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### **Behavioral Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions, 22 Emory Bankr. Dev. J. 13 (2005)**

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## ARTICLES

### BEHAVIORAL ECONOMICS, OVERINDEBTEDNESS & COMPARATIVE CONSUMER BANKRUPTCY: SEARCHING FOR CAUSES AND EVALUATING SOLUTIONS

Jason J. Kilborn\*

Which do you believe are more common in English: words ending in “-ing” or words in which the next-to-last letter is “n”? How about words beginning with the letter “r” or words in which the letter “r” is the third letter? If you are like most people,<sup>1</sup> you responded that “-ing” words and those that begin with “r” are more common—although the other answer is correct for both questions.<sup>2</sup> Scientists who study behavior, particularly decision making, propose that people *systematically* and *consistently* tend to answer these types of questions incorrectly because they are relying on a mental shortcut called “availability.”<sup>3</sup> That is, since it is easier for people to recall words that end in “-ing” or begin with “r,” they erroneously conclude such words are more common than words in which “n” is the second to last letter<sup>4</sup> or words in which the third letter is “r.” Difficult probabilistic questions like these are so taxing that human minds develop short cuts—or “heuristics”—to ease the task.<sup>5</sup> These shortcuts are fine when the questions are relatively inconsequential. These shortcuts, however, raise cause for concern with weightier questions.

Take for example the following: Do you believe that you are more or less likely than the average person to be victimized by crime, stricken with a

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<sup>1</sup> Of course, by “people,” I mean people who speak English. I suspect that examples could be offered of similar “mind tricks” in other languages, however, because the heuristic described seems inherent to human cognition.

<sup>2</sup> These examples and their behavioral implications are described in Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 663 & n.141 (1999).

<sup>3</sup> See *id.*

<sup>4</sup> Notice this *cannot* be true, because *all* words ending in “-ing” also fall into this category.

<sup>5</sup> See generally Hanson & Kysar, *supra* note 2.

serious disease, involuntarily unemployed, or injured in a car accident? In behavioral experiments, more people than logically possible generally suggest they are less likely than the average person to suffer from such negative events.<sup>6</sup> Behavioral scientists ascribe this systematic underestimation of the probability of negative events to self-serving biases of overconfidence present in most individuals.<sup>7</sup> These and many other behavioral findings underlie a modified form of economic analysis of law called “behavioral economics.”<sup>8</sup> This new analytical approach holds exciting predictive and prescriptive potential in a wide range of areas, particularly in fields involving economic risk analysis and behavior modification—such as consumer debt and bankruptcy.

A consensus seems to be developing among societies in Western Europe and in the United States, among others, on the desirability of consumer credit and the resulting necessity of treating the social ills associated with excessive consumer debt. More and more, consumer credit has come to be regarded positively as empowering consumers to make better lives for themselves by leveraging future earning potential. If consumer credit is no longer restricted, it is not possible to eliminate overindebtedness and the social problems it causes. Consumers find themselves financially overextended both as a result of their own poor planning and as a result of external factors, such as job loss, medical problems, and divorce.<sup>9</sup> Thus, more and more countries seem to have agreed on the general notion that “overindebtedness” should be prevented to the extent possible.<sup>10</sup> But if overindebtedness cannot be prevented, it should at least be treated. Western society seems largely to have abandoned *ex ante*

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<sup>6</sup> See, e.g., *id.* at 656.

<sup>7</sup> See, e.g., *id.*

<sup>8</sup> See, e.g., *id.*

<sup>9</sup> See generally, TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 178 (1989).

<sup>10</sup> For a discussion of some of these new systems, see CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE (Johanna Niemi-Kiesiläinen et al. eds., 2003). See also Jason Kilborn, *Continuity, Change, and Innovation in Emerging Consumer Bankruptcy Systems: Belgium and Luxembourg*, 14 AM. BANKR. INST. L. REV. [hereinafter Kilborn, *Belgium & Luxembourg*] (forthcoming 2006); Jason Kilborn, *The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the New U.S. Law from Unexpected Parallels in the Netherlands*, 39 VAND. J. TRANSNAT'L L. (forthcoming 2006); Jason Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States*, 24 NW. J. INT'L LAW & BUS. 257 (2004) [hereinafter Kilborn, *German Approach*]; Jason Kilborn, *La Responsabilisation de l'Economie: What the United States Can Learn from the New French Law on Consumer Overindebtedness*, 26 MICH. J. INT'L L. 619 (2005) [hereinafter Kilborn, *French Law*]; Johanna Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?*, 37 OSGOOD HALL L.J. 473 (1999) [hereinafter Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*].

restriction of the supply of consumer credit in favor of *ex post* treatment of the problems of overindebtedness through legal consumer debt relief.<sup>11</sup>

The question today is whether a consumer debt relief system can help in *preventing* excessive consumer borrowing, and if so, which types of systems are best suited to changing incentives and inculcating responsible borrowing habits. In Part I, I join commentators<sup>12</sup> in arguing behavioral economics can explain some of the reasons why consumers get themselves into trouble despite the obvious dangers of borrowing and overspending.<sup>13</sup> I therefore propose in Part II that we should look to behavioral economics to assess whether the consumer bankruptcy system might affect incentives and attitudes to reduce overindebtedness problems *before* they arise.<sup>14</sup> This Part concludes legal regulation appears virtually powerless to affect the demand side of the consumer credit equation. To the limited extent consumer bankruptcy might reduce overly risky borrowing, I argue in Part III that behavioral economics indicates some models of consumer debt relief are likely to be more effective than others in achieving this goal.<sup>15</sup> Part IV applies several behavioral insights to a number of emerging consumer debt relief systems in Continental Europe.<sup>16</sup> It suggests aspects of certain systems are better suited than others for educating debtors on personal responsibility and inculcating payment morality—the stated goals of these new systems.

To be completely clear at the outset, I do not intend to advance “strong” conclusions about consumer bankruptcy based on behavioral economics in this Article. For one thing, it is not entirely clear the results of behavioral studies<sup>17</sup> conducted on U.S. subjects would produce similar results if conducted on Western Europeans—much less members of other cultures. I strongly believe, however, the behavioral patterns discussed in this Article are, if not universal, at least shared to a significant degree. Thus, I offer for further consideration what I consider to be compelling insights from behavioral economics on the potential role of consumer bankruptcy in preventing and treating the problems

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<sup>11</sup> See Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?*, 44 SANTA CLARA L. REV. 1065, 1068–69 (2004).

<sup>12</sup> See, e.g., Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004).

<sup>13</sup> See *infra* Part I.

<sup>14</sup> See *infra* Part II.

<sup>15</sup> See *infra* Part III.

<sup>16</sup> See *infra* Part IV.

<sup>17</sup> Due to space constraints, I will not analyze the many fascinating experiments that led to the behavioral conclusions discussed here. I will, however, cite sources that describe these experiments in some detail.

associated with consumer overindebtedness—virtually wherever in the world they might arise.

