning in the 1970s, large credit unions focusing on economies of scale came to overshadow smaller unions that focused on responding to the needs of a core common bond group. Many credit unions merged.[520] In 1965, credit unions with over five billion in assets held only 27.5% of total industry assets.[521] By 1980, credit unions with over five billion in assets accounted for 77.2% of all industry assets.[522] When the boom in second-tier lending hit during the early 1980s, credit unions were focused on providing costly services such as automatic teller machines, credit cards, trust services, and automated telephone services to middle and upper income members, rather than moderately priced credit to high-risk borrowers.[523]

2. Deregulation and the Illusion of Current Interest Rate Caps

In the 1970s, government expenditures on the Vietnam War overheated the economy, leading to inflationary pressures which made it harder for banks to gather funds to lend.[524] By the late 1970s, growing unemployment exacerbated the impact of still rampant inflation.[525] Federal monetary policy sought to slow the rapidly diminishing value of currency by allowing high interest rates.[526] As a result, short-term commercial market interest rates rose to above twenty percent.[527] Although constant creditor lobbying had reduced many state interest rate caps to a confusing patchwork, most states still had some upper interest rate limit.[528] But as rising market equilibrium rates forced depository institutions' cost of funds higher, it became difficult for banks and others to profitably lend within

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518. PUGH & INGRAM, *supra* note 258, at 6.

519. *Id.* at 6-7, 19-20.

520. *Id.*

521. *Id.* at 19.

522. *Id.*

523. FERGUSON & MCKILLOP, *supra* note 258, at 23-24; MACDONALD & GASTMANN, *supra* note 470, at 231-32; PUGH & INGRAM, *supra* note 259, at 10, 19, 26, 34-35; Melissa Allison, *Area Credit Unions Not Serving All, Study Says*, CHI. TRIB., Feb. 15, 2001, at Business 1.

524. BEARES, *supra* note 19, at 12.

525. *Id.*

526. *Id.*

527. KEEST, *supra* note 19, at 54.

528. *Id.* at 55.

these legal usury limits.[529] "There was a fear that creditors would be understandably reluctant to lend money at rates below their cost of funds and that mortgage loans and other kinds of consumer credit would dry up."[530] State legislatures responded with a variety of actions, almost all of which significantly decreased regulation of chargeable rates.

> Many states repealed general usury ceilings completely, allowing parties who were not regulated by special usury statutes to contract for the payment of any agreed rate. Other states modified their general usury laws so that the ceilings would fluctuate with some published market interest rate. For example, several states set their ceilings to five or six percentage points above the federal discount rate. Most states simply raised their interest ceilings to a point not binding on traditional lenders.[531]

Congress also joined in. Among other interest rate deregulatory actions, Congress banned any state interest rate caps on home or mobile home first mortgages.[532]

These temporary economic pressures have proven less enduring than the United States Supreme Court's effort at deregulation in the landmark decision of *Marquette National Bank v. First of Omaha Service Corp.*[533] Interpreting Section 85 of the National Bank Act of 1863, the Court held that in the Civil War Era, Congress had intended to preempt state interest rates to the extent they conflicted with the rates charged by out of state lenders.[534] The *Marquette* Court held that the interest rate caps of a card issuer's home state trumped the interest rate caps of the card holder's home state.[535] This set off two races: first for credit card lenders to move their operations to states with no interest rate caps, and second for state legislatures to remove their usury laws in order to attract or hold onto rapidly expanding credit card companies.[536] By the early 1980s, states around the union including Delaware, South Carolina, South Dakota, and

529. BEARES, *supra* note 19, at 12; Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 201 (1986).

530. KEEST, *supra* note 19, at 54.

531. *Id.* at 55.

532. For example, previous banking regulations allowed only national banks to operate under a variable interest ceiling. Congress extended this privilege to all federally insured depository lenders. *See* Depository Institutions Deregulation and Monetary Control Act of 1980 (hereinafter DIDA), Pub. L. No. 96-221, 94 Stat. 132 (1980).

533. 439 U.S. 299 (1978).

534. *Id.* at 312-13.

535. *Id.*

536. *See* KEEST, *supra* note 19, at 74 n.121.

Utah had abolished all interest rate controls.[537] Even though bastions of interest rate regulation like Minnesota soon followed along by raising interest rate caps, the damage was already done. In theory, if every state legislature in the union but one passed low interest rate caps, then lenders could simply set up operations (either in fact or on paper) within that one state. Lenders could export that state's unregulated interest rates to every other state, regardless of objections of the other forty-nine democratically elected state legislatures. In practice, nine Supreme Court justices eliminated two hundred years of democratic state interest rate regulation of bank loans.[538]

Although the *Marquette* case involved credit cards, the doctrine subsequently spread to other types of lending. In the 1990s, the best example was payday lending. Because payday lenders typically charge between 391 and 600 percent, their services do not fit within any of the state usury laws which survived through the 1980s. Many of the states which retained interest rate caps, however, such as Georgia, Pennsylvania, and Virginia, have markets of impoverished potential debtors too tempting for payday lenders to resist. In order to circumvent these caps, payday lenders now broker payday loans on behalf of federally insured banks.[539] By exploiting the Supreme Court's constitutionalization of perceived Civil War Era Congressional intentions, payday lenders have managed to capture the legal authority of the United States Constitution to justify loans with interest rates more than twice as high as those typically offered by mafia loan sharks.[540] One scholar explained that these developments have

537. *Id.*; Peterson, *supra* note 17, at 553.

538. William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 UTAH L. REV. 1009, 1010-11, 1028; Richard P. Eckman, *The Delaware Consumer Credit Bank Act and 'Exporting' Interest Under Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980*, 39 BUS. LAW. 1264, 1264-70 (1984); Donald C. Langevoot, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 686 (1987); Moss & Johnson, *supra* note 406, at 333; White, *supra* note 17, at 447-48.

539. JEAN ANN FOX & EDMUND MIERZWINSKI, RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 10-12 (Nov. 2001), *available at* http://www.pirg.org/reports/consumer/payday/2001/paydayreportnov13.pdf (last visited Feb. 13, 2003).

540. Al Guart, *"Loanshark" Banks Bite Apple*, N.Y. POST, Apr. 7, 2002, at 23 ("The lenders aren't leg-breaking mobsters. They're out-of-state banks that skirt New York's usury laws to make a killing through what is known as 'payday' loans."). In April of 2002, Virginia finally relented to licensing payday lenders as they were already present. Carol Hazard, *Payday Lending gets Warner OK*, RICHMOND TIMES-DISPATCH, Apr. 10, 2002, at B1 ("Until now, [payday] lenders have teamed with obscure national banks to skirt state laws that prohibit triple-digit interest rates."). Eagle National Bank, Country Bank, Brickyard Bank, and Crusader Savings Bank are all examples of federally insured banks which engage in a high volume of payday lending. *NCRC Calls for Immediate CRA Exams for Abusive Payday Lenders*, U.S. NEWSWIRE, Apr. 11, 2002, *available at*

> been hidden from the public and state legislators by the camouflage of usury laws on the books of almost all states that appear to cover loans to that state's debtors. Day by day these local laws have become a more exaggerated illusion; under the *Marquette* doctrine, the sternest state laws are the first to be undermined and the quickest to fall.[541]

For thousands of years social and government leaders have socialized their people with strong messages condemning high-cost personal debt.[542] American government, by gradually removing or at least muddling the old general usury interest rate caps, has abdicated this leadership role. This resignation combined with the sweeping cultural changes wrought by an explosion in mainstream moderately priced consumer credit has eroded a once unified moral stance towards high-cost debt. Today's high-cost debtors are in at least one sense worse off than those of a century ago. Back then, almost all debtors would have had a lifetime of socialization regarding the "evil" of personal debt. Today's high-cost debtors, however, sign credit contracts with the same prices as a century ago, but do so with none of the same moral condemnation to warn them of the risks. In a very real sense, America's culture has become one of reckless borrowing. For many who can afford such carelessness, the consequences are not severe and are perhaps in some ways even beneficial: monthly payments, overtime, mild anxiety about bills, and perhaps less time with the kids, all offset by the fiscal disciplining of credit contracts and the genuine value of consumer products. But for those who cannot afford imprudent credit decisions, the consequences have become as grave as they were more than a century ago when the first "loan sharks" appeared.

IV. THE MODERN INNOVATION AND UNFULFILLED PROMISE OF DISCLOSURE REGULATION

Throughout history there has been no common terminology used in credit contracts. After the explosion of mainstream moderately priced consumer credit use following World War II, the different meanings that

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http://www.usnewswire.com/topnews/first/0411-132.html (last visited Apr. 12, 2002). Although the *Marquette* decision cast itself as merely a case of statutory interpretation, footnote 31 establishes that state interest rate caps are not applicable to federally chartered banks by virtue of the Supremacy Clause of the U.S. Constitution. *Marquette*, 439 U.S. at 318-19 n.31 ("To the extent the enumerated federal rates of interest are greater than permissible state rates, state usury laws must, of course, give way to the federal statute."). *See generally* Comment, *Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 COLUM. L. REV. 167 (1966) (reporting extortionate criminal loanshark interest rates averaging 250% annually).

