LOOKING FORWARD BY LOOKING BACKWARD: THE FUTURE OF CONSUMER FINANCE AND FINANCIAL PROTECTION

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It is often remarked that some seventy percent of the economy is consumer goods and services, from housing, televisions, books, and cell phones to massages, vacations, and playing "Call of Duty." But behind that day-to-day experience rests a complex network of largely unobservable payments, credit, and enforcement of contracts that most consumers take for granted until something goes wrong. Put simply, the modern American economy and the prosperity of every household in America rest on the evolving foundation of consumer finance.

The resiliency of the consumer financial system was most recently exhibited with the remarkable adjustment of the entire American economy to an effectively digital environment in the span of just a few weeks during the 2020 COVID-19 pandemic and government response to it. Restaurants and other consumer businesses shifted online virtually overnight, accelerating a decade's worth of financial innovation and uptake into the span of a few months. Student loan debt, which hardly existed 30 years ago, is now the second-largest tranche of consumer debt in the economy trailing only mortgage credit and surpassing auto loans and credit cards. Checks, a ubiquitous payment method just two decades ago, are virtually nonexistent and likely to be phased out in the near future. And the rise of the digital economy and digital payments brings transformative potential for improving choice, competition, and financial inclusion, but also unprecedented risks to civil liberties and data security.

What does the future hold for consumer finance and consumer financial protection? While the modern challenges and opportunities are new, the underlying dynamic of the co-evolution of technology and consumer finance is not. And prior eras can also provide insights as to how to adapt the consumer financial protection system to these evolving opportunities and threats. Past experience teaches that a failure to act swiftly and sensibly in response to evolving consumer financial technology and consumer preferences can be harmful to consumers and the economy. But the future holds both more promise and peril in consumer finance than perhaps any time before—the opportunities and challenges presented by the Internet, electronic payments,

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and the seamless integration of financial services with everyday life through the "internet of things," social media, commuting, and digital payments. Modern consumer finance promises a degree of global convenience and ubiquity in financial services that empowers consumers. At the same time, the penetration of digital payments presents novel risks to data security and, most menacing of all, the growing use by government and private power of leveraging the digital payments and banking systems to wage a guerilla war on constitutionally-protected rights such as free speech, freedom of religion, gun rights, and even criminal procedure protections. Moreover, the entanglement of the vast and vaguely defined powers of the regulatory state with the provision of consumer financial service to date has proven difficult for courts to police, leading to potential infringements on constitutional values.

This modest paper will only touch the surface of many of these issues but will present a framework for illustrating how consumer financial regulation has evolved in past eras to address changes in technology and consumer preferences. The theme of this evolution of consumer financial protection is simple, but powerful—consumer financial protection regulation in both structure and substance must adapt to changes in technology and the challenges those present. The consumer financial ecosystem consists of hundreds of millions of consumers in the United States alone, using financial services to make their lives better. And in every era and every time there have been consumers (just as there are businesses and governments) who overuse credit and get in trouble. But the historical story is largely a benign one—consumers in general learn to use consumer credit not only responsibly but to make their lives better. At the same time there have always been elites and government regulators who have bemoaned these developments and tried to stand against the tide through paternalistic and misguided regulations that invariably are seen to harm the people they allegedly are intended to help.

But the tide of hundreds of millions of consumers trying to make their lives better day-to-day has proven irresistible. And historically after much pain and struggle the regulatory system has come to recognize these realities. Change has not come easily though, as entrenched interests and ideological predispositions have stood against the change only to usually be overwhelmed. Change in the regulatory framework has tended to come abruptly and decisively in response to a final recognition of new realities, not gradually over time. As economist Vernon Smith put it in his cover blurb to my co-authored book, *Consumer Credit and the American Economy*, the history of consumer financial regulation reveals "an emergent order of behavioral and parallel institutional rules, with no commanding identifiable leader."[1]

Thus, while the particularities of the evolutionary process of consumer finance and its "parallel" institutional rules are unpredictable, the general

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[1] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL STATEN & TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (2014) (cover blurb by Vernon Smith).

direction of change is predictable.[2] Technological innovations that reduce transaction costs and enhance competition and choice for consumers are resisted at first by the forces of the status quo that cling to the old way of doing things both in business and regulation. Eventually, however, this tension snaps the wire, leading to a need to modernize the consumer financial protection system to reflect the changes of consumer reality.

For simplicity's sake we can identify three basic eras of consumer finance and consumer financial regulation: The pre-modern era beginning around the turn of the Twentieth century that featured the early development of consumer finance to meet the needs of growing class of urban wage-earners; the modern era beginning in the post-World War II era as high-quality, reasonably-priced financial services became increasingly accessible to middle-class consumers in a national market; and the post-modern era, where we stand today, looking forward to the digital economy in a world without geographic constraints. Each of these eras calls forth unique challenges and opportunities for consumer behavior. But one constant remains—efforts to try to steer consumers in directions preferred by regulators and other interests have largely failed and, indeed, proven counterproductive.

At the same time, as Smith's cogent observation reflects, these changes in technology and consumer behavior have called forth parallel institutional changes: notably the migration of consumer financial protection authority in the U.S. from local governments to the national government, and today, the unique challenge associated with the Internet and digital technology platforms.

The purpose of this article is to illustrate this historical arc. I will not provide an in-depth analysis of each of these three eras, which I have done elsewhere,[3] but will use these eras to illustrate the general co-evolutionary arc with an eye toward identifying a framework to guide the structure of the future rules and institutions of consumer financial protection.