### I. THE BEHAVIORAL ECONOMICS OF “EXCESSIVE” CONSUMER BORROWING

The United States and Europe set out slowly on the path to consumer overindebtedness in the early 1900s with the rise of installment selling. Lendol Calder’s description of the U.S. credit system at the turn of the twentieth century applies in like manner to Europe: “people who had money could easily borrow more, while people without money found it difficult to borrow at all.”<sup>18</sup> In the first quarter of the 1900s, though, an overhaul of usury laws and the rise of installment selling of consumer goods made “consumer credit” an acceptable concept economically and eventually socially in the United States.<sup>19</sup> In Europe, consumer credit restrictions slowed the tide of consumer lending that rose in the United States after World War II.<sup>20</sup>

The pace of consumer credit expansion accelerated explosively in the late 1970s and early 1980s with the “democratization” of credit in both Europe and the United States. The U.S. Supreme Court all but abolished effective regulation of consumer lending with its 1978 decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*<sup>21</sup> European states followed suit as parliaments “liberalized” consumer credit regulations in the 1980s.<sup>22</sup> Consumers were now left largely to their own devices in choosing whether and to what extent to take on debt. Opening up the consumer credit market introduced a frenzy of competition among the purveyors of this highly profitable “product.”<sup>23</sup> Intense competitive pressures forced lenders to advertise and structure their products in a manner that would take advantage (consciously or unconsciously) of powerful competitive forces—the psychological biases and weaknesses of their customers.<sup>24</sup>

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<sup>18</sup> LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 124 (1999); see also, e.g., Hervé Jaouen, *Quelques transformations d’attitude et de pratiques chez les banquiers de 1965 à 1995*, in LE SURENDETTEMENT DES PARTICULIERS 213–16 (Michel Gardaz ed., 1997).

<sup>19</sup> See CALDER, *supra* note 18, at 124–203.

<sup>20</sup> See, e.g., Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 480.

<sup>21</sup> 439 U.S. 299 (1978); see also Braucher, *supra* note 11, at 1074.

<sup>22</sup> See, e.g., Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 480–82.

<sup>23</sup> See, e.g., David A. Lander, “It ‘is’ the Best of Times, It ‘is’ the Worst of Times”: A Short Essay on Consumer Bankruptcy After the Revolution, 78 AM. BANKR. L.J. 201, 202 (2004).

<sup>24</sup> See, e.g., Bar-Gill, *supra* note 12, at 1373.

Just as lawmakers were throwing consumers into the shark-infested ocean of new borrowing opportunities, cognitive psychologists and behavioral researchers were uncovering systematic hindrances to consumers' attempts to swim in this ocean.<sup>25</sup> These behavioral scientists revealed compelling evidence of cognitive illusions ("biases") and mental shortcuts ("heuristics") that systematically and predictably skew individuals' analysis of probabilities, choices, and behavior in ways inconsistent with logic and welfare maximization.<sup>26</sup>

The behavioralists do *not* claim people act "irrationally," but rather people act in ways that systematically and predictably diverge from the "rational choice" model of traditional economic analysis.<sup>27</sup> People thus inadvertently fail to maximize their own future utility not because they are irrational, but because their rationality is "bounded" by documented and consistent biases and mental shortcuts. These "bounds" of rationality affect behavior in a variety of contexts, particularly contexts involving many complex variables and ambiguous, unpredictable consequences of any given choice—like consumer borrowing.<sup>28</sup>

Scholars in a variety of legal areas have rushed to this new analytical vehicle to explain or support their predictions and prescriptions.<sup>29</sup> Thomas Jackson's landmark analysis of bankruptcy policy led the way in behavioral economic analysis of bankruptcy law.<sup>30</sup> Very little work since then has applied behavioral economic insights to consumer overindebtedness and consumer bankruptcy.<sup>31</sup> But then the discipline is quite new. As one behavioralist scholar observed in 1998, "[w]e are at the beginning of behavioral law and economics."<sup>32</sup>

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<sup>25</sup> See Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499, 1501 (1998) (dating the beginning of the new discipline of "behavioral decision theory" to the late 1970s and early 1980s).

<sup>26</sup> For two seminal pieces in this burgeoning field, see Hanson & Kysar, *supra* note 2, and Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

<sup>27</sup> See, e.g., Hanson & Kysar, *supra* note 2; Jolls et al., *supra* note 26.

<sup>28</sup> See, e.g., Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1076–84 (2000).

<sup>29</sup> See, e.g., Langevoort, *supra* note 25, at 1501.

<sup>30</sup> See generally THOMAS JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986); Thomas H. Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985).

<sup>31</sup> But see Saul Schwartz's excellent discussion in *Personal Bankruptcy Law: A Behavioral Perspective*, in CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 61, 62–67 (Johanna Niemi-Kiesiläinen et al. eds., 2003); see also Bar-Gill, *supra* note 12.

<sup>32</sup> Thomas S. Ulen, *The Growing Pains of Behavioral Law and Economics*, 51 VAND. L. REV. 1747, 1747 (1998).

Behavioral economics offers compelling insights into the tendency of consumers to accumulate “too much” debt when freed from the constraints of legal credit restrictions. Many behavioral insights are not particularly relevant to an analysis of consumer overindebtedness and its “treatment,” however, several are astonishingly apt. For example, behavioral findings suggest consumers suffer from consistent overconfidence, they systematically gauge risk inaccurately based on information readily “available” to them from memory, and they succumb to “bounded willpower” by severely underestimating future costs and overvaluing present benefits.<sup>33</sup> Thus, behavioral economics offers compelling explanations for why consumers so often underestimate the possibility they will be unable to meet their future credit obligations with future income and why they so often fall prey to the powerful siren song of present benefits while all but ignoring future costs. If the supply side of consumer credit is unconstrained, behavioral economics reveals powerful forces render control of the demand side virtually impossible.

#### A. *The Overconfidence Bias*

Individuals tend to be overly optimistic and overconfident regarding their own susceptibility to risk.<sup>34</sup> Specifically, people systematically underestimate their own chances of suffering an adverse event, even if they understand perfectly well or even overstate the probability of others suffering the same fate (“It can’t happen to me.”).<sup>35</sup> People of all social categories are prone to overconfidence in their own judgment and susceptibility to risk, even those who are more informed about the actual statistical probability of adverse events.<sup>36</sup> This overconfidence bias is exacerbated by the “illusion of control,” which leads individuals to overestimate their ability to avoid negative events by controlling their own behavior (“I’ll never have a car accident—I’m a good driver.”).<sup>37</sup>

The overconfidence bias figures prominently in the history of consumer credit in the United States. Lendol Calder explains, as U.S. consumers after World War II took on more and more debt, “liv[ing] beyond their income but not beyond their credit,” they palliated their anxiety with “the optimistic conviction that . . . ‘we’ll make it somehow. Things will always be better—

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<sup>33</sup> See *infra* Part I.A-C.

<sup>34</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 654–62.

<sup>35</sup> See, e.g., *id.*

<sup>36</sup> See, e.g., Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1188–89 (1997).