541. White, *supra* note 17, at 447-48.

542. *See generally* TUCKER, *supra* note 286, at 1-15.

lenders ascribed to terms became more noticeable than at any other time in human history. Even the most basic contractual terms such as interest rates had no commonly shared definition. The result was that consumers neither shopped for cheap credit nor even understood how much they were actually paying for the credit to which they agreed. A 1964 study asked families to estimate the average interest rate on their consumer debt.[543] The average response was 8%—a third of the true cost of 24%.[544] The complexity of quoted credit prices was causing the manifold confusion. For example, there are a wide variety of methods for computing interest, which can produce a wide variety of actual costs. Lenders might calculate rates through the discount method, the discount-plus-fee method, the add-on method, the actuarial method, or perhaps others.[545] Some lenders would quote yearly interest rates, while others might quote monthly or even weekly rates.[546] Moreover, on many monthly loans "the interest was computed not on the declining balance actually owed by the borrower, but instead on the original amount borrowed."[547] Thus, these creditors charged interest on money that debtors had already repaid, which "meant that the real rate of interest was approximately double the one quoted."[548] Compounding the problem, state governments also used a large and incompatible variety of terms and classifications in statutes regulating consumer credit.[549] Although this may have been less of a problem for sophisticated commercial debtors, the new breed of consumer debtors lacked the expertise and patience necessary for distilling the true meaning of credit contracts.[550] The result was that consumer debtors rarely understood the true price of credit contracts to which they agreed.[551]

A. *The Rise of Truth in Lending*

Truth in lending sought to remedy this confusion.[552] The basic idea was that government should require creditors to calculate and quote interest rates and other important contractual terms in a clear and uniform

543. H.R. Rep. No. 90-1040, *reprinted in* 1968 U.S.C.C.A.N. 1962, 1970.

544. *Id.*

545. *See* PAUL H. DOUGLAS, IN OUR TIME 105-06 (1968).

546. *See id.* at 95.

547. *Id.*

548. *Id.*

549. KEEST, *supra* note 19, at 48.

550. *See* Barry A. Abbott & John W. Campbell, *The Truth in Lending Act After 15 Years: Its Goals and Its Limitations*, 9 OKLA. CITY U.L. REV. 1, 2 n.4 (1984) (providing illustrative example).

551. *See* Ford Motor Credit v. Millhollin, 444 U.S. 555, 559 (1980); Mourning v. Family Publ'ns Serv., Inc., 411 U.S. 356, 363-69 (1973); JOHN R. FONSECA, 1 HANDLING CONSUMER CREDIT CASES 301 (3d ed. 1986); KEEST & KLEIN, *supra* note 25, § 1.1; Abbott & Campbell, *supra* note 550, at 1-2; Rubin, *supra* note 27, at 233-34.

552. *Mourning*, 411 U.S. at 364.

manner.[553] Former Senator Paul H. Douglas of Illinois is commonly credited with innovating some of the first modern credit price disclosure proposals.[554] Years later Senator Douglas recounted a story of the first time he suggested such a requirement. Working for FDR's National Recovery Administration for the consumer finance industry, Douglas served on a committee responsible for drafting proposed credit code revisions.[555]

> At the first meeting of the code authority in 1934, I brought up these facts and suggested that the members of the industry should quote their rates on an annual rather than a monthly basis and charge interest only on the unpaid balance. Never did the temperature of a meeting drop so sharply and so far. A chilling silence set in and the authority shortly adjourned. A few days later, I received a letter suggesting that I might want to resign.[556]

Douglas did not dare to revisit the proposal for twenty-five years and until he had a decade of experience in the United States Senate.[557]

When Senator Douglas did finally introduce the first federal credit price disclosure bill in 1960, the idea was not received any better than in 1934. An awesome array of opponents including the nation's automobile dealers, finance companies, mail order houses, the National Association of Manufacturers, the U.S. Chamber of Commerce, the American Bankers Association, the American Bar Association, virtually all Congressional Republicans, and most of the Southern Democrats denounced the bill.[558] One commentator colorfully summarizes what followed:

> Congress spent the eight years from 1960 to 1968 debating the Truth-in-Lending Act. According to the military metaphor that is almost obligatory in these cases, the process must be counted as an epic battle. Forces were rallied, maneuvers undertaken, salvoes exchanged, and casualties incurred. While the reality was political rather than military, it was no less intensely fought and, at some points, no less gruesome.[559]

The magnitude of Congress' debate is somewhat tarnished when one realizes the bill was not reported out of the Senate Banking Committee for

553. *Id.*
554. KEEST & KLEIN, *supra* note 25, at 31.
555. DOUGLAS, *supra* note 545, at 95-96.
556. *Id.* at 96.
557. *Id.*
558. *Id.* at 97.
559. Rubin, *supra* note 27, at 242.

debate by the whole Senate until 1967.[560] In reality, much of the struggle was between only a few influential members of a Senate Subcommittee.[561] As for casualties, it is worth noting that Senator Douglas' defeat in the 1966 election bears a striking resemblance to the political demise of Governor Hai Jui in the late Chinese Ming Dynasty. Both eroded their political capital through alienating powerful commercial interests in fighting for widespread credit reform of regulatory systems based on inadequate interest rate caps. Both also fell from power despite their informed and passionate commitment to populist government policy.

While early bills all faltered, they did provide Senator Douglas and later Wisconsin Senator William Proxmire the excuse to hold extensive hearings exploring the issue and hammering out the details.[562] Particularly influential were a series of four 1963 hearings held outside of Washington D.C. in New York City, Pittsburgh, Louisville, and Boston.[563] Supporters of the legislation hoped that these hearings would raise public awareness and put pressure on Banking Committee members to allow the bill onto the Senate floor.[564]

In particular, the Boston hearings may have helped spawn one of the first statutes which can fairly be characterized as modern credit disclosure law.[565] In 1966, both the Canadian province of Nova Scotia and the State of Massachusetts adopted local versions of the Truth in Lending Act.[566] Portentously, the Massachusetts legislation included almost the same disclosure requirements as the federal bill.[567] This state statute came to create a feedback effect in the effort to pass uniform federal disclosure rules.

560. *See id.* at 255.

561. *See id.* at 245.

562. *See id.* at 245-50.

563. *See id.* at 250-51.

564. *Id.*

565. DOUGLAS, *supra* note 545, at 99. Senator Douglas commonly called credit disclosure an old idea, citing the requirement that loan contracts be written down in Hammurabi's ancient Babylonian code. *See id.*; *see also* HOMER & SYLLA, *supra* note 1, at 26-27. However, this may be rhetorical flourish since the Babylonian rule was probably directed not at debtor understanding so much as preventing false contracts and violations of other code provisions. The Babylonian rule is probably better characterized as an early version of the much more common statute of frauds.

566. DOUGLAS, *supra* note 545, at 99.

567. Rubin, *supra* note 27, at 252. One important difference between the Massachusetts rules and the federal bill was that Massachusetts did not include a private right of action for debtors to sue violating creditors. Instead, the state rule provided that "failure to comply barred recovery of finance charges and subjected the lender to a fine of up to $500 or imprisonment of up to six months, or both." *Id.* at 252 n.116 (citing 1966 Mass. Acts ch. 284 §§ 29-30; 1966 Mass. Acts ch. 587, §§ 10-11).

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> How effectively [the Massachusetts law] was working was an open question, but clearly it had not produced the commercial Armageddon which the opponents of Truth-in-Lending had predicted. Small businesses had not closed overnight, nor had the state economy collapsed, no sales clerks had suffered nervous breakdowns at the credit counter, and no bank officials had hanged themselves from their flourescent lights. With life in Massachusetts going on pretty much as it had before, the opposition found itself somewhat embarrassed by the vigor of its prior rhetoric.[568]

This state law, combined with 1968 election results favoring supporters of the disclosure bill, led the Senate Banking Committee to allow the bill out onto the Senate floor where it quickly passed.[569]

In the House, Representative Leonore Sullivan led a much faster and more dramatic charge than the plodding Senate culminating in the ultimate passage of a much more robust statute.[570] The composition of the House of Representatives was decidedly more liberal than the Senate. This enabled Sullivan to introduce a much more liberal bill which included many substantive provisions in addition to the disclosure bill passed by the Senate.[571] She and her Democratic colleagues on the House Banking Committee's Subcommittee on Consumer Affairs inserted provisions requiring more comprehensive disclosure including those regarding first and second mortgages and credit advertising.[572] Additional substantive proposals included a national interest rate cap of eighteen percent prohibition of all wage garnishments and confessions of judgment in consumer credit cases, the establishment of a national commission on consumer finance, and creation of new, presidential power to control consumer credit rules during economic crises.[573]

House Republicans reacted by supporting the comparatively conservative Senate bill.[574] Many of the substantive provisions, including the national usury limit, were bargaining chips which House Democrats intended to trade away in order to strengthen the Senate bill.[575] On the House floor, Republicans, looking to salvage a "tough on crime" theme out

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568. *Id.* at 252-53 (footnotes omitted).

569. *Id.* at 251-52.

570. *See id.* at 255-63. Kathleen Keest and Gary Klein have adroitly pointed out that if Paul Douglas is the father of Truth in Lending, Representative Sullivan, the chief House sponsor, must fairly be counted as its mother. KEEST & KLEIN, *supra* note 25, at 31 n.4.

571. Rubin, *supra* note 27, at 255-57.

572. *Id.* at 256.

573. *Id.*

574. *See id.* at 257.