I. THE PRE-MODERN ERA OF CONSUMER FINANCE: THE RISE OF URBAN WAGE ECONOMY

For most of human history, consumer finance was largely nonexistent for one obvious reason—the concept of a consumer economy was largely nonexistent. Most individuals worked from sunup to sundown farming, either eating what they produced or bartering for other agricultural commodities (such as grain for eggs). Similarly, most goods that we today think of as "consumer goods" such as clothing or furniture, were made at home. The

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2 *See* Friedrich August von Hayek, *The Pretence of Knowledge*, 79 AM. ECON. REV. 3, 5–7 (1989) (Nobel Memorial Lecture, Dec. 11, 1974).

3 *See generally* DURKIN, *supra* note 1; CONSUMER FINANCIAL PROTECTION BUREAU, REPORT OF THE CONSUMER FINANCIAL PROTECTION TASKFORCE ON FEDERAL CONSUMER LAW (2021) (hereinafter, "CFPB TASKFORCE REPORT").

idea that ordinary working people could earn wages or generate a surplus that could be exchanged for consumer goods was largely unknown.

The wealthy, by contrast, held land and other assets that could be offered as security to acquire credit. Indeed, many Southern plantation owners were in chronic debt to creditors to maintain their large estates and luxurious consumption habits. But non-elites had little access to credit and little need for it.

This reality changed with the Industrial Revolution. Peasants left the countryside to work in factories for wages. Instead of growing their own food and making their own clothes, they instead exchanged their labor for wages which they then used to purchase goods previously produced at home. In the United States these dynamics were especially pronounced. Millions of penniless immigrants and farmers, most with little property but strong backs and an equally strong work ethic, flooded into American cities looking for work in the wage economy. Industrial work brought with it new economic opportunities. Mass production of reasonably-priced consumer goods such as clothing, hardware, radios, and others made it possible for workers to seek and obtain a great array of useful consumer goods. But at the same time, it also brought new challenges—the need to pay rent, acquire consumer goods (such as food, clothing, and furniture), and to deal with the challenges of urban industrial life, such as novel illnesses and cyclical unemployment.

The prosperity of the post-Civil War era, the emergence of a middle class, and the growing fortunes of many ordinary Americans brought with it new desires for consumer goods. Entrepreneurs responded by allowing creditworthy workers to buy consumer goods such as carpets, clothing, pianos, sporting goods, and other goods "on time."[4] Since they mostly had little in the way of assets they could post as collateral for a loan, the installment loan arrangement allowed ordinary Americans to purchase goods and pay for them out of their most valuable asset—their future wages.

Access to "cash credit," however, remained limited and expensive, primarily because of archaic usury law and others. Consumers who needed cash for a medical bill or to pay rent were stymied by restrictive usury ceilings that dated back centuries and served as an accompaniment to "sumptuary" laws that were intended to restrict what was considered excessive consumption. This was especially the case with respect to members of the elite and wealthy class, who sneered at the pretenses of ordinary wage-earners seeking to raise their standard of living by acquiring new consumer goods.

Theorists of the time, including none other than Adam Smith himself, criticized this use of consumer credit.[5] Speaking for the conventional wisdom of the time, Smith distinguished between two types of credit—productive loans to "sober" individuals, i.e., low-risk, responsible borrowers, on one hand, and loans to "prodigals and projectors," such as risky speculators, as

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[4] *See* DURKIN, *supra* note 1, at 88–90.

[5] Jeremy Bentham's famous tract, *In Defense of Usury*, was a response to Smith's justification of usury laws. *See generally* JEREMY BENTHAM, IN DEFENSE OF USURY (1787).

well as loans to fund consumption on the other hand. Because the latter borrowers were inherently riskier, Smith assumed they would be required to pay a higher rate of interest. Usury ceilings, it was thought, would provide a means of dampening this unproductive activity by making it unaffordable to lend to those problematic borrowers.[6]

Smith's analysis, however, ignores a key point—since the beginning, the overwhelming use of consumer credit has been for what should be considered *productive* purposes, namely investments in household consumer durables. Although styled "consumer" goods, the goods acquired with these loans are in the nature of *capital* goods, not mere consumption. This is most obvious in the case of residential mortgages, which enable a consumer to forego monthly rent payments while living in the good and to acquire the good's equity value at the end of the loan term. Student loans are equally obvious—it makes little sense to require an individual to work in low-paid unskilled jobs in order to save up enough money to attend college and to get a college degree. Student loans allow a consumer to borrow against his or her future income to acquire human capital skills today—a future income that will be *higher* as a result of attending college, leaving the consumer with a surplus after the loan is paid off.

But it may not be appreciated that most consumer durables are also very valuable capital investments. A refrigerator, sofa, television, stove, microwave, bed, etc.—although consumer goods, all of these are actually better understood as capital goods that provide extremely high value to a consumer immediately and for which it makes sense to advance the time of acquisition. Consider, for example, the humble clothes washing machine—acquiring a washing machine early in one's adult life will likely be one of the most productive investments one can make, as opposed to schlepping to the laundromat every weekend with a pocket full of quarters. In light of the time, inconvenience, and cost associated with washing clothes at a laundromat, a washing machine may be among a household's most high value investments.[7]

As a result, it is rational behavior for consumers to shift the timing of purchase of consumer durable goods through the use of consumer credit, even at relatively high rates of interest. Hence it is not surprising that installment credit to acquire consumer durables emerged early on in the transition to a consumer, wage-earner economy. To be fair to Smith, however, this logic that most consumer credit is for the acquisition of capital goods rather than consumption, remains elusive to most economists today.

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6 *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 300 (Cannan, ed. 1776); *see also* Joseph M. Jadlow, *Adam Smith on Usury Laws*, 32 J. FIN. 1195, 1195–96 (1977). Jonathan Diesel has argued that Smith actually opposed usury restrictions but argued in an esoteric fashion for their retention for political reasons. *See generally* Jonathan Diesel, *Adam Smith on Usury: An Esoteric Reading*, 184 J. ECON. BEHAV. & ORG. 727 (2021). I do not attempt to resolve that debate here, simply to observe how widespread support for usury restrictions have been through history.