<sup>37</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 658–59; Korobkin & Ulen, *supra* note 28, at 1092.

maybe a lot better.”<sup>38</sup> Robert Manning suggests optimistic economic projections by the Reagan and Bush administrations led many consumers to use more and more credit to achieve lifestyles commensurate with better days that surely lay ahead.<sup>39</sup> “It can’t happen to me” overconfidence bias eventually led more and more consumers to underestimate the likelihood they would fall victim to a simple mismatch between present borrowing and future income or to an unexpected liquidity crisis.<sup>40</sup> Moreover, laboring under the illusion of control, consumers budgeted—some more carefully than others—enhancing their feeling of control over their financial futures and invincibility to future financial crisis.<sup>41</sup> Given the complexities of interest rate calculations and the vagaries of a family budget, it is not difficult to see how overconfidence has lured many a consumer too close to the edge of financial stability. Real “control” over our financial futures is elusive, indeed, and much more so for some than for others.

### B. *The Availability Heuristic*

In studying how individuals use mental shortcuts to simplify predictions of the likelihood of future events—particularly negative events—“researchers have uncovered a veritable fool’s gold mine of nonrational cognitive anomalies.”<sup>42</sup> For example, researchers have shown individuals most often tend to assess the likelihood of a future event based on how easily similar events can be recalled, in other words, how “available” such an event is.<sup>43</sup> Three factors especially influence the “availability” of a negative event: frequency, recency, and salience.<sup>44</sup> If a person has witnessed an event (or reports of an event) frequently or recently—such as recent media coverage of airplane or car accidents—that person will tend to overestimate the likelihood of a similar accident occurring in the future.<sup>45</sup> And if a person witnesses one particularly salient occurrence of a negative event—such as a particularly violent crash or a nuclear catastrophe—that vivid image will form a readily

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<sup>38</sup> CALDER, *supra* note 18, at 297.

<sup>39</sup> See ROBERT D. MANNING, CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA’S ADDICTION TO CREDIT 64–65 (2000) (noting credit card debt as a percentage of disposable income rose from 65.4% in 1980 to 83.5% in 1990).

<sup>40</sup> For an intriguing counterargument that overconfidence might cause consumers to borrow too little see Richard M. Hynes, *Overoptimism and Overborrowing*, 2004 BYU L. Rev. 127, 145–57 (2004).

<sup>41</sup> See, e.g., CALDER, *supra* note 18, at 297.

<sup>42</sup> Hanson & Kysar, *supra* note 2, at 662; see *id.* at 662–69.

<sup>43</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 662–64; Jolls et al., *supra* note 26, at 1477, 1518–19.

<sup>44</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 662–64; Jolls et al., *supra* note 26, at 1477, 1518–19.

<sup>45</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 662–64; Jolls et al., *supra* note 26, at 1477, 1518–19.



“available” basis for overestimation of the risk of similar incidents in the future.<sup>46</sup>

The converse is also true. That is, if instances of a negative event are infrequent or distant, or if a negative event or the factors that led to it are not salient, people will underestimate the likelihood of a similar future negative event.<sup>47</sup> For example, people discount the likelihood of cancer or lung disease because the risk of one cigarette at a time lacks salience. Indeed, given the underlying effects of the overconfidence bias, one would expect individuals to underestimate considerably the risk of *negative* events that are not “available.”

For most consumers, serious incidents of overindebtedness lack “availability,” so consumers understandably underestimate the risk of their own overborrowing. If consumers have not been exposed frequently or recently to a liquidity crisis or other potential financial problem, they are likely to underestimate the possibility of such a problem in the future. Even if consumers are bombarded with statistics about default rates and levels of bankruptcies among *others*, the sheer number and dry, impersonal nature of these statistics might rob them of salience. Just as people discount the likelihood of cancer or lung disease because the risk of one cigarette at a time lacks salience, consumers understandably discount the risks of small, incremental borrowing (especially using credit cards) leading to big financial trouble.<sup>48</sup>

Indeed, even if a default or other financial crisis has struck the consumer personally, the powerful overconfidence bias might well overcome even “available” negative events, leading consumers to distinguish and discount distant past negative events from future similar risks—after all, “it can’t

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<sup>46</sup> I believe the availability heuristic played an important role in the development of federal bankruptcy relief in the United States because our first national bankruptcy bill passed only after great numbers of particularly prominent debtors were imprisoned following the collapse of huge speculation schemes in the 1790s. See BRUCE H. MANN, *REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE* 114–16, 177, 180, 191–94, 203–04 (2002). Similarly, I believe the availability heuristic contributed significantly to the development of European consumer bankruptcy relief in the 1990s as consumers more and more frequently experienced financial distress due to financial overextension. Obviously, many factors were in play in both systems at both times, but the role of the availability heuristic in influencing legislation—at least its timing—can hardly be gainsaid. See, e.g., Jolls et al., *supra* note 26, at 1518–22 (suggesting environmental legislation is driven in part by media coverage of low-probability and otherwise low-profile risks).

<sup>47</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 662–64; Jolls et al., *supra* note 26, at 1477, 1518–19.

<sup>48</sup> See SULLIVAN ET AL., *supra* note 9 (observing “[d]ebtors who never dream of seeking a \$5,000 bank loan might run up \$5,000 in charges of \$50 at a time”).

happen to me.” Combining a lack of availability—particularly salience—with the overconfidence bias leads consumers to underestimate substantially financial risk.<sup>49</sup> The bias toward overconsumption of credit plagues consumers coming and going.

### C. *Hyperbolic Discounting and Bounded Willpower*

Confirming something most of us have witnessed in ourselves and others, behavioralists have amassed evidence that individuals systematically overvalue immediate benefits and costs and undervalue delayed benefits and costs.<sup>50</sup> In particular, present gratification tends to be highly *overvalued*, and future costs tend to be even more heavily *discounted*.<sup>51</sup> To use the scholarly jargon, individuals apply “hyperbolic discounting” to downplay future costs even more powerfully than future benefits as the costs and benefits move farther and farther into the future.<sup>52</sup> Ultimately, even if a cost might outweigh a benefit in the *present*, as that cost extends further into the future, the “hyperbolically” discounted perception of that future cost might ultimately fall below the less discounted perception of the future value of the benefit, thus reversing the balance between costs and benefits—and the ultimate decision whether to take a risk—over time.<sup>53</sup>

A closely related problem is the tendency of individuals to suffer from “bounded willpower.”<sup>54</sup> People often minimize the benefits and acknowledge the costs of risky *future* activity (e.g., smoking or eating fatty foods) and may decide to avoid such behavior while its benefits lie in the *future*.<sup>55</sup> But once the “moment of truth” arrives, the immediate (and now overvalued) *present* benefit of the risky activity outweighs the still distant (and still heavily discounted) future costs.<sup>56</sup> In many cases, this skewing of the relative weights of costs and benefits results in weakening or abandonment of the earlier willpower to forego that risky activity.<sup>57</sup>

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<sup>49</sup> See Jolls et al., *supra* note 26, at 1541–42.

<sup>50</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 678–80; Sunstein, *supra* note 36, at 1193–94.

<sup>51</sup> See, e.g., Jolls et al., *supra* note 26, at 1539; Robert H. Frank, *Departures from Rational Choice: With and Without Regret*, in *THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR* 13, 16–18 (Francesco Parisi & Vernon L. Smith eds., 2005).

<sup>52</sup> See, e.g., Jolls et al., *supra* note 26, at 1539; Frank, *supra* note 51.

<sup>53</sup> For a wonderful explanation of this effect, see Bar-Gill, *supra* note 12, at 1396–98.