575. *Id.* at 256.

of the impending consumer legislation, added provisions making extortionate credit collection a federal crime.[576] When the legislation surfaced from a joint House and Senate Conference Committee it "retained the structure and discourse of the parent Senate bill," but included many of the added House provisions on first and second mortgages, credit life insurance, credit advertising, wage garnishment, administrative enforcement, loansharking, and the National Commission on Consumer Finance.[577] Because the final bill went far beyond disclosure, it was renamed the Consumer Credit Protection Act.[578] However, Congress retained the "Truth in Lending" label for the disclosure provisions, which still made up the most important and influential bulk of the act.[579]

The most important requirements of the Truth in Lending provisions centered around the disclosure of the cost of credit based on standard uniform requirements set out by the act and by the Federal Reserve Board.[580] The two most important disclosures were the "finance charge" and the "annual percentage rate." The finance charge is "the sum of all charges, payable directly or indirectly by the creditor as an incident to the extension of credit."[581] It includes all interest and fees that a creditor requires the debtor to pay. The annual percentage rate is an interest rate based on the actuarial method and calculated in accordance with regulations set out by the Federal Reserve Board.[582] The Act was enforced with tough civil penalties. It gave debtors the right to sue their creditors where the creditor failed to disclose prices and other contract provisions in accordance with the law.[583] To deter noncompliance, creditors found to be in violation of the Act were liable to the debtor for actual damages, statutory damages, attorney's fees, and court costs. In extreme cases a noncomplying creditor was even subject to criminal prosecution.[584]

B. *The Unique Promise of Disclosure*

Although, unsurprisingly, neither industry nor consumer advocates have ever been entirely satisfied with the Truth in Lending Act (TILA), the disclosure approach has in general garnered wide acceptance. It has only been in the past decade that consumer advocates have become

576. *Id.* at 261.

577. *Id.* at 262.

578. *Id.*

579. *Id.*

580. JOHN R. FONSECA, CONSUMER CREDIT COMPLIANCE MANUAL §1:4 (2d ed. 1984).

581. 15 U.S.C. § 1605(a) (2002); *see also* FONSECA, *supra* note 580, §1:4; DEE PRIGDEN, CONSUMER CREDIT AND THE LAW §§ 6:1, 6:2 (1990 & Supp. 2002).

582. 15 U.S.C.A. § 1606(a) (West 2002).

583. KEEST & KLEIN, *supra* note 25, at 34.

584. *Id.*

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progressively disenchanted with disclosure law. Nevertheless, TILA has remained the cornerstone of Federal consumer credit regulation, and further, most state governments have come to rely heavily on disclosure provisions in state laws. Moreover, industry, rarely welcoming government oversight, has still come to a grudging acceptance of TILA. In particular, high-cost creditors have advocated disclosure rules to deflect legislative pressure for more substantive rules.[585]

In retrospect, Congress' adoption of TILA was only possible because the price disclosure approach has distinct political and theoretical advantages over other consumer credit policy options. In theory, disclosure simultaneously provides consumer protection and promotes market outcomes consistent with the conditions classical economics prescribes for efficient market economies. This characteristic makes the disclosure approach unusually attractive in the American political climate. Economic discourse in the United States has typically been characterized by two groups of thinking: those—anchored by Adam Smith—advocating relatively less or no governmental control in the distribution of scarce resources, and those—anchored (albeit in the American case very distantly) by Karl Marx—advocating more or complete governmental control. This dichotomy of economic thinking has had profound influence on policymakers seeking to deal with problems arising in the respective rights of debtors and creditors. The disclosure strategy for controlling the harmful consequences of high-cost lending has the rare advantage of falling within an ideological overlap palatable to both of these usually divisive perspectives.

Disclosure is acceptable in the classical economic perspective because it promotes informed decisionmaking. For classical economists, the ideal method of constructing social policy was to leave nearly all policy decisions to individual economic behavior. Classical economists believed society could rely on its individual members to protect their own best interests, and in turn protect overall social well-being at the same time. Individuals neither intend nor generally recognize that their selfish actions promote societal welfare, but that nevertheless do so. When every member of society is making well-informed decisions in their own best interest, the collective result is better policy than any government planning board might make. The famous metaphor Adam Smith used to describe this predicted phenomenon was that individual self-interested decisions would act as "an invisible hand" guiding social policy to the optimal outcome. In Smith's words:

585. Keest, *supra* note 32, at 360.

> [O]f which the produce is likely to be the greatest value, every individual, it is evident, can, in his local situation, judge much better than any statesman or lawgiver can do for him. The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.[586]

Thus, in this view there is a presumption against governmental interference with each individual's own decisions about whether or not to purchase a good or service, with credit being no exception.

Nevertheless, most economists are willing to agree that governmental action is sometimes necessary to protect the market conditions which facilitate competition. Where the private decisionmaking process in some way breaks down, the government must intervene to either reestablish the private decisionmaking or correct the failure. One introductory economics textbook plainly explains.

> Adam Smith extolled the virtues of private markets, arguing that consumers and producers "promote the public interest" more effectively than any government. If this were always true, then government intervention could only harm the public interest. Smith's argument holds, however, only when certain ideal conditions prevail. When these conditions are not satisfied, market outcomes are not optimal. In such cases government may serve the public interest. Among these reasons for market failure, and therefore government regulation, are natural monopoly, externalities and *imperfect information*.[587]

Information is important because it is a necessary prerequisite to efficient market decisionmaking. Efficient market outcomes can only come about as a result of individuals selecting those product options with the lowest opportunity costs.[588] Opportunity costs are the costs of forgone alternatives to any economic decision. "[G]iven limited or scarce resources and time, the undertaking of any activity or the expenditure of any funds means that we must forgo some other activity or some other use of these

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586. SMITH, *supra* note 440, at 225-26.

587. JAMES F. RAGAN, JR. & LLOYD B. THOMAS, JR., PRINCIPLES OF MICRO ECONOMICS 371 (1993) (emphasis added).

588. KARL E. CASE & RAY C. FAIR, PRINCIPLES OF MACROECONOMICS 2-4 (4th ed. 1996).

funds."[589] The driving force behind market-based policymaking is harnessing the good sense and local perspective of each individual to make the best decisions available to that person.[590] Without accurate information about the quality and especially the price of any good, no person can minimize their opportunity costs, since they cannot compare the value of that product to their next best option. Thus, in a policymaking system of private decisionmaking, where individuals act without accurate cost information, there is no policymaking at all, rather just the random and often tragic outcomes of market anarchy.

Disclosure regulation of creditors fits within the traditional classical economic perspective because disclosure is directed at fixing a breakdown in the private decisionmaking process which guides markets to optimal outcomes. Traditional government regulation controls the private decisions of debtors. For example, where there are interest rate caps, debtors are not free to choose loans at above ceiling prices. Classical economics recommends debtors have the freedom to make whatever bargains they choose, provided they understand the consequences of their actions. Or as Jeremy Bentham explained, "no man of ripe years and sound mind, acting freely and *with his eyes open*, ought to be hindered . . . from making such bargain, in the way of obtaining money, as he thinks fit."[591] But to the extent a debtor does not have his or her "eyes open," for classical economics, all bets are off. Unlike interest rate caps and other control devices, disclosure regulation—at least in theory—*increases* the freedom of consumers through giving the opportunity to open one's own eyes. With a uniform method of learning the costs and characteristics of credit contracts, debtors can determine which credit contracts are in their best interests. With disclosure regulation, consumers have relatively greater freedom to control their financial destiny. In theory, each debtor is empowered to protect their own best interest, and in doing so will contribute to the overall welfare of society.

On the other hand, disclosure regulation is also acceptable to the control-oriented perspective in American economic discourse. This perspective is skeptical that private decisionmaking of individuals in unregulated markets can actually create the society we all hope to have.[592]

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589. ROBERT B. CARSON & WADE L. THOMAS, THE AMERICAN ECONOMY: CONTEMPORARY PROBLEMS AND ANALYSIS 508 (1991); *see also* PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 119 (15th ed. 1995) ("The opportunity cost is the value of the good or service forgone.").

590. SMITH, *supra* note 440, at 225-26.

591. *See* HOMER & SYLLA, *supra* note 1, at 81 (quoting Bentham and describing the historical context of Bentham's arguments).

592. *See, e.g.*, E.K. HUNT, PROPERTY AND PROPHETS: THE EVOLUTION OF ECONOMIC AND INSTITUTIONAL IDOLOGIES 192 (7th ed. 1995) (serving as a stark example of the social liberal approach).

Often these thinkers will point to actual stories of economic injustice, as well as empirical data demonstrating economic inequality, to show that market outcomes are not what we want. Apologists for governmental control of markets also often point to the assumptions of classical economic models, arguing that these assumptions are false, and therefore generate flawed predictions.[593] Many of our nation's most respected political leaders consistently advocate regulation at odds with the predictions of economic models. For instance, the continuing support of interest rate caps in many states, despite widespread circumvention, demonstrates that policymakers and the American public have not followed blindly the recommendations of classical economics. Although exceptions for various lenders are both common and complex, all but six states retain some interest rate cap language in their statute books.[594] For those that take this control-oriented statutory language seriously, the emphasis of government action should not be on facilitating private policymaking, but on protecting society's vulnerable members.

This emphasis on protection is why disclosure regulation also fits well within the perspective of those that advocate governmental control of markets. Disclosure regulations provide consumers with an important opportunity to protect themselves from credit bargains that are not truly in their own best interests.[595] Although thinkers with this control-oriented perspective are likely to hope for additional regulations that more completely clamp down on high-cost lending (such as interest rate caps with stiff enforcement and penalties), disclosure regulations are at least a palatably good start.

Historically, the basic strategy of modern price disclosure represents a fundamentally new approach to solving the problems associated with consumer credit. Other American efforts have been variations on older strategies invented long ago on other continents. Interest rate caps throughout most of American history were little different than those enacted in Ming China, Rome, and Babylon.[596] American charitable lending strategies, including cooperative lending societies and community reinvestment efforts, suffer from the same problems as did the first Italian *montes pietatum*.[597] American cooperative strategies including saving and loan societies and credit unions, albeit important contributions, have not been able to include those who need their services most.[598] And sadly, racially discriminatory mortgage loan policies such as those used by the

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593. *Id.*

594. FOX & MIERZWINSKI, *supra* note 539, at 25-26.

595. *See* 15 U.S.C. § 1601 (describing the purpose of the Truth in Lending Act).