7 *See* CFPB TASKFORCE REPORT, *supra* note 3, at 175–76.

Cash credit can be analyzed through more or less the same lens. Borrowing money, even at a relatively high rate of interest, is rational depending on what the alternative is. If the alternative is eviction, foregone medical care, or your child being thrown out of day care, the value of a short-term cash loan can be very high. Magical thinking that the consumer should just "save more" doesn't meet the needs of young consumers with minimal assets and entry-level wages faced with urgent expenses.

More generally, consumer credit use follows a life-cycle model. Early in an individual's life, a consumer has a high demand for credit and a low supply. This is most obvious in borrowing to acquire an education. But once a young person graduates from college, he then has to move to a new city, get established, find a place to live, acquire furniture, a work wardrobe, and probably a car, and a variety of other high-value acquisitions. At the same time, he has the lowest access to the supply of credit in his life—he will have minimal savings (and will often be technically insolvent if he has student loans), the lowest wages of his working life, a minimal and relatively thin file credit score, and no valuable assets. Eventually, he moves on to get married, start a family (which is far from inexpensive), buy a house and incur all of the expenses associated with living, including clarinets, braces, and soccer cleats.

As our now-happily married hypothetical house-owning father matures, this dynamic changes. He goes from being a *borrower* early in his adult life to becoming a *lender*. At the same time he pays down the debt acquired earlier in his lifecycle, the urgency and value of his investment needs declines. He now has a house, a car, a refrigerator, a wardrobe, a stove, etc. His education is complete. It is conventional to refer to this period of life as "saving" money, but it should not be overlooked that in fact one is not saving, one is *lending* and investing in others. Banks are financial intermediaries that convert pools of excess funds into loanable funds to invest in other individuals and companies through mortgages, car loans, and the like. Investments in financial assets such as equities or fixed-interest investments, such as through mutual funds or retirement accounts, serve a similar purpose. The bank borrows money from you and bundles it with other people's money to lend the money to other people and pays interest to use that money.

Finally, as he stops working and eases into retirement, he begins to draw down on this lifetime of accumulated savings and wealth. Empirical evidence confirms the intuition—as one ages, purchases on consumer durables (such as cars, clothes, and furniture) decline and purchases on true consumption (mostly health care but also leisure activities such as travel) tend to rise. Retirement also shifts the slope of an individual's budget constraint between time and money—financial expenditures drop as individuals engage in more time-intensive activities such as preparing more meals at home and doing their own lawn work and home maintenance, and eliminating many of the expenses associated with working, such as commuting costs, lunches, and wardrobe purchases, and laundering.

Pawnbrokers provided one major source of consumer credit to lower-income consumers. Pawnbrokers had an ingenious way of evading usury restrictions—by simply offering a lower price for the goods that were pawned, thereby implying a lower interest rate than otherwise would have been the case. (Retailers similarly marked-up the prices of the goods they sold to offset their inability to charge a market rate of interest on purchase-money installment loans).

But pawn shops were of limited usefulness because they required consumers to actually own property that was actually of value if resold (which many did not) and then they would be required to part with that property in order to acquire the loan. Moreover, because the property is usually of minimal value to anyone other than the owner, the value offered for the property is small, other than items such as jewelry.

Most wage earners entered into unsecured loans and promised to pay off the loan from their stream of future wages, much like modern installment or payday loans. Needless to say, these loans were risky and also incurred high administrative and underwriting costs relative to the modest size of the loan. Because of the unreasonably low usury ceilings in effect at the time, access to these loans from legal providers was virtually nonexistent.

Faced with an urgent need for cash that they were unable to obtain because of usury laws and other restrictions on lending, desperate wage earners turned to illegal lenders to meet their needs. City workers, who were considered good customers because of their relative job stability, were especially heavy users of illegal lenders. One economist estimated that in 1911 approximately 35% of New York City employees owed money to an illegal lender. Former Federal Reserve Chairman Alan Greenspan once referred to the plight of city-dwellers in that era as one of "virtual serfdom."[8]

During the 1910s and 1920s the Russell Sage Foundation launched a project of research and political advocacy to study the needs of wage-earners for credit and the effects of usury ceilings and other regulations on these consumers.[9] They pointed particularly to the adverse effects of usury ceilings in blocking access to legal lenders and thereby driving consumers to illegal lenders.

The result was the proposal for the Uniform Small Loan Law, which created a template for regulation of small loans.[10] The USLL was based on a simple premise—while regulators can try to eliminate the supply of legal credit to consumers, they cannot limit demand, especially by wage earners. Supporters of the new law, particularly the Russell-Sage Foundation,

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8 Remarks by Chairman Alan Greenspan, *Consumer Credit and Financial Modernization* 2 (Oct. 11, 1997), https://www.federalreserve.gov/boarddocs/speeches/1997/19971011.htm.

9 *See* Elisabeth Anderson, *Experts, Ideas, and Policy Changes: The Russell Sage Foundation and Small Loan Reform, 1909-1941*, 37 THEORY & SOC'Y 271, 275 (2008).

10 *See* LOUIS N. ROBINSON & ROLF NUGENT, REGULATION OF THE SMALL LOAN BUSINESS 113–17 (1935) (Russell Sage Foundation); Rolf Nugent, *Three Experiments with Small-Loan Interest Rates*, 12 HARV. BUS. REV. 35, 35–36 (1933).

supported a more realistic interest rate ceiling (36-48% APR) and increased competition as the best means to meet consumer demand. In a phenomenon that has reoccurred through history, an unlikely coalition of Baptists and Bootleggers opposed the reforms, as upper-class elites paternalistically sought to prevent workers from gaining access to credit, while the illegal lenders fought to maintain their profitable stranglehold on desperate workers and to prevent competition from legal sources.