<sup>54</sup> See, e.g., Jolls et al., *supra* note 26, at 1479, 1523.

<sup>55</sup> See *id.*

<sup>56</sup> See *id.*

<sup>57</sup> See, e.g., *id.* (noting “bounded willpower” undergirds Thomas Jackson’s theory of the discharge and non-waivable exemption policies in consumer bankruptcy).

The effects of bounded willpower and hyperbolic discounting are especially pronounced in the average consumer credit transaction, particularly those involving revolving credit sources like credit cards. Consumer credit facilitates, indeed, *enhances* consumers' susceptibility to the bias toward present consumption and against delayed gratification. Hyperbolic discounting explains (at least in part) why consumers can only be expected to overvalue the benefits of "buying now" while downplaying the costs of "paying later."

Even if a consumer understands the potential costs of present borrowing in excess of certain future income, when the time comes to choose whether to buy a thing on credit or save for later, hyperbolic discounting pushes the decision powerfully in favor of borrowing. The overvalued present benefit of having the thing can be expected to outweigh the heavily discounted future benefit of having the thing unencumbered by debt. And the overemphasized present cost of foregoing present consumption can be expected to outweigh the discounted future cost of paying back the loan (or the discounted future risk of being unable to do so). Even if the *objective* future costs and risk of default accurately gauged might outweigh the present benefit, hyperbolic discounting skews this decision-making process and blinds the consumer decision-maker to this negative reality.

It turns out that the urge for instant gratification is not a character flaw of "Generation X," but a deep-seated psychological phenomenon that affects most consumers. While the bias toward present consumption and against delayed gratification is not a shocking discovery, behavioralists offer scientific evidence that human nature—not individual "prodigality"—underlies this bias.

Before credit was widely available to consumers, these biases remained largely in the shadows. Now that credit has been "democratized," consumers are diving into the water, confident of their ability to swim, but not knowing that millstones hang from their necks. Social and economic Darwinism offers no acceptable answer to this problem. Unlike in the business world, "market corrections" cannot destroy consumers who suffer more from these biases, leaving only those strong enough to resist. Society cannot allow the weak to be devoured in the new economic jungle—at least Western societies have signaled their unwillingness to do so. The question is how to deal with the epidemic of overindebtedness caused in part by these biases.

## II. OVERINDEBTEDNESS LIKELY CANNOT BE PREVENTED BY DEMAND-SIDE EFFORTS

If behavioral economics offers compelling explanations for the *causes* of over-borrowing, then behavioral economics should be consulted for directly countervailing potential *solutions* to the problem. It turns out that these biases are exceedingly difficult to overcome, perhaps so much so that we ought to abandon thoughts of *curing* overindebtedness and focus on *treating* its inevitable effects.

The revelations of behavioral economics not only suggest consumers labor under a variety of powerful biases, but “debiasing” is difficult if not impossible.<sup>58</sup> Behaviors like the overconfidence bias and hyperbolic discounting stubbornly persist even when people are made keenly aware of such biasing forces and the actual probabilities of adverse events.<sup>59</sup>

This suggests most if not all *ex ante* efforts at getting more information to consumers about the risks of over-borrowing will do little to avoid consumer overindebtedness. Information can help consumers only if they are able to use it to gauge risk more accurately and avoid “too much” risk. But behavioralists have shown people are often simply unable to benefit from more information.<sup>60</sup> Biases and heuristics influence behavior more powerfully than information—indeed, inaccurate predictions of risk persist even in the presence of accurate statistics about risk.<sup>61</sup>

Perhaps we ask too much of bankruptcy law if we expect it to change overly risky consumer borrowing behaviors. Current “debtor education” programs that focus on money-management skills seem more likely to *exacerbate* the biases explored above. These programs enhance the illusion of control that leads to overconfidence in future borrowing.<sup>62</sup> Indeed, behavioral evidence strongly suggests inevitable failure awaits even debtor education that

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<sup>58</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 654–58; Korobkin & Ulen, *supra* note 28, at 1071; see also Jolls et al., *supra* note 26, at 1527.

<sup>59</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 654–58; Korobkin & Ulen, *supra* note 28, at 1071; see also Jolls et al., *supra* note 26, at 1527.

<sup>60</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 654–58; Korobkin & Ulen, *supra* note 28, at 1071; see also Jolls et al., *supra* note 26, at 1527.

<sup>61</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 654–58; Korobkin & Ulen, *supra* note 28, at 1071; see also Jolls et al., *supra* note 26, at 1527.

<sup>62</sup> See *supra* notes 37–41.

reveals these biases and focuses consumers on avoiding them.<sup>63</sup> Passive debtor education on the ills of overborrowing is no match for the powerful psychological forces driving overconfidence and over-enthusiasm for present borrowing. To be sure, consumer financial education is valuable.<sup>64</sup> Behavioral economics suggests, however, we ought not expect too much from passive “debtor education” as a core part of consumer overindebtedness treatment.

Even “active” learning from negative experience resulting from overborrowing is not likely to be particularly effective. Researchers suggest, to be effective, “lessons” on the ills of these biases must be immediate and unambiguous, particularly if the causal connection between the risk and the adverse event is complex.<sup>65</sup> Thus, even if the consequences of overborrowing are severe, consumers are exceedingly unlikely to learn from past mistakes with overborrowing. The ills of overborrowing will, by definition, occur long after biases and heuristics have driven a consumer to risky borrowing that produces the ill effects. Such lessons will neither be immediately nor unambiguously tied to the past risky behavior (indeed, they are more likely to be attributed to intervening liquidity problems beyond the consumer’s control).

Perhaps behavioral economics teaches us we simply must accept that back-end *relief* from overindebtedness is the best we can manage. If front-end restrictions on the supply side of consumer credit are judged inefficient or politically inexpedient, perhaps we just have to accept that cognitive biases will naturally lead to overconsumption of credit by many consumers.

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<sup>63</sup> Braucher suggests that some current U.S. programs implicitly attempt to address such biases. See Braucher, *supra* note 11, at 1081 & n.93.

<sup>64</sup> Additionally, framing the educational programs in certain ways might enhance their effects. Programs might discourage risky borrowing more effectively by (1) framing lessons in terms of avoiding losses rather than achieving benefits (to exploit loss aversion), (2) offering vivid and personal information on the risks of excessive debt (to enhance availability), and (3) moving the focus away from the consumer’s role in the credit system and onto the powerful and dangerous tactics used by lenders in enticing overborrowing (avoiding overconfidence). See Jolls et al., *supra* note 26, at 1536–37. It appears, however, that most U.S. debtor education programs are decidedly *not* focused on reducing consumer borrowing—perhaps not even overly risky consumer borrowing. See Jean Braucher, *Debtor Education in Bankruptcy: The Perspective of Interest Analysis*, in CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 319 (Johanna Niemi-Kiesiläinen et al. eds., 2003).

<sup>65</sup> See, e.g., Jennifer Arlen, *The Future of Behavioral Economic Analysis of Law*, 51 VAND. L. REV. 1765, 1783 (1998); Hanson & Kysar, *supra* note 2, at 691–92.