596. For instance, *compare* note 74, *supra with* note 273, *supra*.

597. *Compare* note 223, *supra with* notes 434 & 509, *supra*.

598. *See supra* note 518.

Federal Housing Administration in the thirties are prime examples of selective protection of a favored majority from the risks of high-cost borrowing.[599] Truth in Lending does not properly fit into any of these classifications. Although the relative novelty of modern disclosure regulation does not by itself demonstrate greater promise than these older strategies, that so many of us can agree about the basic theoretical advantages of disclosure, may. Both classical market liberals and control-oriented supporters of regulation tend to agree on the formidable theoretical potential of price disclosure policies in regulating consumer credit.[600] This area of agreement is notable not just because it is rare, and not just because it facilitates legislative compromise, but also because the agreement itself speaks well about the value of the approach. None of history's other strategies for controlling the harmful consequences of high-cost lending captures the ideological overlap between laissez-faire capitalists and protection-oriented government regulators so well as does price disclosure.

599. Many believe similar discrimination continues to exist in mortgage lending markets. For an introduction to this extensive debate, see Harold A. Black, *Is There Discrimination in Mortgage Lending? What Does the Research Tell Us?*, 27 REV. OF BLACK POL. ECON. 23 (1999); Cathy Cloud & George Galster, *What Do We Know About Racial Discrimination in Mortgage Markets?*, 22 REV. OF BLACK POL. ECON. 101 (1993); Theodore E. Day & S. J. Liebowitz, *Mortgage Lending to Minorities: Where's the Bias?*, 36 ECON. INQUIRY 3 (1998); Stephen A. Fuchs, *Discriminatory Lending Practices: Recent Developments, Causes and Solutions*, 10 ANN. REV. BANKING L. 461 (1991); Fred Galves, *The Discriminatory Impact of Traditional Lending Criteria: An Economic and Moral Critique*, 29 SETON HALL L. REV. 1467 (1999); Glenn W. Harrison, *Mortgage Lending in Boston: A Reconsideration of the Evidence*, 36 ECON. INQUIRY 29 (1998); Helen F. Ladd, *Evidence on Discrimination in Mortgage Lending*, 12 J. ECON. PERSP. 41 (1998); Stanley D. Longhofer, *Discrimination in Mortgage Lending: What Have We Learned?*, ECON. COMMENT., Aug. 15, 1996 at 1; Robert E. Martin & R.Carter Hill, *Loan Performance and Race*, 38 ECON. INQUIRY 136 (2000); Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data*, 86 AM. ECON. REV. 25 (1996); Reynold F. Nesiba, *Racial Discrimination in Residential Lending Markets: Why Empirical Researchers Always See It and Economic Theorists Never Do*, 30 J. ECON. ISSUES 51 (1996); Ron Nixon, *Application Denied: Do Lending Institutions Overlook Hispanics?*, 11 HISP. 30 (1998); Ronald K. Schuster, *Lending Discrimination: Is the Secondary Market Helping to Make the 'American Dream' a Reality?*, 36 GONZ. L. REV. 153 (2000/2001); Peter P. Swire, *The Persistent Problem of Lending Discrimination: A Law and Economics Analysis*, 73 TEX. L. REV. 787 (1995); *see also* ROBERT SCHAFER & HELEN F. LADD, DISCRIMINATION IN MORTGAGE LENDING (1981).

600. Lenders made a similar point in explaining support for Truth in Lending as derived from "the traditional yankee faith in the shrewdness of the consumer, and his ability to police the market place and choose the best buy." Ndiva Kofele-Kale, *The Impact of Truth-in-Lending Disclosures on Consumer Market Behavior: A Critique of the Critics of Truth-in-Lending Law*, 9 OKLA. CITY U. L. REV. 117, 120 (1984) (quoting Johnathan M. Landers, *Some Reflections on Truth in Lending*, 1977 ILL. L. J. 669).

C. *The Unfulfilled Potential of Truth in Lending: Truth Is Not Enough*

Sadly, the thirty-five year history of modern credit price disclosure regulation has evinced a wide gap between Truth in Lending theory and market reality. Although the basic notion of preventing credit problems before they develop with a uniform price tag disclosure sounds simple, the practical implementation of TILA turned out to be extremely complicated.[601] The statute charged the Federal Reserve Board (FRB) with ironing out the details of the law in what was called Regulation Z.[602] In addition to Regulation Z, between 1968 and 1980 the FRB issued approximately 1500 advisory opinions interpreting what the rules meant.[603] In order to help creditor's digest this vast amount of technical information, the FRB also issued informal pamphlets.[604] In some cases, creditors relied on these pamphlets in designing their disclosure forms, only to have the courts later rule the pamphlets themselves were incorrect.[605]

Following passage, consumer advocates did not hesitate to make use of the new laws.

> Legal Services attorneys made extensive use of the TILA on behalf of low-income consumers. In addition the private bar developed a consumer segment which relied heavily on TILA. Creditors who did not comply with the Act found themselves defendants in thousands of lawsuits filed on the basis of TILA noncompliance, or found themselves losing what had previously been routine collection actions because of TIL counterclaims.[606]

Between 1969 and 1980 over 14,000 suits alleging TILA violations were filed in federal court.[607] By 1979, Truth in Lending litigation constituted

601. *See* Abbott & Campbell, *supra* note 550, at 3; Elwin Grifith, *Truth in Lending—The Right of Recission, Disclosure of the Finance Charge, and Itemization of the Amount Financed in Closedend Transactions*, 6 GEO. MASON L. REV. 191, 192-94 (1998); Kofele-Kale, *supra* note 600, at 126-29; Jonathan M. Landers & Ralph J. Rohner, *A Functional Analysis of Truth in Lending*, 26 UCLA L. REV. 711, 713-25 (1979); Rubin, *supra* note 27, at 279-80, 306.

602. 15 U.S.C. § 1604; KEEST & KLEIN, *supra* note 25, at 43.

603. KEEST & KLEIN, *supra* note 25, at 36.

604. *See generally* Ives v. W.T. Grant Co., 522 F.2d 749 (2d Cir. 1975) (holding that reliance on federal reserve board staff letters and pamphlets was not justified).

605. *Id.; see* KEEST & KLEIN, *supra* note 25, at 35-36, 368 n.85.

606. KEEST & KLEIN, *supra* note 25, at 34.

607. *See* David S. Willenzik & Mark Leymaster, *Recent Trends in Truth-in-Lending Litigation*, 35 BUS. LAW. 1197 n.4 (1980). This, however, does not include suits filed in state courts where debtors also asserted TILA defenses. *Id.* at 1197 n.5.

about two percent of the civil case load in federal courts.[608] Congress, hoping to insure enforcement of the intentions of the Act, included language urging courts to broadly interpret TILA requirements and hold creditors to the strict letter of the law.[609] This requirement forced courts to impose penalties on creditors who made only minor disclosure errors.[610] Just as advocates of TILA had seized on the horror stories of cheated debtors, opponents of the legislation found new ammunition in the woes of creditor compliance troubles.[611] Amplified by the finest lobbyists the consumer credit industry could buy, the stories of creditor compliance problems gradually forced Congress to reconsider the ardor with which they passed TILA.[612]

Independent of creditor complaints about litigation and the difficulty of compliance, the credit industry as well as many neutral academics led a rhetorical challenge to TILA asserting the information provided to debtors was not useful. A body of academic literature had developed discussing Truth in Lending even before Congress adopted the Act, but it has grown larger and decidedly more skeptical.[613] The early objection which resonated the most was the claim that TILA caused "information overload."[614] The argument rested on studies showing debtors did not understand most of the

608. *See* Federal Reserve Board, Regulatory Analysis of Revised Regulation Z, 46 Fed. Reg. 20941, 20942 (1981); *see also* KEEST & KLEIN, *supra* note 25, at 36.

609. *See, e.g.*, Semar v. Platte Valley Fed. Sav. & Loan Ass'n, 791 F.2d 699, 704 (9th Cir. 1986); Bizier v. Globe Fin. Serv., 654 F.2d 1, 3 (1st Cir. 1981); Smith v. Wells Fargo Credit Corp., 713 F. Supp. 354, 355 (D. Ariz. 1989).

610. *See, e.g.*, Smith v. No. 2 Galesburge Crown Fin. Corp., 615 F.2d 407, 416-17 (7th Cir. 1980) ("It is not sufficient to attempt to comply with the spirit of TILA . . . . Rather, strict compliance with the required disclosures and terminology is required . . . . [W]e will not countenance deviations from those requirements, however minor they may be in some abstract sense." (citations omitted)), *overruled by* Pridegon v. Gates Credit Union, 683 F.2d 182 (7th Cir. 1982).

611. KEEST & KLEIN, *supra* note 25, at 35.

612. *Id.* at 35-36.

613. A sample of the academic literature includes: Abbott & Campbell, *supra* note 550, *passim*; William K. Brandt & George S. Day, *Information Disclosure and Consumer Behavior: An Empirical Evaluation of Truth in Lending*, 7 U. MICH. J.L. REFORM 297 (1974); Davis, *supra* note 31, at 906; Robert W. Johnson, *The New Law of Finance Charges: Disclosure, Freedom of Entry, and Rate Ceilings*, 33 LAW & CONTEMP. PROBS. 671, 673-76 (1968); Robert L. Jordan & William D. Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285 (1966); Kofele-Kale, *supra* note 600, at 146-47; Homer Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445 passim (1968); Landers & Rohner, *supra* note 601, at 751-52; Paul R. Moo, *Legislative Control of Consumer Credit Transactions*, 33 LAW & CONTEMP. PROBS. 656, 661-62 (1968); Rubin, *supra* note 27, at 306; William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400. *See also* S. Rep. No. 96-73, at 2-3 (1979), *reprinted in* 1980 U.S.C.C.A.N. 236, 281-82.