The USSL was a success. Illegal lenders were driven from the market and wage-earners for the first time found access to credit on competitive terms, transparent prices, and without the unsavory collection methods they confronted under the old system. During the 1920s, use of consumer credit more than doubled.[11] Consumers increasingly used credit to purchase consumer durables, including furniture, pianos, radios, encyclopedias, sporting goods, and others. The emergence of auto financing in the mid-1920s through the creation of the GMAC auto financing plan, played a particularly large role in mainstreaming the use of consumer credit for consumer durables.[12] Previewing rhetoric that would reoccur through American history, elites criticized this growing access to credit for middle class Americans, arguing that it allowed consumers to live beyond their means, encouraged "conspicuous consumption," produced financial ruin for families, and generated macroeconomic instability.[13]

II. THE MODERN ERA OF CONSUMER FINANCE: THE GREAT DEPRESSION AND THE RISE OF THE MIDDLE CLASS

In yet another preview of later criticisms of consumer credit, some commentators argued that one cause of the Great Depression and subsequent economic distress of American households was an overextension of consumer credit. Retailers and other lenders seduced consumers into overconsumption

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[11] *See* MARTHA OLNEY, BUY NOW, PAY LATER: ADVERTISING, CREDIT, AND CONSUMER DURABLES IN THE 1920S 86–91 (1991); *see also* Martha L. Olney, *Avoiding Default: The Role of Credit in the Consumption Collapse of 1930*, 114 Q. J. ECON. 319, 321 (1999).

[12] Ford responded with its own financing plan—an opportunity to buy a Ford on layaway, i.e., the consumer could send money to Ford every month and eventually accumulate enough of a balance to purchase a car. This peculiar arrangement reflected in part Henry Ford's dislike of consumer credit (as a result of negative family experiences growing up) but also Ford's notable anti-semitism which led him to see consumer credit as a plot by stereotypical "Jewish bankers" to exploit hard-working Americans by luring them into living beyond their means, another rhetorical trope that has recurred repeatedly in discussions about consumer credit through American history.

[13] *See* LENDOL CALDER, FINANCING THE AMERICAN DREAM 158 (2001). Thorstein Veblen's famous book *The Theory of the Leisure Class* was published in 1899. In that book he claimed to have identified a new form of "conspicuous consumption," whereby people purchase consumer goods to gain relative status with their neighbors. Veblen argued that in part this conspicuous consumption was funded by excessive borrowing by consumers living beyond their means.

through debt. Of particular concern were the emerging class of small-loan licensed lenders under the USSL, that supposedly were engaged in overzealous and cutthroat competition for customers, leading them to lend ever-greater amounts to ever-riskier borrowers, hoping to "hook" them on loans and drag them deeper into debt. In response, the revisions of the USSL in the 1940s included a new requirement that provided that new licenses should be granted only after applying for a certificate of "convenience and advantage" and establishing that the local market was not being served adequately by the existing lenders.[14] Like the emergence of requirements in other markets (such as healthcare) the logic that underlay this concept was that small loan lending was a type of public utility that featured a particular minimum efficient scale of operation. As intended, these rules reduced competition, leading to higher prices and less access for consumers.

At the same time, many legislatures and others saw the Great Depression as an opportunity to reinstate the punitive usury ceilings that had been a pervasive feature of law in the pre-industrial era. The results were sadly predictable and tragic: By the 1960s, illegal loan sharking was ubiquitous, especially in urban America, where organized crime preyed on wage-earners using violence and intimidation to support their collections.

The economic impact of renewed usury regulations was especially devastating in minority urban communities, where many residents lacked established credit records and the restrictions on competition created an economic environment ripe for indulging discriminatory preferences by lenders that lacked strong competitive checks.[15] Residents of urban communities, referred to as "ghetto" communities in the argot of the time, sadly were forced to rely on so-called "ghetto shops" where retailers sold overpriced goods of shoddy quality to low-income consumers who were trapped into relying on these merchants because they were the only providers of credit to purchase household durables.

To illustrate the point, consider the case of *Williams v. Walker-Thomas Furniture*, a case that is a fixture in law school curriculums.[16] *Williams* is famous for its holding that the contract terms offered by the furniture company were deemed "unconscionable" by the court in that case and nullified. What is not mentioned by the court in that case, however, is that there *was not a single consumer finance company* operating in Washington, DC, at that time. Why? Because the District's unreasonably low usury law made it impossible for personal finance companies to operate and provide credit on

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[14] *See* FRANK BROOKES HUBACHEK, ANNOTATIONS ON SMALL LOAN LAWS: BASED ON THE SIXTH DRAFT OF THE UNIFORM SMALL LOAN LAW 54 (1938) (publication of Russell Sage Foundation) (criticizing "tendency for excessive competition to increase costs of lending")*; see also* Anne Fleming, *Anti-Competition Regulation*, 93 BUS. HIST. REV. 701, 702–03 (2019).

[15] CFPB TASKFORCE REPORT, *supra* note 3, at 558–84.