### III. IF PREVENTION IS POSSIBLE, WHICH KIND OF BANKRUPTCY REGIME WILL BE MORE EFFECTIVE?

Whether we need formal consumer debt relief is a separate question that Western society seems to be answering in the affirmative. Country after country in Europe has joined the United States in recent years in offering more or less generous relief to consumers unable to meet their credit obligations.<sup>66</sup> Now the question is what *kind* of relief system holds the most potential for not only treating but also preventing the problems associated with overindebtedness. If the biases discussed above can be overcome at the margins, perhaps different types of bankruptcy relief might do so by turning these biases to productive use.

Behavioral economics suggests some solutions have the potential to be more effective than others in shifting incentives.<sup>67</sup> Since those who have fallen into the traps of overindebtedness are now ending up in bankruptcy in many countries, that process offers a concentrated source of consumer education for discouraging overly risky borrowing—both by debtors and by others who hear about the process from debtors or the press. Even if an *uncontrollable* liquidity crisis leads to bankruptcy in most cases, if the relief process is not too draconian, its structure might combat the biases that contribute to *controllable* overborrowing and reinforce good attitudes about credit by debtors and non-debtors alike.

Apparently, little can be done about hyperbolic discounting, bounded willpower, or the overconfidence bias<sup>68</sup>—and we would not want to dampen consumer confidence too much given how modern economies depend on consumer borrowing and spending. The bankruptcy system might contribute to making the risks of overborrowing marginally more “available,” however,

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<sup>66</sup> See, e.g., Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 482–97.

<sup>67</sup> To be sure, classical “law and economics” similarly suggests changing demands might affect debtor behavior. For example, classical economic analysis of law also would observe that overly lenient systems produce little incentive for consumers to control their debt burden *ex ante*, but overly demanding systems might create a disincentive for consumers to cooperate with the system to produce returns for creditors *ex post*. Behavioral economics reveals *additional*, primarily *psychological* effects of overly liberal and overly demanding systems. The primary one is presented below; for example, consumers will more readily accept or reject a system’s lessons regarding payment morality depending upon the balance of costs and benefits. See *infra* Part IV. Teaching lessons on personal responsibility and payment morality, rather than maximizing economic incentives for efficient consumption, seems to be the focus of European consumer debt relief law, so a behavioral economic analysis seems particularly enlightening here.

<sup>68</sup> See *supra* notes 58–61 and accompanying text.

by increasing the frequency, recency, and salience of information about the costs of overborrowing.<sup>69</sup>

As for the debtors themselves, repeat filing rates are low even in the extremely generous U.S. system,<sup>70</sup> so “re-educating” bankrupt debtors does not seem to be of primary importance. On the other hand, since relatively few cases of consumer bankruptcy result purely from excessive debt—as opposed to a liquidity crisis like job loss, medical problems, or family interruption<sup>71</sup>—perhaps the small number of repeat filers are precisely that margin of filers on whom credit “re-education” efforts should concentrate. It is impossible now to know how effective or necessary re-education of *debtors* might be. But it is worth considering the attitude-shifting affects the system might—or might not—have on debtors who might be lured back into the trap of overindebtedness.

The consumer bankruptcy system might also affect those *not* directly involved in the system but who hear or see the messages it sends about the dangers of excessive debt. If the risks of overborrowing can be made more frequent, recent, or salient for *potential* debtors, that information might *at the margins* influence the credit behavior of potential victims of overindebtedness.<sup>72</sup> People talk about others’ experiences in bankruptcy; lawyer advertising, the news media, and government agencies<sup>73</sup> are increasingly involved in disseminating information about consumer debt and relief from excessive debt. Widely dispersed information about the nature of the debt relief system might, therefore, have some effect on changing behaviors among financially healthy consumers weighing the risks and benefits of their credit options.

#### A. The “Get-Out-Of-Jail-Free” System in the United States

The quick in-and-out structure of most U.S. consumer bankruptcies seems to offer little potential for increasing awareness of risk—either for debtors or for those outside the system looking in. The overwhelming majority of

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<sup>69</sup> See *supra* Part I.

<sup>70</sup> See, e.g., SULLIVAN ET AL., *supra* note 9, at 191–98 (reporting results of empirical study suggesting the individual bankruptcy repeat rate in the United States is no higher than 8%, and perhaps as low as 3–4%).

<sup>71</sup> See generally *id.*

<sup>72</sup> See *supra* Part I.

<sup>73</sup> For example, in Belgium, a special fund is used in part to finance dissemination of information on the consumer debt relief system. See Law of 22 December 2003, art. 430, MONITEUR BELGE, 31 Dec. 2003, p. 62160, 62246.

consumer bankruptcy cases in the United States pass through chapter 7 of the U.S. Bankruptcy Code.<sup>74</sup> This system usually proceeds within three months through three simple and largely ministerial steps: (1) the debtor's filing of a petition for relief and detailed financial information, (2) the debtor's meeting with a trustee to answer questions about the debtor's financial situation, and (3) the trustee's filing of a report of "no available assets" and entry of a judgment soon thereafter discharging the debtor from most unpaid debts.<sup>75</sup> The overwhelming majority of U.S. consumer debtors dedicate none of their future income to paying their debts.<sup>76</sup> After filing and meeting with the trustee once, they need not give another thought to the process that led them into and out of overindebtedness.<sup>77</sup>

This system seems to ignore—indeed, perhaps even to aggravate—the biases that lead many consumers down the path of danger. This quick and minimalistic approach to debt relief does very little to increase the "availability" of information about the potential risks and costs of overborrowing—neither among debtors passing through the system nor among those who hear about the system's operation second-hand.<sup>78</sup> To be sure, forcing debtors to admit publicly their financial "failure" and subjecting them to probing inquiry about their financial lives does increase the salience of credit risks somewhat. I would not argue that no "stigma" attaches to bankruptcy in the United States today. The ease and speed with which ultimate relief arrives seems to rob the U.S. system of virtually any impact on longer-term attitudes.

Even if information about financial distress is "frequent," given the million-and-a-half annual consumer bankruptcy filings in recent years in the United States,<sup>79</sup> mere frequency most likely confirms to consumers that effortless relief is available for the taking. Frequency without salience seems to *reduce* availability, as when consumers underestimate the impact of

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<sup>74</sup> See Am. Bankr. Inst., Bankruptcy Filing Statistics – Annual Filings, [http://www.abiworld.org/Template.cfm?Section=Annual\\_U\\_S\\_Filings&Template=/TaggedPage/TaggedPageDisplay.cfm&TPLID=62&ContentID=3256](http://www.abiworld.org/Template.cfm?Section=Annual_U_S_Filings&Template=/TaggedPage/TaggedPageDisplay.cfm&TPLID=62&ContentID=3256) (last visited Dec. 20, 2005). In my view this will remain true even under the law as recently modified by the "means test."

<sup>75</sup> For a general description of the U.S. bankruptcy system, see MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY (1995).

<sup>76</sup> See, e.g., *id.*

<sup>77</sup> See, e.g., *id.*

<sup>78</sup> See *supra* Part I.B.