614. Kofele-Kale, *supra* note 600, at 128.

disclosed information.[615] Because TILA required disclosure of too much information, disclosures resembled just another legal form, which debtors did not bother to read.[616] Embracing this view, a Governor of the Federal Reserve Board told Senators:

> [I]n our opinion, the total present disclosure requirements are simply too extensive to permit effective use by the vast majority of consumers . . . . [T]he mass of information now provided may produce a kind of "information overload" that overpowers many consumers and renders the entire disclosure statement a forbidding and incomprehensible document. Indeed, behavioral research suggests that when confronted with more than a few "bits" of information, consumers cease to read or retain *any* of the material offered.[617]

Opponents of reform countered that most of the complexity of disclosures was due to creditors' unnecessary and over-aggressive contractual efforts to protect themselves in every possible circumstance of default.[618] Consumer advocates also argued that information overload could be solved by visually segregating the most important information apart from less important disclosures.[619] Thus, consumers could have simplified disclosure, but still have the important, more complex information available if they chose to explore it. But, after the FRB—the very administrative agency charged with implementing the Act—called for abandoning many TILA disclosures, fundamental change was inevitable.[620]

The 1968 Act endured small amendments to correct technical problems in 1970, 1974, twice in 1976, and again in 1978.[621] But by 1980 Congress bowed to the inescapable industry pressure and the growing tide of deregulation around the country. The Truth in Lending Simplification and Reform Act (1980 Act) cut out many of the most difficult provisions with respect to creditor compliance.[622] At the same time, Congress preempted

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615. *See id.*

616. *See id.*

617. *Simplify and Reform the Truth in Lending Act: Hearings Before the Subcomm. on Consumer Affairs of the Comm. on Banking, Hous., and Urban Affairs United States Senate*, 95th Cong. 16 (1977) (statement of Philip C. Jackson, Jr.).

618. KEEST & KLEIN, *supra* note 25, at 36 n.37.

619. *Id.* at 36.

620. In addition, the Federal Trade Commission also expressed concern over creditor compliance troubles. *Simplification of the Truth in Lending Act: Oversight Hearings Before the Subcomm. on Consumer Affairs of the House Comm. on Banking, Fin. and Urban Affairs*, 95th Cong. 6 (1978) (statement of Michael Pertschuk, FTC Chairman).

621. KEEST & KLEIN, *supra* note 25, at 34 n.27.

622. *See* Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, tit. VI, 94 Stat. 168 (1980).

state interest rate caps on first mortgage home loans, effectively allowing mortgage lenders to charge whatever interest rates home equity debtors might agree to.[623] The changes to Truth in Lending were so thorough that the Federal Reserve Board considered the law a "new" Truth in Lending Act, rather than an amended version of the old statute.[624] The most important changes included the limitation of statutory penalties to only "significant" violations of the Act, elimination of itemization of the finance charge, and in some instances elimination of itemization of the amount financed.[625] Also, the 1980 Act eliminated or streamlined a variety of secondary, but potentially important, disclosures relating to the legal right to acceleration, security interests, late charges, and rebates. Finally, and perhaps in practical terms most important, the 1980 Act required the FRB to promulgate "safe haven" forms which further encouraged uniformity and gave an added assurance to lenders about liability risks.[626]

Many changes, however, had nothing to do with making disclosure documents simpler, but rather focused on protecting major players in the lending markets. For instance, in the 1968 Act, assignees of the original creditor were sometimes held equally liable for any Truth in Lending violations.[627] This encouraged the secondary lending market to police loan originators. But under the 1980 Act, assignees became liable only for violations apparent from the face of the contract.[628] The 1980 Act also reduced the maximum recovery for multiple class actions, eroding the incentive of plaintiffs lawyers to engage in major litigation battles with large lenders.[629] One scholar recently explained, "it was undoubtedly the onslaught of TIL lawsuits, most of which were being won by consumers, more than the failure of the Act to assist consumers in comparison shopping that led Congress to enact a major overhaul of the Act, effective in 1980."[630] It is also worth noting that the claim that Truth in Lending lawsuits in the pre-1980 era were largely premised on technical problems with secondary disclosure requirements is something of a myth. On the contrary, more than half of TILA litigation in this period challenged the accuracy of finance charges "not a 'technicality,' but one of the two most

623. The Truth in Lending Simplification and Reform Act was passed as part of the Depository Institutions Deregulation and Monetary Control Act which preempted state interest rate caps on first mortgage home loans. DIDA, Pub. L. No. 96-221, 94 Stat. 132 (codified as amended at 12 U.S.C. § 1735f-7a).

624. KEEST & KLEIN, *supra* note 25, at 34.

625. *Id.* at 35-36.

626. *See* 15 U.S.C. § 1604(b) (2002).

627. PRIGDEN, *supra* note 581, § 4:3.

628. *Id.*

629. *Id.*

630. *Id.* § 4:2.

fundamental disclosures mandated by TIL."[631] Nevertheless, when the Supreme Court quickly resolved several of the most important controversies Congress left unaddressed, many creditor compliance concerns were essentially eliminated. The result was that soon after simplification the levels of litigation over TILA subsided to "relatively sparse" levels.[632]

1. The Market for High-Cost Credit Information

While industry has come to a grudging acceptance of Truth in Lending as litigation and compliance problems have largely been solved, it is far less clear whether the Act has achieved the ultimate goal of protecting consumers by creating informed credit decisions. Unfortunately there are strong indications that, at least in the market for high-cost credit, Truth in Lending has failed almost entirely in promoting price informed borrowing decisions among the most vulnerable debtors. In the high-cost credit market, structural and market forces act, not to promote price competition, but to promote confusion and strategic lending behavior.[633] High-cost lenders have a greater incentive to erect barriers to price shopping than moderate and low-priced lenders. The reason relatively inexpensive lenders sell their loan products at lower prices is because their clientele are responsive to those prices. The lender offering the cheapest loan has every incentive to advertise that price. But for lenders who have abandoned price competition for other means of acquiring customers, the wisest course is to hide those prices for as long as possible.[634] The ideal high-cost debtor is one who continues paying without even realizing the true opportunity costs of her purchasing decision.

One way of discouraging comparison of loan products is by making those products complex. After-the-fact legal battles are at least partially to blame in encouraging high-cost credit contract complexity. Because in our legal system courts take the text of contractual provisions seriously—usually regardless of whether the parties understood their own

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631. KEEST & KLEIN, *supra* note 25, at 36; *see also Truth in Lending Simplification and Reform Act, Hearings on S.108 Before the Sentate Comm. on Banking, Hous., and Urban Affairs*, 96th Cong. 30-31 (1979) (statement of Richard Hobbs, National Consumer Law Center).

632. FONSECA, *supra* note 551, § 1:1; KEEST & KLEIN, *supra* note 25, at 35-36; PRIGDEN, *supra* note 581, § 4.3.

633. W. David Slawson, *The New Meaning of Contract: The Transformation of Contracts by Standard Forms*, 46 U. PITT. L. REV. 21, 38-39 (1984) (making a similar point about form contracts in general); *see also* R. Ted Cruz & Jeffrey J. Hinck, *Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 HASTINGS L.J. 635, 640-46 (1996) (providing a useful summary of related articles).

634. Brian Ratchford makes a related point with respect to the economic model of human capital. *See* Brian T. Ratchford, *The Economics of Consumer Knowledge*, 27 J. CONSUMER RES. 397, 406-07 (2001).

bargain—creditors have a great incentive to pack their documents to preempt every contingency they can imagine. Affirmative defenses in litigation as well as statutory penalties for flawed disclosure and other debtor consumer protection rules create perverse incentives to craft complex contractual provisions which undermine the ability of consumers to make meaningful comparisons between competing products.[635] Even where the added complexity of a contract does not provide legal protection for a lender in the long run, the *threat* of protection can be just as effective. High-cost debtors do not know which lending practices are and are not enforceable. This means complexity which looks defensible is often good enough. Especially, if it can scare off the few overworked and often inexperienced lawyers who serve the nation's most vulnerable debtors.

Even absent litigation risks, in the high-cost credit market, many creditors inject complexity into their contracts and the negotiation process preceding them simply for the strategic value of the complexity itself. High-cost mortgage debtors often complain that lenders present stacks of irrelevant brochures, letters, and advertisements in addition to already complex settlement forms in order to cloak their true prices. The story of John Evans, an eighty-seven-year-old retired laundry pressman from Columbia, South Carolina, is indicative.[636] Mr. Evans and his wife bought their home in 1960. Since his retirement seven years ago he has worked part time bagging groceries at a local Kroger supermarket. A telemarketer from Collateral One Mortgage Company called Mr. Evans and convinced him they could refinance his loan with lower monthly payments. Anxious to stretch his small paycheck and social security income farther, he expressed interest. Collateral One, a seven-year-old mortgage lender with operations in Kentucky, North Carolina, South Carolina, and Tennessee immediately sent a salesman to Mr. Evans' home. Soon after, Collateral One signed up Mr. Evans for a $71,000 mortgage with higher monthly payments and a 10.792% interest rate. Financed in the loan were more than $6,100 in fees which will cost around $26,000 over the life of the loan. And, after thirteen years of regular monthly payments, Mr. Evans at 101 years of age will be due to make a balloon payment of $58,622. The spokesman for Collateral One insisted Mr. Evans was fully informed about the terms of his completely fair loan. Collateral One provided Mr. Evans all the required paperwork detailing all loan terms and other information prior to closing. They emphasize Mr. Evans never objected or indicated he

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635. *See* Michael I. Meyerson, *The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts*, 47 U. MIAMI L. REV. 1263, 1274-76 (1993) (discussing Professor Prosser's concerns over this incentive in the context of contractual waiver of product liability).