[16] Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

competitive terms.[17] The 1964 codification of the Washington, DC consumer credit code defined as "usury" any verbal contract to pay an interest rate greater than 6 percent per year or a written contract at greater than 8 percent per annum.[18] As a result, Ms. Williams and many others like her, were dependent on retailers to provide them credit to be able to by household goods and appliances. And while "ghetto" retailers also were limited in the interest rates they could charge, they could evade those limits by simply marking up the price of the goods they sold, thereby burying the cost of credit in the price of the goods. Needless to say, however, this practice made credit pricing much less transparent and increased the opportunities for discrimination. The growing frustration of minority urban populations with the perceived predatory practices of so-called "ghetto" retailers has been identified as one of the underlying causes of the urban unrest and riots of the late-1960s.[19]

As was the case half a century before, usury ceilings were supported by a coalition of Baptists (elite, self-proclaimed consumer advocates) and Bootleggers (organized crime and other loan sharks) who benefited under the prevailing system. As Economics Nobel Laureate Paul Samuelson observed in 1969: "For fifty years the Russell Sage Foundation and others have demonstrated that setting too low ceilings on small loan interest rates will result in drying up legitimate funds to the poor who need it most and will send them into the hands of the illegal loan sharks. History is replete with cases where loan sharks have lobbied in legislatures for unrealistic minimum rates, knowing that such meaningless ceilings would permit them to charge much higher rates."[20] Similarly, in 1964 New York's Senator-elect Robert F. Kennedy urged the state legislature (which was investigating organized crime operations in the state) that the most effective way of reducing the influence of organized crime would be to "alter[]the state laws on usury so an insolvent

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17 *See* REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 180 (Dec. 1972) (noting that there were no small loan companies operating in Harlem or the District of Columbia at that time as a result of excessively low interest rate ceilings and other legal barriers to entry); *see also* CFPB TASKFORCE REPORT, *supra* note 3, at 565. I have not been able to determine whether the Washington, D.C., regulatory code at the time also placed formal barriers to entry such as Certificate of Convenience and Necessity requirements. Professor Duncan Kennedy recently responded to law and economics criticisms of the *Williams* decision by arguing that inner-city credit markets were "oligopolistic" at the time of *Williams*, yet he fails to acknowledge that the lack of competition was the result of the District's harmful consumer finance regulation that made competition by small-loan lenders infeasible. *See* Duncan Kennedy, *The Bitter Ironies of* Williams v. Walker-Thomas Furniture Co. *in the First Year Law School Curriculum*, 71 BUFFALO L. REV. 225, 250–54 (2023). Anne Fleming's in-depth analysis of *Williams*, on which Kennedy relies extensively, is likewise silent on this reality. *See generally* Anne Fleming, *The Rise and Fall of Unconscionability as the "Law of the Poor,"* 102 GEO. L.J. 1413 (2014).

18 *See* 78 Stat. 676, Pub. L. 88-509, Subtitle II, Chapter 33—Interest and Usury, Usury Defined §28-3303 (Aug. 30, 1964).

19 *See* LOUIS HYMAN, DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK 150–51 (2012).

20 Paul Samuelson, Testimony Before the Massachusetts State Legislature Judiciary Committee on the Uniform Consumer Credit Code 164 (Jan. 29, 1969).

person who needs money for legitimate purposes might borrow it at rates that were not exorbitant" rather than being forced to turn to the mafia for funds.[21]

These two factors—the resurgence of loan sharking and the persistent poverty and economic distress of American cities—combined with four other factors to create an environment ripe for reform of the consumer financial system. First, the growing economic power of American women and their entry into the workforce in the 1970s created a push to reform traditional practices by banks that discriminated against married women in the granting of credit.[22] In particular, the emergence of the feminist movement, led by professional women with economic and social power, pushed for regulatory reform. Second was the rise of comprehensive credit bureau reporting and—even more important—the development of "credit scoring" models, such as Fair-Isaac (FICO) that enabled a more objective assessment of a borrower's credit-worthiness than the subjective (and often discriminatory) systems of the past. Third was a general wave of regulatory reform designed to sweep away many of the old restrictions on competition that dated to the Progressive Era and New Deal and to replace it with a more competitive market framework, a development from which banking regulation would not be spared.[23] Finally, and perhaps most important, was the rise of a *national* consumer finance system that produced a need for a greater national consumer financial regulatory framework.

At the same time, it is important to recognize that, for leading thinkers of the age, these factors were intertwined—for example, it was recognized that a major cause of the persistent patterns of improper discrimination in lending markets was the presence of usury ceilings and other regulations that dampened competition and thereby enabled discrimination to occur without economic penalty.[24] Moreover, the primary means for which reformers advocated to increase competition and consumer access to credit and reduce discrimination was the increased reliance on nondiscriminatory means of

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21 *Inquiry Is Begun on Loan Sharks: Underworld's Investment in Racket is Put at Billion*, N. Y. TIMES at 1 (Dec. 2, 1964) (describing letter from Senator Robert F. Kennedy to New York State Investigations Commission that recommended raising usury ceilings so that borrowers would not have to turn to loan sharks).

22 There is little evidence that banks discriminated against single women. But when women married their credit histories were merged into their husbands'. This was problematic in its own right, of course, but created even greater problems if the couple was later divorced, which was a growing social phenomenon at the time. *See* discussion in HYMAN, *supra* note 19, at 163–74.

23 These developments culminated in the Riegle-Neal Act that led to the elimination of restrictions on interstate branch banking.

24 For example, one notable study found that following banking deregulation, more women became executives at banks than prior, and overall salaries of bank officials declined, consistent with the hypothesis that anti-competitive banking regulation enabled discrimination and inefficiency by banks. Sandra E. Black & Philip E. Strahan, *The Division of Spoils: Rent-Sharing and Discrimination in a Regulated Industry*, 91 AM. ECON. REV. 814, 816 (2001).

assessing creditworthiness, such as credit scores, rather than the old subjective means.

With respect to consumer financial regulation, of particular relevance is the growth of a national consumer credit economy. This was in large part technological—the declining cost of long-distance telephone calls increasingly made it easier to offer credit and to collect on debts across interstate lines and limited the abilities of state and local enforcement. As a result, one of the first areas of federal regulation involved regulations on debt collection, such as the Fair Debt Collections Practices Act and related regulations. In addition, many traditional local department stores and retailers were displaced by large national department store chains such as Sears, JC Penney's, and Woolworths. These large department store chains eventually developed centralized credit processing and collections facilities supporting outlets across the country, further creating a more national market for credit.