<sup>79</sup> Information on filing rates can be found on the website of the American Bankruptcy Institute, at [http://www.abiworld.org/Content/NavigationMenu/Online\\_Resources/Bankruptcy\\_Statistics/ABI\\_-\\_Bankruptcy\\_Statistics.htm](http://www.abiworld.org/Content/NavigationMenu/Online_Resources/Bankruptcy_Statistics/ABI_-_Bankruptcy_Statistics.htm).



smoking, failing to exercise, or engaging in similar incrementally harmful activities.<sup>80</sup> Indeed, if the information available to consumers is that the system represents an easy way out of debt, that may well exacerbate consumers' tendency to discount the potential future costs of risky credit behavior.<sup>81</sup> After all, if future discharge is free for the taking, why worry about the risks of present borrowing?

### *B. Emerging European Systems and Extended Payment Plans*

The emerging European consumer debt relief systems seem to proceed in a way that behavioral economics suggests offers much more potential to impact consumer behavior. Each of these new systems begins much as the U.S. system does, with a petition and schedules describing in great detail the consumer's situation of financial collapse.<sup>82</sup> The new European systems proceed in slightly different ways from that starting point; however, unlike the U.S. system, they all eventually demand the great majority of debtors make at least an *attempt* at repayment of debt from several years of future income.<sup>83</sup> As it turns out, in many cases, the debtor does not *actually* give up any future income, or only gives up a small portion of it,<sup>84</sup> but every case requires the debtor at least submit to a plan for payment of all future income beyond a threshold maximum amount.<sup>85</sup>

The emerging European payment-system approach has greater potential salutary effects on consumers' credit risk assessments, at least at the margins. Requiring a payment plan in every case makes the costs of overindebtedness more salient in every case—at least a little, and perhaps significantly.<sup>86</sup> Indeed, when cases extend over several years (through the payment plan period), that also increases the likelihood debtors and non-debtors will have readily “available” exposure to a recent example of the risks and costs of overborrowing.<sup>87</sup> The mental impact of a ninety-day in-and-out U.S. case is fleeting even on the debtor, but it is much less likely that any given third party will encounter an open case during this short period. The “debiasing” effect of multi-year payment periods may be slight, and it may ultimately not be worth

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<sup>80</sup> See *supra* Part I.B.

<sup>81</sup> See *supra* Part I.C.

<sup>82</sup> See *supra* note 10 and sources cited therein.

<sup>83</sup> See, e.g., Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 482–97.

<sup>84</sup> See, e.g., Kilborn, *German Approach*, *supra* note 10, at 291–92.

<sup>85</sup> See *supra* note 10 and sources cited therein.

<sup>86</sup> See *supra* Part I.B.

<sup>87</sup> See *supra* Part I.B.

the administrative cost,<sup>88</sup> but these European systems seem at least tacitly to be addressing the biases that lead to overindebtedness—both among debtors and among third-party observers.

The European-style payment-plan systems leverage the most powerful form of learning available, maximizing educational *potential*, even if that potential is never realized. Indeed, the Europeans seem to have focused more on the educational aspect of this process—rather than on the economic return to creditors—from the beginning.<sup>89</sup> At least for the debtors, these systems require hands-on, *active* learning about the consequences, the costs, and the responsibilities of overborrowing.<sup>90</sup> Submitting to several years of lost revenue (or at least the potential for lost revenue) will likely stick much more in the mind of a consumer reintroduced into the open credit economy. This is debtor education in a very meaningful sense. Moreover, this active learning might leverage the passive learning represented by credit counseling, particularly if that counseling focuses in part on alerting debtors to the behavioral biases that may have lured them into trouble. Ultimately, payment-plan systems send more constructive messages to potential consumer debtors about the costs and responsibilities of credit.

#### IV. THE DELICATE BALANCE OF QUIDS AND QUOS: THE “FAIRNESS” INSIGHT OF BEHAVIORAL SCIENCE

For what little impact the consumer bankruptcy system might have in shifting general consumer attitudes about the risks of debt, it seems the European-style payment-plan systems hold more potential for preventing overindebtedness. Behavioral economics offers some further insights into which of those widely varied systems has *greater* potential to affect behaviors positively. I submit that debtor and non-debtor consumers might welcome and

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<sup>88</sup> The new Belgian system shows that the costs of this learning process can be visited on lenders. See Law of 5 July 1998, art. 19, *MONITEUR BELGE*, 31 July 1998, p. 24613, 24621; Law of 19 April 2002, art. 2, *MONITEUR BELGE*, 7 June 2002, p. 26229. One might impose costs on lenders not only as punishment for having acted “irresponsibly,” but also because they have consciously or unconsciously manipulated consumer biases to achieve a profit. See, e.g., Hanson & Kysar, *supra* note 2, at 635, 721–43. Thus, it might well be fair and sensible to ask lenders to dedicate a small part of their profits to pay for treatment of the victims of these bias manipulations.

<sup>89</sup> See Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 498.

<sup>90</sup> It is, of course, a truism of learning theory that *active* learning by doing is superior to *passive* learning by listening to lectures and the like. See, e.g., JAMES HARTLEY, *LEARNING AND STUDYING: A RESEARCH PERSPECTIVE* 17 (Routledge 1998).

learn from a payment-plan system, but only if they view it as being administered “fairly.”

Behavioral scientists have found not only do people exhibit “bounded rationality” in their decision-making, they also exhibit “bounded self-interest” in their interaction with others.<sup>91</sup> Contrary to traditional economic premises, behavioralists have demonstrated people are not one-minded, selfish, value-maximizers.<sup>92</sup> Instead, they want to be treated fairly and to treat others fairly, even if that means sacrificing potential benefits or rejecting opportunities for advancing self-interest. “Fair” in this context is generally not an indeterminate concept. Fairness is a measure of how the situation coincides with or diverges from what *normally* happens in such situations.<sup>93</sup> The closer a situation comes to the “norm” (or at least what the individual views as the norm), the more likely that situation is to be deemed “fair” and thus accepted as positive or constructive.<sup>94</sup>

In societies with strong contract law—like those in the United States and especially Europe—abiding by one’s obligations is definitely “the norm.” The overwhelming majority of contractual obligations are honored in these societies, they are strongly *expected* to be honored, and those who fail to honor their obligations generally feel guilty about their failure to some degree.<sup>95</sup> Thus, most people can be expected to view paying their debts as “fair.” At the very least, most people can be expected to feel that making reasonable efforts to pay off most types of debt is fair, and doing so or seeing others do so should register positively. A system that allows debtors to evade their obligations with little effort is likely to be viewed as unfair by most, even if it achieves

<sup>91</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1479, 1489–97; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>92</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1479, 1489–97; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>93</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1479, 1489–97; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>94</sup> See, e.g., Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1479, 1489–97; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>95</sup> The legislative histories of the European consumer “bankruptcy” laws are replete with references to the sanctity of contracts and to the norm of payment, and the few existing studies of European debtors suggest they feel quite guilty about their inability to fulfill their obligations. See, e.g., L’OBSERVATOIRE DU CRÉDIT ET DE L’ENDETTEMENT, 10 ANS D’OBSERVATOIRE 32–33 (2004), available at [http://www.observatoire-credit.be/SiteOce/site.nsf/a9ee787768a96ef2c12569a7004bc215/56c2f0c718aa7806c1256f54002ade3b/\\$FILE/BrochureFR.pdf](http://www.observatoire-credit.be/SiteOce/site.nsf/a9ee787768a96ef2c12569a7004bc215/56c2f0c718aa7806c1256f54002ade3b/$FILE/BrochureFR.pdf). Of course, the debate rages about whether the “stigma” of financial failure has died in the United States. Without getting drawn into that great debate, suffice it to say the *general* sense undoubtedly remains that one should pay one’s obligations whether one feels bad or not when one is ultimately unable to do so.

other laudable goals. Thus, for example, although the U.S. system seeks quite reasonably to protect debtors from the accidents of life (unemployment, divorce, medical problems), to avoid an undue burden on the social welfare system and to preserve the incentive for debtors to work and add value to society, many are likely to view this system as “unfair” if it makes no demand on debtors to abide by the “norm.”