636. Mr. Evans story is chronicled in Rick Brundrett, *How Mounting Loans Devastated 87-Year-Old*, THE STATE (Columbia, S.C.), Feb. 24, 2002, at A1. *Also see* Editorial, *Predatory Lending A Shameful Practice That Must Be Ended*, THE STATE (Columbia, S.C.), Feb. 24, 2002, at A1.

could not understand the loan terms. For his part, Mr. Evans says, "[he] thought the contract was all right," but admits he cannot read, having left school after the first grade.[637] What he does know for certain is that he was not told his monthly payments would be more than $100 larger than before. With his limited fixed income Mr. Evans can barely make ends meet and is afraid he "can't hang on much longer."[638] If he stops making payments, he will lose his home in foreclosure.[639]

An anonymous former branch manager for Associates Financial Service, a major national high-cost lender, paints a similar picture of typical high-cost mortgage loan closings. The former manager confided to a noted Virginian investigative journalist:

> "The sales methods are so deceiving." . . . [W]ith all the numbers and documents involved, it's easy for a loan officer to throw out some figures and say, "I can save you $25,000, isn't that great?" The loan officer nods his head up and down and makes eye contact. The bewildered customers nod their heads yes too. "They'll be signing their lives away . . . ." It's not until too late that they suddenly realize, "I have an $800-a-month house payment."[640]

Contrasting the legal doctrine of "informed consent" which governs medical doctors, the former high-cost lending manager emphasized in his business, the norm is to sell credit products under "the doctrine of *assumed* consent."[641] Such lax communication with potential debtors combined with the increasing complexity of creditor contracts threatens to undermine our system of rational choice policymaking. Credit contracts are often the most important contracts a consumer will sign in a lifetime. When courts enforce contracts, as though there were a real meeting of the minds as to all material terms, when in fact there was not, an enormous potential exists for lenders to include provisions which charge more than the amount to which the customer actually agreed.

Independent of information barriers erected by high-cost creditors, high-cost debtors often have limited resources and skills to invest in price shopping.[642] The costs of acquiring information must be evaluated relative to the resources of credit shoppers. Because current price disclosures only

637. Brundett, *supra* note 636.

638. *Id.*

639. *See id.*

640. Michael Hudson, *"Signing Their Lives Away"—Ford Profits from Vulnerable Consumers*, *in* MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY 42, 47 (Michael Hudson ed., 1996).

641. *Id.*

642. *See* Peterson, *supra* note 17, at 565.

provide information about one credit contract in a vacuum, in order to make a price comparative decision, debtors must still travel to other creditors, learn the prices they offer money at, and then compare which is the best deal. Those, like Mr. Evans, who rely on creditors to come to them as telemarketers or door-to-door salespersons take extreme risks.[643] Comparing product price and quality in some markets can be a relatively easy task. At a grocery store, a consumer might compare the prices of several different breakfast cereals, looking at the ingredients and the convenience of packaging, recalling advertising claims, and contrasting the quantities offered all in a matter of minutes or even seconds. This is because in the market for breakfast cereals shopping costs are low.

But in the market for high-cost credit, making a similar comparison involves traveling between different locations, asking for the relevant documentation, conversing with clerks, potentially negotiating on the purchase price of a similar financed good, and probably undergoing multiple credit checks. Moreover, the most inexpensive lenders may have short operating hours, intimidating employees and environments, parking congestion, might frown on bringing children along for the application process, and might unintentionally or even intentionally assemble other more subtle, but nevertheless socially profound, barriers as simple as offhand rude remarks or disapproving stares. A debtor must also have an arsenal of resources to keep these shopping costs from skyrocketing. If, for example, a debtor uses public transportation, taking the bus between different potential creditors could take hours upon hours. If the debtor is mobility-limited by a disability, old age, or illness, traveling to more than one or two creditor locations may be impossible. If the debtor has difficulty reading, the time which it would take to wade through many different disclosure statements alone would be prohibitive. At some point shopping costs will outweigh any uncertain benefits of reduced prices which might be gained from shopping, making it irrational for many if not most or all consumers to do pre-transactional shopping.

The problems of cost comprehension and price comparison are only magnified for the growing number of Americans who speak little or no English. Bringing a friend or family member along to translate roughly doubles the shopping costs. In practice, "Spanish speaking consumers essentially rely on the verbal promises of a salesman to get through the process."[644] Unscrupulous high-cost lenders aggressively target Spanish speakers to generate heterogeneously inflated prices. A Port Lavanca, Texas consumer poignantly complained to the Texas Attorney General

643. *Id.*

644. Reggie James et al., *In Over Our Heads: Predatory Lending and Fraud in Manufactured Housing*, *in* 5(1) CONSUMERS UNION SOUTHWEST REGIONAL OFFICE PUBLIC POLICY SERIES 1, 16 (2002), *available at* http://www.consumersunion.org (last visited Feb. 23, 2002).

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about the credit practices of mobile home dealers. The Spanish letter translates, "[t]hey are soliciting business amongst the folks that have poor English skills in order to cheat . . . unsophisticated buyers."[645]

Some economists predict that consumers adopt shopping strategies which effectively cope with these types of information problems. For example, when consumers face a wide diversity of product choices, finding the best deal becomes prohibitive. Because the costs of examining the benefits of each possible option outweigh the potential gains from finding the optimal choice, consumers have no incentive to find the best deal. But, if consumers use a few important criteria to screen out options that are unlikely to be ideal, they can come up with an option that is the best choice given their circumstances. Then the consumer selects the best option from the limited set of choices. Although the selected option may not in fact be ideal, if the consumer uses sensible screening criteria, it will still be close enough to force price and quality competition in the market. In these cases, consumers are thought to "satisfice" rather than "optimize."[646]

But even if we assume prospective high-cost debtors do attempt to satisfice, it is still unlikely they could effectively force price competition. In the market for high-cost lending, search costs are so high that consumers must typically screen out all but one or two product options from further more detailed investigation. For instance, a recent Consumers Union study of the Texas manufactured home market indicates buyers seeking financing must pay expensive credit report and application fees as well as place deposits long before they ever see a contract or price disclosure statement.[647] The price of a manufactured home loan is almost always much higher at closing than when first quoted.[648] Moreover, sales staff

645. James et al., *supra* note 644, at 16-17; *see also* Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1034-35 (1996).

646. JAMES G. MARCH & HERBERT A. SIMON, ORGANIZATIONS 140-41 (1958); SCOTT PLOUS, THE PSYCHOLOGY OF JUDGEMENT AND DECISIONMAKING 94-95 (1993); David M. Grether et al., *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277, 285-89 (1986). Satisficing behavior can be conceptualized as either a welfare maximizing response to imperfect information or as a problem of irrational behavior. *See, e.g.*, AVERY WIENER KATZ, FOUNDATIONS OF THE ECONOMIC APPROACH TO LAW 268 (1998). In this Article, I take satisficing behavior to be consistent with welfare maximization. Consumers rationally satisfice when the opportunity costs of pursuing larger product data sets outweigh the predictive potential gains to further shopping. Nevertheless, this does not necessarily imply that high-cost debtors *always* behave rationally. There may be irrational cognitive errors which impede optimal market outcomes in addition to transaction cost distortions. However, irrational behavior is beyond the scope of this article.

647. James et al., *supra* note 644, at 4-6.

648. RESPA requires lenders provide a "Good Faith Estimate" of closing costs within three days after a customer applies for a loan. 12 U.S.C.A. § 2601(b)(1) (West 2002). However, RESPA does not include any penalties or liability for wild inaccuracies on the estimate or even failure to

often caution borrowers not to shop around since the outdated credit reporting system used by many manufactured home lenders penalizes the credit ratings of borrowers for whom lenders submit multiple report requests in a short duration.[649] The story of Porfirio P. from El Paso, Texas is typical of the direct financial charges imposed on those who try to shop. In order to find the best deal, Porfirio left a $100 deposit with one El Paso mobile home lender and then a $300 deposit with a second lender, buying from a third.[650] When he asked for his initial two deposits back, both mobile home dealer/lenders refused. His "exercise in comparison shopping . . . left him $400 out of pocket until the [Texas] Attorney General intervened."[651] Sometimes manufactured home buyers are asked to sign blank documents and dealers often refuse to give buyers copies of loan contracts.[652] The Federal Reserve Board and the Department of Housing and Urban Development confirm that the practice of charging application fees to potential borrowers *before* providing any closing cost or finance charge estimates is frequent and widespread all around the country.[653]

Even "fast loan" businesses have subtle but significant ways of raising shopping costs. For instance, payday and car title lenders often telephone first time loan applicants' bosses or human resource managers to verify applicants are employed. Employment verification almost always occurs before debtors see a contract or any TILA disclosures.[654] Telephone employment verification serves the lender's interests in several respects. Obviously, the practice helps evaluate loan risk. But, it also dramatically increases search costs for first time loan purchasers. Payday lenders themselves admit their customers almost always have unsteady employment.[655] Most borrowers are understandably nervous about

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provide the estimate at all. Both the Federal Reserve Board and HUD have characterized RESPA good faith estimates as "unreliable." Board of Governors of the Federal Reserve System & United States Department of Housing and Urban Development, *Joint Report to Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act* 20 (1998), *available at* www.federalreserve.gov/boarddocs/RptCongress/tila.pdf (last visited May 15, 2002).

649. James et al., *supra* note 647, at 4.

650. *Id.* at 4.