Most significant in driving the demand for consumer credit was the great migration of Americans to the suburbs in the post-World War II era.[25] This migration was fueled by the use of consumer credit. Most obvious, the home ownership rate exploded, as consumers moved from rented housing in the city to new, mortgage-financed homes in the suburbs. But that was just the beginning. Relocating to the suburb required purchasing a car—usually with a car loan (and then later, a second car)—along with a bedroom set, dining room furniture, and modern appliances such as a refrigerator, stove, and washing machine. Needless to say, all of these accessories were bought "on time," usually through either a finance company loan or directly through credit extended by the retailer. Use of consumer credit grew rapidly and concomitantly with home ownership rates and the migration to the suburbs as consumers "financed the American Dream."[26] Indeed, available data indicates that the overall level of household non-mortgage debt relative to income or assets has remained more or less steady since the 1960s but has simply changed composition as revolving credit card debt has over time supplanted credit supplied by retailers and personal finance companies.[27]

Just as the Russell-Sage Foundation catalyzed research and advocacy in the 1920s for reform, the National Commission on Consumer Finance (NCCF) served a similar role. Originally created by President Lyndon Johnson and inherited by Richard Nixon, the NCCF was a bipartisan, blue-ribbon

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25 *See* Todd Zywicki, *Your Credit History (the Accurate Version)*, L. & LIBERTY (Oct. 20, 2014), https://lawliberty.org/your-credit-history-the-accurate-version/.

26 To borrow the title from Lendol Calder's marvelous book on consumer credit in America. LENDOL CALDER, FINANCING THE AMERICAN DREAM (2001).

27 *See* DURKIN, *supra* note 1, at 86–87. Thus, it is simply false to claim as then-Professor Elizabeth Warren did, that prior to the 1980s and widespread access to credit cards, consumers preferred to save up and "pay cash" for purchases. *See Interview with Elizabeth Warren*, *Secret History of the Credit Card*, FRONTLINE (No. 23, 2004), https://www.pbs.org/wgbh/pages/frontline/shows/credit/interviews/warren.html. Similarly, and more importantly, the current debt ratio has remained more or less constant since the 1980s and reflects this same substitution. But for the massive increase in student loan debt, the consumer debt ratio for the typical household would be significantly lower today than forty years ago.

commission tasked with studying and modernizing the consumer financial protection laws and regulations to meet these challenges of the modern era. The NCCF Report was withering with respect to economically archaic ideas such as usury ceilings and paternalistic notions of consumer financial regulation. Instead they called for a system based on consumer sovereignty, competition, choice, and disclosure-based regulation designed to promote competition and consumer choice. Indeed, the NCCF went so far as to call for national preemption of state usury laws and the creation of a national charter for personal finance companies that could lend to consumers without the interference of state usury laws and other anti-competitive laws.

The NCCF both captured and accelerated the intellectual and policy zeitgeist of the era, producing a wave of deregulation and regulatory reforms designed to promote competition and consumer choice. Moreover, it promoted financial inclusion, both through the adoption of pro-competitive reforms (such as the greater use of systems like credit scoring in granting credit) as well as the elimination of anti-competitive barriers such as usury restrictions and limits on branch banking that blocked inclusion and created conditions favorable to discriminatory practices. Although the NCCF failed to gain federal preemption of usury ceilings or the recognition of a personal finance company national bank charter, this was largely obviated by the Supreme Court's unanimous decision in *Marquette National Bank v. Bank of Omaha*[28] in 1978, which effectively deregulated credit card interest rates (initially) but which later led to a more general deregulation of interest rates (and later other terms and conditions) of other consumer financial products offered across state lines by banks.

The result of the regulatory framework ushered in by the legislative, regulatory, and judicial reforms of the 1970s were hugely beneficial to American households. Loan sharking largely declined and competitive forces led to an explosion in consumer access to high-quality financial services such as credit cards, auto loans, and the like. The replacement of checks and cash by debit cards and other electronic payments systems led to an unprecedented growth of access to bank accounts and later, ancillary services such as automated overdraft protection, which traditionally had been limited to a select few. While challenges remained, in terms of inclusion and access, as well as legacy effects of discriminatory federal policies in the past, the framework established in the 1970s grounded in competition, choice, and a minimum of substantive regulation created a framework for an innovative and high-quality financial system that served most consumers well. Moreover, middle-class consumers were particular beneficiaries of this system, having access to a wide array of credit and banking services on competitive and transparent terms that enables us to shop, travel, and otherwise live life easily and seamlessly.

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[28] 439 U.S. 299 (1978).

III. THE 2008 CRISIS AND THE FUTURE OF CONSUMER FINANCIAL REGULATION

To summarize the argument so far, prior to the late-19th century the American economy was largely agricultural and the average American's need for consumer credit was limited. During this period, usury ceilings were widespread under archaic and paternalistic theories supported by elites that sought to limit access to credit for ordinary people. At the same time, by restricting the ability to lend to ordinary workers, these rules essentially subsidized borrowing by elites who held land and other collateral to support their loans and who possessed the personal connections and reputation to be able to gain access to loans. The growth of American cities and the wage economy in the late-19th century produced the pre-modern era of consumer credit. The migration of farm workers and immigrants into the city created a need for credit among wage-earners that ran up against these archaic restrictions on lending, depriving wage earners of access to finance and driving them to loan sharks.