A system that makes reasonable demands on overextended debtors to attempt to abide by the norm of paying debts should be met with, if not enthusiasm, at least acceptance. Even such debtor-friendly and creditor-antagonistic groups such as the former German Communist Party have argued in favor of multi-year payment plans as part of a consumer debt relief system.<sup>96</sup> Not only does a desire to avoid undermining “payment morality” underlie European insistence on payment plans for all, but plans of reasonable duration and demand likely represent the “fair” approach in the eyes of the great majority of people—debtors and non-debtors alike.

But behavioral economics reveals one final danger of the bounds of self-interest: people are willing “irrationally” to sacrifice their own self-interest and welfare not only to help others who act fairly, but also to *punish* those who they believe are not acting fairly.<sup>97</sup> In a simple but telling experiment called the “Ultimatum Game,” two players who neither know nor see each other are instructed to split a sum of money.<sup>98</sup> The first player must make an offer, and the second has only two options: (1) accept the offer, in which case both players take home their share of the money, or (2) reject the offer, in which case both players take nothing.<sup>99</sup> The consistent outcome of this game is both surprising and contrary to traditional economic “self-maximizing” predictions:

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<sup>96</sup> See Kilborn, *German Approach*, *supra* note 10, at 289.

<sup>97</sup> See, e.g., Vincy Fon & Francesco Parisi, *Revenge and Retaliation*, in *THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR* 141, 143–44 (Francesco Parisi & Vernon L. Smith eds., 2005); Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1489–97 (theory at 1494), 1511–13; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>98</sup> See, e.g., Fon & Parisi, *supra* note 97, at 143–44; Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1489–97, 1511–13; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

<sup>99</sup> See, e.g., Fon & Parisi, *supra* note 97, at 143–44; Hanson & Kysar, *supra* note 2, at 680–82; Jolls et al., *supra* note 26, at 1489–97, 1511–13; Korobkin & Ulen, *supra* note 28, at 1135–38; Ulen, *supra* note 32, at 1755.

almost all subjects divide the money so as to give the first player no more than 60% and the second no less than 40%.<sup>100</sup>

More surprising yet, the vast majority of second players reject the offer—and give up a free benefit for themselves—if the first player offers less than 30%.<sup>101</sup> This tendency of the second players to sacrifice their own selfish interest in obtaining a cost-free benefit simply to “punish” the first players’ greed or stinginess—essentially, their “unfairness”—suggests something important about the operation of a payment-plan system. On the one hand, debtors are likely to accept a plan process that requires a fairly equal distribution of benefits and burdens, gains and costs among debtors and creditors. On the other hand, though, debtors—and those on the verge of becoming debtors—are likely to sacrifice their own self-interest in achieving a benefit if they view creditors or system administrators as “overreaching” or acting unfairly in the plan process.

Unlike the cognitive biases discussed earlier, the results of the Ultimatum Game might well differ for European players—at least for players from some European cultures. The results in U.S. experiments may not reveal a universal rejection of imbalance, but rather an aggressively “individual rights-oriented” mentality unique to residents of the United States. My sense is that this is not so. I believe, and recent scholarship suggests,<sup>102</sup> the Ultimatum Game would play out very similarly with subjects from most parts of Europe, at the very least northern Europe.

To the extent that the implications of the Ultimatum Game do apply to consumer behavior in Europe, some of the European approaches seem more likely than others to achieve positive results in light of debtors’ “bounded self-interest.” Whatever the economic or social reasons supporting a particular consumer debt relief provision, behavioral economics offers a revealing perspective to consider in evaluating the effectiveness of a given approach. I submit that the level of required sacrifice for the promised benefit, the length

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<sup>100</sup> See, e.g., Fon & Parisi, *supra* note 97, at 143-44; Hanson & Kysar, *supra* note 2, at 680-82; Jolls et al., *supra* note 26, at 1489-97, 1511-13; Korobkin & Ulen, *supra* note 28, at 1135-38; Ulen, *supra* note 32, at 1755.

<sup>101</sup> See, e.g., Fon & Parisi, *supra* note 97, at 143-44; Hanson & Kysar, *supra* note 2, at 680-82; Jolls et al., *supra* note 26, at 1489-97, 1511-13; Korobkin & Ulen, *supra* note 28, at 1135-38; Ulen, *supra* note 32, at 1755.

<sup>102</sup> See Fon & Parisi, *supra* note 97, at 143-44 (suggesting a universally shared, deeply rooted “innate sense of fairness” and tendency toward “negative reciprocity” in policing and punishing violations of social fairness norms).

of waiting time for that benefit, and the consistency of sacrifices and rewards among debtors in different districts all impact the “fairness,” and consequently the debtor-educational potential, of a debt relief system.

A. *The Danger of Mismatching Benefits and Burdens: “Unfair” Sacrifices*

European legislators have agonized over how best to chart the line between the Scylla of “de-responsible-izing”<sup>103</sup> debtors with “easy” relief and the Charybdis of demanding too much sacrifice and thereby dooming payment plans to fail. The Ultimatum Game suggests one more potential danger of plans debtors perceive as mismatching benefits and burdens; payment-plan laws that make demands debtors might view as overreaching and “unfair” might well lead debtors to sacrifice their self-interest in obtaining debt relief.<sup>104</sup> Instead of accepting the message of payment morality and engaging the system, debtors and non-debtors alike might seek to “punish” creditors whom they view as unduly advantaged at the expense of consumers in the system. Such laws may well leave debtors and non-debtors with a sour taste for credit and a vengeful attitude toward creditors, undermining the positive educational potential of the payment-plan approach.

Paying one’s debts may well be “the norm,” but maintaining a modest but “dignified” lifestyle is certainly also the norm. This is probably particularly true in the states of Continental Europe, which take a much more active role in guaranteeing a minimal level of social support for their citizens.<sup>105</sup> The Ultimatum Game suggests people have a deeply ingrained sense of the importance of fairness in balancing benefits and burdens.<sup>106</sup> Even if a system offers discharge of debt or other effective relief, if it demands debtors divert so much of their income to creditors that they are left worrying about how basic needs will be met (housing, food, health care), consumers are likely to view such a system as imbalanced, abnormal, and unfair. Debtors might sacrifice

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<sup>103</sup> I use this odd English non-word because this is the French word (*désresponsabilisation*) that so accurately describes the undesirable potential effect on consumers of making debt relief too available and too easy. Europeans widely fear this effect, and the French word appears over and over in the legislative history of the laws in France, Belgium, and Luxembourg. See *supra* note 10 (collecting sources on the legislative history of these laws).