651. *Id.* at 4-6.

652. *Id.*

653. *See* Board of Governors of the Federal Reserve System & United States Department of Housing and Urban Development, *supra* note 648, at II.

654. *See* Peterson, *supra* note 17, at 573; Christopher Peterson, *Only Until Payday: A Primer on Utah's Growing Deferred Deposit Loan Industry*, 15 UTAH BAR J. 16, 16 (2002).

655. One industry funded demographic survey of payday loan debtors remarks, "[p]ayday advance customers are not deeply rooted in their employment. 50% of respondents have had their current job for three years or less, and 70% have had their current job for five years or less." IO DATA CORPORATION, UTAH CONSUMER LENDING ASSOCIATION: UTAH CUSTOMER STUDY 30 (2001) (available on file with author).

exposing their financial circumstances to their uncommitted and sometimes capricious employers. After the first employment verification telephone call, many prospective debtors immediately end their search because they (perhaps correctly) predict that embarrassment and the risk of jeopardizing their job from additional phone calls will outweigh any potential savings from searching for a cheaper loan.[656] Moreover, the practice encourages a form of artificial brand loyalty. By only verifying employment over the telephone for the first loan, lenders create a subtle but stiff "penalty" for borrowers who choose to look elsewhere in the future.[657] Under this incentive structure the priority for lenders is to make themselves the first option potential borrowers will inspect. Telephone employment verification creates an incentive to compete with flashy signs, promises of quick cash, location, and name recognition, rather than price reduction. Search costs may be so high, borrowers satisfice after inspecting only one or perhaps two market options—an insufficient number to force price competition.

Payday lenders systematically delay divulging accurate comparative price information such as the annual percentage rate of their loans. A nationwide survey found only thirty-seven percent of payday lenders contacted for price information would divulge even a nominally accurate annual percentage rate over the telephone.[658] "Others claimed they 'didn't know' or that the APR was equal to the fee for a two-week loan."[659] A different local study focusing on lenders in Salt Lake City found that even when approached at store locations over sixty-five percent of payday lenders would not disclose the rate of their loans in annual percentage rate format.[660] These results indicate nearly two-thirds of the nation's payday lenders are in consistent violation of the TILA's most basic requirement to respond to oral credit rate inquiries only in terms of the annual percentage rate.[661]

Moreover, in the high-cost credit market, many of the inexpensive and more informal shopping strategies used by upper class borrowers are not available. Some economists predict that markets self-correct despite

656. Peterson, *supra* note 17, at 573.

657. This penalty has also been conceptualized as a "sunk" cost. Gilian K. Hadfield et al., *Information-Based Principles for Rethinking Consumer Protection Policy*, 21 J. CONSUMER POL'Y 131, 139 (1998).

658. PUBLIC INTEREST RESEARCH GROUP AND CONSUMER FEDERATION OF AMERICA, SHOW ME THE MONEY! A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES 6 (2000).

659. *Id.*

660. Peterson, *supra* note 17, at 564-65.

661. The Truth in Lending Act states, "In responding orally to any inquiry about the cost of credit, a creditor, regardless of the method used to compute finance charges, shall state rates only in terms of the annual percentage rates . . . ." 15 U.S.C.A. § 1665a (West 2002).

Peterson: Truth, Understanding, and High-Cost Comsumer Credit: The Historic

information asymmetries because consumers use abstracted information sharing strategies such as business reputation to offset seller advantages.[662] This is to say, consumers can effectively shop through more informal channels such as gleaning a producer's reputation from friends, co-workers, and family. But, in the market for high-cost credit, competition through creditor reputation is unlikely to succeed. Initially, because entry and exit costs are low for high-cost creditors, the market is characterized by "a large number of fly-by-night operators with few sunk costs and only modest investments in reputational capital."[663] Because many high-cost lenders do not invest time and effort in building a solid reputation, they have little to fear from word of mouth criticism. Moreover, high-cost debtors often are less embedded within their communities. Because high-cost debtors tend to have more fragile workplace, neighborhood, community, church, and family relationships, they may be less integrated into effective reputation based shopping networks. For example, an inner city single mother of four working nights as a nurse is likely to have less access to reliable information about the reputation of various payday lenders, than two affluent married suburban CPAs would have about the reputation of various banks. Also, high-cost debtors are unlikely to share reputation information because they often suffer from embarrassment and shame over past credit failures and the prospect of imminent default. One study indicated that less than a quarter of borrowers behind on their home mortgages ever mention their trouble to family friends.[664] Sharing word of mouth criticism of high-cost lenders often means exposing embarrassing financial problems.[665] Finally, all reliable shopping information must at some point be obtained on a first hand basis. If virtually no one in a family or neighborhood has access to reliable and effective shopping information, then there is no basis for an effective informal word of mouth shopping process to begin. One Latino social advocate explains,

> [i]n many white families, there is a long history of home ownership, so there is someone to help walk them through the process. Many Latinos are first generation home-owners. There is no one to say, "Here's what you should do and here's who you should talk to when getting a loan."[666]

662. See Hadfield et al., *supra* note 657, at 161 (noting regulations affecting business reputation can provide effective consumer protection at a low cost).

663. *Id.* at 155.

664. JANET FORD, THE INDEBTED SOCIETY: CREDIT AND DEFAULT IN THE 1980S, at 126 (1988).

665. CASKEY, *supra* note 22, at 70-71; FORD, *supra* note 664, at 126-30; W.C.A.M. Dessart & A.A.A. Kuylen, *The Nature, Extent, Causes, and Consequences of Problematic Debt Situations*, 9 J. CONSUMER POL'Y 320, 328 (1986).

666. Ron Nixon, *Application Denied: Do Lending Institutions Overlook Hispanics?*, 11 HISPANIC 30, 30 (1998) (quoting Luis Artega, executive director of the Latino Issues Forum in San

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Because many low income and minority communities are conspicuously devoid of branches of lower cost credit providers, such as credit unions and some banks, shopping may become extremely time consuming for entire social groups. As a result these debtors are likely to select credit on the basis of familiarity, the "convenience" of low initial shopping cost investments, and other non-price related factors.[667]

2. The Limitations of Current Disclosure Rules

Sadly, our current credit disclosure laws do not meaningfully address these information distortions, and sometimes encourage them. Initially, current disclosures come too late. Truth in Lending as well as the Real Estate Settlement Procedures Act allow creditors to manipulate the timing of information exchange to inefficiently increase the transactional costs of acquiring price information. Truth in Lending disclosures

> come at, or very shortly before, the consummation of a transaction to which the consumer is already verbally and psychologically committed. At this point, comparative shopping by the consumer is unlikely. Moreover, it is equally unlikely that at this point the consumer will opt to pay with cash. Thus, [Truth in Lending] does not put us[e]able credit information into the consumer's hands at a time when it will affect transactional behavior.[668]

One study of lenders in the New Orleans area found that, even when specifically asked for disclosure information prior to signing the agreement, every lender surveyed "refused to issue a credit disclosure statement at this point in the transaction."[669] Instead, such statements were "issued *only* at the time the loan is consummated, never prior to that time."[670] But by then, consumers have already invested a significant time and effort into obtaining the loan. Even short delays in receiving disclosure

Francisco).

667. Even if a simpler disclosure procedure existed, "improved disclosures may not aid comparison shopping significantly in underserved markets where there is less competition." Board of Governors of the Federal Reserve System & United States Department of Housing, *supra* note 648, at 51; *see also* A. CHARLENE SULLIVAN, UNDERSTANDING THE CONSUMER CREDIT ENVIRONMENT 35 (1989) ("Consumers tended to choose among the various classes of credit grantors on the basis of perceived relative costs, but chose a particular creditor on the basis of familiarity."); Melissa Allison, *Poorer Areas of Chicago Also Remain Poor in Bank Branches*, KNIGHT RIDDER TRIB. BUS. NEWS, Nov. 26, 2001, *available at* 2001 WL 31004762.

668. Landers & Rohner, *supra* note 601, at 715-16 (footnotes omitted).

669. Simplify and Reform the Truth in Lending Act: Hearings, *supra* note 617, at 333.

670. *Id.* at 334.

statements, when encountered with every lender, can erode borrowers' willingness to compare loans.

Furthermore, Truth in Lending regulations have departed so far from the original vision of a simple all cost inclusive price tag, the key material disclosures themselves can often be a source of *disinformation*. The credit industry has for years seized on the complaint that credit disclosures are not useful because they are too hard to understand.[671] But, a significant amount of confusion is attributable to the industry's unnecessarily complex contracts which make current disclosures awkward. The complexity of disclosure statutes, regulations, administrative interpretations, and case law, as well as the disclosure statements they produce is a symptom of creditors' evasion. As consumer advocates, regulators, and policymakers have attempted to respond to the endless evolution of new contractual provisions and practices, they have lost sight of a simple truth: *credit contracts do not have to be complicated.* Creditors can always protect their investment by raising interest rates. Contract and in turn regulatory and then disclosure complexity only develops when lenders seek to protect their investment through uncomparable contract provisions such as junk closing fees, pre-payment penalties, credit insurance, and other hidden revenue producers, rather than interest rates. The principle advantage of these relatively complex and difficult to compare provisions is that they forestall and confuse debtor price resistance.[672]

Perhaps the most serious among the Truth in Lending Act's drafting problems is the increasingly misleading calculation of the finance charge disclosure. Theoretically, the finance charge is the total dollar amount debtors must pay to borrow the principal including interest as well as other non-interest charges.[673] Ideally, the finance charge should be equal to the total amount financed minus the principal of the loan.[674] Original proponents of Truth in Lending believed the finance charge would be an extremely powerful shopping device for consumers, since it would make comparing prices a simple matter of comparing a single dollar figure representing all the costs associated with borrowing a given amount. If a consumer wanted to borrower a certain amount, all she would have to do is compare each lenders' finance charge, and she would immediately know which contract was the least expensive. The finance charge is also crucial

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671. KEEST & KLEIN, *supra* note 25, at 35.