This led to the movement for reform spearheaded by the Russell-Sage Foundation in the 1920s, an effort that culminated in the adoption of the Uniform Small Loan Law, which increased permissible interest rate ceilings and promoted competition as the most effective way to empower and protect consumers. Following the Great Depression, however, many states began to ratchet down usury ceilings again and to adopt other anti-competitive regulatory schemes. These rules proved punishing to lower-income Americans, especially urban minorities. Middle Class Americans, however, were undertaking the great migration to the suburbs during this era, fueling a demand for consumer credit to purchase and establish their new households. This led to much-needed reforms to address the new challenges presented by the growth of an increasingly national consumer finance economy. Technological developments, including a declining cost of long-distance telephone service as well as computerized credit scoring systems, led to an explosion of competition and a growing need for federal regulation.

This brings us at last to the current and future era of consumer financial regulation. What lessons can we learn about the future from what has come before?

Most obvious, just as technology changed consumer finance in the mid-20th century, technology is once again fundamentally transforming consumer finance today. The rise of the Internet has not only moved us to a world of *national* consumer finance markets (as was the case at the time of the NCCF Report) but what amounts to a global, or effectively, "nowhere" model of consumer finance. Ubiquitous use of the Internet to solicit and provide financial services, disclosures delivered on smartphones and attested by electronic signatures, and the ability to instantaneously shop and compare competing offers for provision of services, all challenge the 1970s model of paper-based disclosures and shopping. New underwriting models using "Big Data" that

go beyond traditional credit-scoring models raise new opportunities for inclusion of traditionally-excluded populations but also raise new concerns about consumer privacy and the like. Finally, the growing dominance of electronic payments and online shopping raise new concerns about data security and use of consumer data beyond traditional concerns.

In my opinion, the fundamental goal of consumer financial regulation going forward should be to promote greater consumer inclusion among traditionally underserved Americans. The modern consumer financial system works quite well for the typical middle class and upper-middle class family. By and large, most middle-class Americans have easy, ample, and competitive access to most of the financial products they need to make their lives work—bank accounts, mortgages, car loans, credit cards, etc. Although far from perfect (what is?), by and large, middle class people fare well in the modern economy. If they are dissatisfied with a particular provider, they find it relatively easy to switch and find another company.

Sadly, this wide variety of choice in a competitive market free from burdensome government regulation is not the case for many lower-income Americans. Promoting greater financial inclusion will have two elements: first, continuing to clear away legal and regulatory barriers that interfere with this goal today and, second, adopting policies that will promote innovation, competition, and inclusion.

First, and most important, it is imperative to eliminate the many regulatory barriers that currently stand in the way of greater inclusion of underserved populations. Most notably, the Dodd-Frank Financial Reform legislation included a number of provisions that haven proven harmful to lower-income Americans. Most notable, of course, was the so-called "Durbin Amendment" that imposed price controls on debit card interchange fees and other regulatory restrictions on debit card markets. The impact of these mandates has been well-documented: a dramatic decrease in free checking (especially for lower-income consumers) and a dramatic increase in monthly maintenance fees.[29] This whipsaw has led to many lower-income consumers losing access to bank accounts or never acquiring one in the first place. Astonishingly, Congress is now seriously considering extending the Durbin Amendment to credit card routing, which would have a similar detrimental effect with respect to credit card access and pricing.

Also extremely problematic for low-income consumers has been the effects of the Credit CARD Act of 2009, which placed new limits on the ability of credit card issuers to engage in risk-based pricing, which has led to higher costs and reduced access for many consumers, but especially relatively higher-risk borrowers. Provisions that limit the access of college students to credit cards have also disparately impacted lower-income consumers and interfered with their ability to gain access to credit cards. Because credit cards

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[29] *See* Julian Morris, Todd J. Zywicki & Geoffrey A. Manne, *The Effects of Price Controls on Payment-Card Interchange Fees: A Review and Update*, ICLE WHITE PAPER 2022-03-04, at 33 (Mar. 23, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4063914.

are for many people the first step on establishing a credit file, this delay in the ability of lower-income consumers to gain access to credit cards has the follow-on effect of delaying their ability to develop a credit file, which puts them years behind their higher-income peers in establishing a credit record.

Regulators should also investigate more carefully the potential impact of anti-money laundering and other similar regulations on financial inclusion. Anecdotal conversations with industry experts suggest that banks may be deterred from dealing with certain customers, especially immigrants from certain countries, simply to avoid the cost and risk of AML and other regulations. While that may be worth it for wealthier and higher-income accounts, the cost may be disproportionate to the benefits for dealing with lower-income customers.

The entire system of consumer disclosures and how consumers process information must be updated to deal with the realities of the modern technological world. Today, consumers are buried in disclosures that fail to distinguish in any way between what is truly relevant to the consumer in deciding whether to use a product or service and what is not.[30] Moreover, mandated disclosures often require what I have deemed "normative disclosure"—disclosure of information that regulators think consumers *should* care about, rather than what they actually *do* care about—that distracts consumers and leads them to focus on information that is not relevant to their decision.[31]

Except in rare instances, disclosures should be focused on those terms and conditions that are most useful and relevant to consumers when shopping for a product.[32] There is a cost in terms of time and attention for every disclosure a consumer is forced to consider, and other purposes of disclosures should be set aside or provided at a different time of a transaction when actually relevant. Moreover, regulators should also be aware of the limits of disclosure as a device for consumer protection—given the transaction costs associated with both provision of disclosures and its processing by consumers, some modest substantive regulation of terms and conditions (perhaps subject to modification by consumers) may be appropriate in some conditions. The theory is consistent with standard law and economics analysis that suggests tort-type approaches may be appropriate in certain circumstances where transaction costs are high or the costs of one party of avoiding a harm are disproportionately high relative to the other party.

With respect to disclosures, it is also imperative that disclosure requirements be updated to reflect the realities of modern screens and other ways in which consumers access information. For example, rather than starting with a list of everything that a regulator thinks should be disclosed in an ideal world and then mandating it, perhaps regulators should begin with a

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[30] *See* OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 7–9 (2014).

[31] *See* Todd Zywicki, *The Market for Information and Credit Card Regulation*, 28 BANKING & FIN. SERV. POL'Y REPORT 13, 15 (2009).

[32] *See* CFPB TASKFORCE REPORT, *supra* note 3, at ch. 7.

consideration of how much time an average consumer is willing to spend reading and digesting information in disclosures and then require a prioritization of disclosures that will fit within that time.

Bad economics also threatens the future development of the consumer financial system. Junk economic analysis promoted by "Behavioral Economics" is increasingly being pushed to promote new schemes, and to resuscitate old schemes, that effectively amount to little more than the same warmed-over paternalism that proved so disastrous for some any consumers for so many generations. Indeed—astonishingly—proposals to reinstate usury ceilings on credit cards and other types of consumer loans are being discussed once again.[33] I am not aware of any fundamental changes in the law of supply and demand that would suggest that these laws will prove any less harmful to consumers than prior efforts with similar regulations.

Although technological evolution promises great potential for innovation in consumer financial services, it also presents novel threats from both private and public sources. The challenge of protecting one's private financial and personal information from hackers and thieves is profound and will require ongoing innovation to respond to new digital threats.

More important than private threats, however, is the increasingly aggressive and predatory set of government regulators and private financial services providers who increasingly view the financial regulatory tool as a means to accomplish other social and political goals, such as controlling speech or other behaviors, shaping consumption habits, or promoting wealth redistribution. Consider each in turn.

First, the past decade has seen an increasing tendency for government regulators to control speech and other behaviors through the use of the financial system. This practice took hold during the Obama Administration through its nefarious "Operation Choke Point" initiative that targeted legal industries (such a payday loans) as well as providers of constitutionally-protected products such as "racist materials" and firearms and ammunition dealers.[34] Although that initiative was finally rolled up after being attacked through litigation, in recent years it appears that a similar initiative has been underway to "debank" individuals and groups on the basis of their political speech.[35] The use of financial sanctions against the Canadian Truckers to crush their anti-vaccine mandate protests provides a warning as to how financial regulators can use the finance system to crush free speech, freedom

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33 *See* Todd Zywicki, *The Sanders-AOC Protection for Loan Sharks Act*, REAL CLEAR POL'Y (June 2, 2019); https://www.cato.org/commentary/sanders-aoc-protection-loan-sharks-act; *Hawley Introduces New Legislation to Cap Credit Card Interest Rates and Provide Relief to Working Americans*, SEN. JOSH HAWLEY (Sept. 12, 2023), https://www.hawley.senate.gov/hawley-introduces-new-legislation-cap-credit-card-interest-rates-and-provide-relief-working.

34 *See* Norbert Michel, *Newly Unsealed Documents Show Top FDIC Officials Running Operation Choke Point*, FORBES (Nov. 5, 2018), https://www.forbes.com/sites/norbertmichel/2018/11/05/newly-unsealed-documents-show-top-fdic-officials-running-operation-choke-point/?sh=2fa131af1191.

35 *See* Todd Zywicki, *Cancel Culture Comes to Banking*, NEWSWEEK (Jan. 13, 2022).

of association, and other constitutional rights.[36] Congress should act to prohibit this practice to protect individuals, nonprofit groups, and businesses from discrimination based on their political views.[37]

More alarming are proposals for the adoption of a Central Bank Digital Currency, which would present even greater opportunities for government officials to target individuals based on their speech or other activity or to control consumer decisions. Congress should prohibit the Federal Reserve or any other agency from issuing Central Bank Digital Currencies.

Finally, it is evident that left-wing politicians and activist groups increasingly are looking at the consumer financial system as tool for wealth redistribution, especially in pursuit of racial and other "equity" goals. This includes proposals to tinker with the credit reporting system or even to establish a government monopoly credit-reporting system that will enable regulators to eliminate disparities in credit scores among different racial groups.[38]

History has taught fundamental lessons of consumer finance and financial regulation that must be heeded in the future—consumer finance and consumer financial regulation have co-evolved in a spontaneous evolutionary development. Trying to redirect the patterns of consumer finance into directions preferred by regulators, rather than consumers, has proven to be a self-defeating process that ends up harming the most vulnerable consumers and those the laws are ostensibly intended to help. I fear that instead of heeding these lessons, we are again repeating the same mistakes of the past and pretending like somehow this time the results will turn out differently. They won't.

In his Nobel lecture, the great economist Friedrich Hayek provided an admonition to government planners of all stripes, warning them that in trying to shape the evolutionary and economic patterns in a beneficial manner, policy-makers should not try to "shape the results as the craftsman shapes his handiwork" but to "cultivate a growth by providing the appropriate environment, in the manner in which the gardener does this for plants."[39] Hardly a better guide could be provided to those looking to shape the future growth of the consumer financial system in the decades to come.

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36 In one poll, an alarming 65.7% of American Democrats approved of the actions taken by Canadian Prime Minister Justin Trudeau against the protesting truckers while only 17.2% disapproved. *See Nationwide Issues Survey,* THE TRAFALGAR GROUP, (Feb. 2022), https://www.thetrafalgargroup.org/wp-content/uploads/2022/02/COSA-Trudeau-Truckers-Poll-Report-0221.pdf.

37 *See* DEP'T OF THE TREASURY, OFF. OF THE COMPTROLLER OF THE CURRENCY, FAIR ACCESS TO FIN. SERVS., 12 CFR Part 55 (Jan. 14, 2021), https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-8a.pdf.

38 *See, e.g.*, Todd Zywicki, *A Government Credit-Rating Monopoly?* 45 REGUL. 22 (Spring 2022).

39 Hayek, *supra* note 2, at 7.