672. As Kathleen Keest has persuasively explained, high-cost creditors "place the point at which prices hit market resistance higher by deceptively understating the price." Keest, *supra* note 32, at 362.

673. *See* RALPH J. ROHNER & FRED H. MILLER, THE LAW OF TRUTH IN LENDING ¶ 4.01[2][c][i] (1984).

674. *See id.*

because it is the basis for calculating the annual percentage rate, which is simply a yearly percentage expression of the finance charge.[675]

But in the years since Truth in Lending, high-cost mortgage lenders have learned to exploit regulatory exceptions to calculation of the finance charge disclosure. When Congress passed Truth in Lending in 1968, most mainstream lenders described all non-interest charges as "points." These points would cover all the incidental costs of closing a loan including title searches, appraisals, and others. One point is usually equal to one percent of the total amount financed. But, over the past twenty years lenders have increasingly "unbundled" the costs which originally justified charging points into a variety of junk fees.

> Now, *in addition* to points (sometimes outrageously high), those costs that points were designed to cover (and more) are unbundled and separately passed on: underwriting fees, warehousing fees, interim funding fees, loan processing fees, document preparation fees, loan disbursement fees, lenders' closing attorney's fees, courier and expedited delivery fees to ferry the paper between the lender and closing agent. Of course, more familiar closing costs are also passed on: . . . title-related fees, credit insurance, property insurance, mortgage guarantee insurance, broker's fees. The list goes on.[676]

These fees create enormous difficulty for regulators as well as federal and state courts. Courts must grapple with the invention of each new fee to determine whether it is properly calculated as a finance charge and therefore included in the annual percentage rate. Different types of lenders have different fees and even the same lender will have different fees for different types of loan products. The result is a body of law that is rarely penetrable by the attorneys and judges who work in the legal trenches where—in the best case scenario—high-cost lending disputes are resolved. Because high-cost lending cases are notoriously labor intensive for plaintiffs' attorneys, in practice if not in law, it is left to the discretion of lenders whether to include junk fees in the finance charge.[677]

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675. *See id.*

676. KEEST & KLEIN, *supra* note 25, at 77.

677. The few attorneys that do provide services to high-cost borrowers must be very selective because of the formidable time commitment each case involves. Cynthia Vinarsky, *Youngstown, Ohio, Program Helps Homeowners Victimized by Predatory Lenders*, KNIGHT-RIDDER TRIB. BUS. NEWS, Apr. 14, 2002, *available at* 2002 WL 19772538. Moreover, many debtors themselves prefer to cut their losses and walk away from the hassle of a lawsuit even after learning of a creditor's illegal actions. *See* Deborah A. Schmedemann, *Time and Money: One State's Regulation of Check-Based Loans*, 27 WM. MITCHELL L. REV. 973, 995 (2000).

The Truth in Lending statute itself, its regulations, rare court oversight, and inadequate debtor access to trained attorneys allow lenders to wedge more and more of these fees into exceptions to the finance charge. Because the annual percentage rate is derived from the finance charge, these seemingly innocuous exceptions can completely undermine the whole transaction cost reducing value of Truth in Lending. In order to know the total price of borrowing a certain amount of money, consumers must search through the documents, find every non-finance charge inclusive fee, and then add those fees to the finance charge themselves. In order to do this debtors must wait until all of the final documents are prepared. And then, they must start all over again and go through the documents for *each loan* they want to consider. When customers want to rely on the annual percentage rate, there is no guarantee it is accurate, since it is derived from an often horribly distorted finance charge. In reality, most high-cost debtors have trouble understanding the simple notion of a finance charge itself. Most debtors cannot distinguish interest from an annual percentage rate, or understand why the latter is much more reliable. And virtually no debtors can identify and distinguish those fees not included in the finance charge and then comprehend why that understanding is absolutely crucial to knowing the true price of the loan.

The result is that there is no single easily comparable figure which describes the price a borrower will pay for financing—but, to the casual observer *it looks like there is*. These junk fees are almost always financed as part of the loan principal. Since they do not come directly out of the consumer's pocket, unsuspecting borrowers cannot tell the difference. In the high-cost credit market, borrowers who do not figure this process out until it is too late are forced to pay outrageous fees for worthless services, as well as interest on those fees, in monthly payments over a course of years—sometimes over a lifetime. And, if the borrower refuses to pay, the lender will use well-paid veteran lawyers to quickly and mercilessly take the borrower's home—possibly reaping a big additional home equity windfall in the process. In the hands of sophisticated but shameless high-cost lenders, the TILA as it is currently written may not provide *any* pre-transactional shopping protection to debtors. Since prospective borrowers can never tell beforehand which lenders are packing the loan with non-finance-charge-inclusive fees, Truth in Lending only serves to create a veneer of legitimacy and safety where there is none. Credit industry lobbying to preserve the legality of these practices has so successfully battered down "Truth in Lending" with manipulative complication, ever expanding exceptions, unnecessary delays, and outright deception, even U.S. Circuit Judge Richard Posner, quarterback for the neo-classic

economic analysis of law team recently quipped "[s]o much for the Truth in Lending Act as a protection for borrowers."[678]

The irony is this system may hurt forthright and efficient lenders as much as debtors. Lax finance charge disclosure calculations and other disclosure distortions create a disincentive for all lenders to comply with the spirit of Truth in Lending. Lenders who in good faith include all fees within the finance charge, offer disclosures promptly, and do not bury key price tag information in a stack of misleading and irrelevant information are likely to hurt their own competitiveness. The mainstream banker's opposition to uniform bright line no-exceptions price tag disclosure may be born out of an instinctive reaction against government regulation, rather than good business sense. Because all creditors operate under the same field of government regulation, lenders who intend to comply with the law have much more to fear from easily circumvented disclosure regulations than bright line uniformly enforced regulations. Lenders who are not afraid of efficiency and price competition have nothing to fear from robust disclosure rules. It is only creditors who have something to hide—namely the prices of their loans—who should fear more thorough and consistently enforced disclosure.[679]

What the basic approach of Truth in Lending fails to capture is that truth and understanding are not always (or perhaps are rarely) synonymous concepts. One cannot have understanding based on false information, therefore truth is a necessary element of understanding. But, one can have true information and not understand it. In the best of current circumstances, status quo federal law is only concerned with whether disclosures truthfully and completely describe the cost of a loan. The true descriptions provided by federal disclosure rules only provide an *opportunity* to understand credit prices. If the past thirty years of high-cost consumer credit experience teach one lesson, it is that *truth* is not enough—vulnerable high-cost debtors need *understanding*.

V. CONCLUSION

Although the history of consumer credit in America retains many unique features, the policies we have relied upon to protect vulnerable debtors from the danger of high-cost credit are in most cases older than our country. Sadly, these strategies have not reliably cured the social ills associated with high-cost debt nor prevented our most resent surge in the high-cost credit market. Ironically, many advocates of these policies are quixotically unaware of the histories of failure plaguing each policy option

678. Emery v. Am. Gen. Fin., Inc., 71 F.3d 1343, 1346 (7th Cir. 1995); *see also* Keest, *supra* note 32, at 364 (making a similar point).

679. KEEST & KLEIN, *supra* note 25, at 75.

which date back hundreds or even thousands of years. This Article has attempted to provide a new historically grounded classification of high-cost credit policy which helps highlight these limitations. Debtor amnesty, interest rate caps and other contractual restrictions, selective protection schemes, charitable lending, cooperative lending, and the over reliance on unregulated markets have all had histories indicating inherent drawbacks. As a result our efforts have tended to protect those who least need it—the relatively affluent.

Today America is in the throws of an identity crisis with respect to consumer credit. Social conservatives do not know how to resolve Biblical injunctions against abusive money lending and their tradition of stalwart thrift with their embrace of laissez faire capitalism. Social liberals do not know how to resolve their empathy for the plight of working poor and lower-middle class debtors with their new found commitment to market decisionmaking. Both conservatives and liberals alike have embraced mainstream moderately priced consumer credit. But as of yet both groups have lacked the cultural sophistication to morally distinguish relatively new mainstream moderately priced credit with the millennia old high-cost credit sold in the second tier alternative finance market. It is precisely this collective moral disorientation which has allowed payday lenders, pawnbrokers, rent-to-own retailers, rapid tax refund lenders, car title lenders, and predatory home and manufactured home lenders to cloak themselves with mainstream legitimacy like never before. It is this moral disorientation which has allowed such lenders to slip within the jurisdiction of laws designed to protect the relatively affluent upper and upper-middle classes. It is this disorientation which has allowed some banks to depart from the honorable tradition of American banking by stooping to triple digit interest rate payday lending.

In this respect, the TILA and disclosure laws in general have thus far proven a mixed blessing. From a long term historical perspective, unlike other American high-cost credit policy strategies, the disclosure approach is relatively untried. Despite limitations made apparent over the past thirty-five years, the disclosure approach to preventing harmful social consequences of high-cost credit may yet prove more valuable than other far older strategies. However, to date, Truth in Lending has not lived up to its potential. The challenge for consumer advocates is to rhetorically recapture disclosure law from industry lobbyists. To do so, consumer advocates must recast the goal of disclosure law as aiming not merely to truthfully describe contracts, but as aiming to create practical contractual understanding on the part of vulnerable debtors. Anything less risks wasting the historically unique opportunity of credit disclosure law as yet another demobilizing illusion of debtor protection.