<sup>104</sup> See *supra* notes 97–101.

<sup>105</sup> The meaning of a “dignified” life is obviously vague, but this norm is memorialized, for example, in article 23 of the Belgian Constitution: “Everyone has the right to lead a life in conformity with human dignity.” CONST. art. 23. The laws in Belgium and Luxembourg incorporate this norm by requiring that payment plans allow the debtor and her family to lead a life “in conformity with human dignity.” See CODE JUDICIAIRE/GERECHTELJK WETBOEK art. 1675/3 [hereinafter CJ/GW]; Law of 8 Dec. 2001, art. 1.

<sup>106</sup> See *supra* notes 97–101.

their own benefit by opting to transfer or destroy assets or go underground rather than engaging in an “unfair” bankruptcy system that demands too much sacrifice for an eventual benefit of some form of relief from debt. Ultimately, if consumers (both debtors and non-debtors) view the system as unfair and thus not worthy of respect, this jeopardizes whatever potential the system might have for inculcating positive lessons about responsible use of credit.

Among Continental European consumer bankruptcy systems, recent years have witnessed a general progression away from pressing debtors to satisfy creditor demands and toward requiring more moderate sacrifices by debtors and offering them greater relief in return.<sup>107</sup> The “bounded self-interest” revelation of behavioral economics suggests this evolution toward balancing sacrifices and rewards will improve these systems’ potential to achieve their goals of social education. To be sure, these developments doubtlessly occurred for other reasons—to ensure debtors could successfully complete the plans and receive needed relief. But once again, behavioral economics offers one more reason to applaud some developments and to challenge others.

### 1. Germany

The German system is a prime example of one that has evolved in ways behavioral economics predicts will enhance consumers’ view of the system as “fair” and successful. When the German legislature adopted its new *Insolvenzordnung* in 1994 (in force only since 1999), it offered complete discharge of unpaid debts, but it imposed weighty demands on consumer debtors.<sup>108</sup> Debtors had to cede to creditors 100% of their nonexempt income for four years, and between 80% and 90% for three additional years.<sup>109</sup> Income exemption levels at this time were relatively modest, leaving an absolute maximum of, for example, only about \$16,500 per year to a childless couple.<sup>110</sup> Sensitive to the criticisms of debt counselors and other debtor advocates, the German parliament responded to enhance the system beginning in 2002.<sup>111</sup> It increased the income exemption levels for the vast majority of German households by 50%, and it instituted biannual indexing to ensure that these levels would keep pace with rising costs of living.<sup>112</sup> Consciously or

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<sup>107</sup> See *supra* note 10 and sources cited therein.

<sup>108</sup> See Kilborn, *German Approach*, *supra* note 10, at 283–84.

<sup>109</sup> See *id.*

<sup>110</sup> See *id.* at 267–68.

<sup>111</sup> See *id.* at 285–86.

<sup>112</sup> See *id.*

unconsciously, the German parliament has crafted an approach to consumer overindebtedness that carefully balances relief with reasonable and “fair” demands for debtor responsibility. This should maximize the potential for positive attitudes from debtors and consumers generally, and consequently, the educational potential of the system as a whole.

## 2. *France*

The French system has also evolved toward offering more valuable benefits to debtors and making more “reasonable” demands for that relief. Change has arrived more slowly and less powerfully in France, however, than in Germany. In 1989, France launched the second consumer debt-relief system on the European continent.<sup>113</sup> It started out quite hesitantly, focusing simply on encouraging negotiated plans among creditors and debtors, and very seldom did such plans offer any discharge of debt.<sup>114</sup> Only in 1999 were French courts empowered to impose a discharge of any portion of the debtor’s unpaid obligations at the conclusion of a payment plan.<sup>115</sup> Even since then, the French courts have applied this “ultimate” relief very sparingly,<sup>116</sup> more often requiring debtors to pay all of their debts through long-term payment plans that leave debtors at a very low standard of living. Since February 2004, a small subset of the most financially troubled French consumers can receive an almost immediate and total discharge of debt, however, courts have remained reticent to offer such relief.<sup>117</sup>

In the early years of the new French system, many negotiated plans left debtors with less than \$2300 per year per person in the debtors’ households.<sup>118</sup> Many sources have predicted a majority of these early French payment plans are doomed to failure.<sup>119</sup> Beginning in 1999, however, the legislature addressed the problem of this miserly system by requiring that all plans leave to debtors at least that part of their income the law exempts from seizure (as in

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<sup>113</sup> See Kilborn, *French Law*, *supra* note 10, at 621.

<sup>114</sup> Like the other European systems, the French system strongly favored (and still favors) consensual plans negotiated with creditors. See *id.* at 639–40. Because these negotiations are inherently unpredictable, I focus on court-imposed measures of relief. I must admit, however, that negotiated plans represent an extremely important part of the French system, currently disposing of around 70% of all cases. See *id.* at 640. Whether the debtors will manage to complete these negotiated plans is an open—and hotly disputed—question. See *id.* at 640–45, 662–63.

<sup>115</sup> See *id.* at 648–51.

<sup>116</sup> See *id.* at 654.

<sup>117</sup> See *id.* at 655–60.

<sup>118</sup> See *id.* at 642.

<sup>119</sup> See *id.* at 640, 662–63.



the German system).<sup>120</sup> A review of French plans in 2001 nonetheless revealed that 65% of plans left debtors between \$8400 and \$16,800 per year, and only 3% left debtors with more than this.<sup>121</sup>

At least in the early years, and perhaps even now, it seems the French approach to consumer overindebtedness potentially asks too much of debtors and offers too little in return. As a result, consumers might well view this system as not offering a “fair” division of value to debtors and creditors. The balance of rewards and sacrifices in the French system does not bode well for inculcating a sense of fairness among debtors and consumers observing the system from the outside. This may undermine the educational value of the French system and ultimately reduce its effectiveness in both treating and curing overindebtedness in France.

### 3. *Belgium*

The Belgian system, among the very newest, has the potential to move even further from a “fair” allocation of benefits and burdens. In force since January 1999, the Belgian consumer debt relief law encourages out-of-court agreement to a plan formulated by a “debt-mediator” chosen by the debtor, but it vests wide discretion in the court to impose a plan in case of failure to reach such agreement.<sup>122</sup> Like the original French law, the Belgian law resists offering a discharge and allowing debtors to escape their debts. It readily allows the court to impose a plan discharging debts for penalties and fees, but not for basic principal or interest.<sup>123</sup> The proponents of the law clarified that a plan *without* a discharge of principal would be the norm.<sup>124</sup> Only under extraordinary circumstances may the court proceed to consider a discharge of principal, and even then the law as written allows only a *partial* discharge.<sup>125</sup>

Of course, a reduced potential benefit would not cause potential “fairness” concerns if the demands made of the debtor were limited, but they are not. The Belgian law appears somewhat ambivalent about moderating the demands on

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<sup>120</sup> See *id.* at 644.

<sup>121</sup> See *id.* at 644–45.

<sup>122</sup> See C/JGW, *supra* note 105, arts. 1675/10 to 1675/13.

<sup>123</sup> See *id.* art. 1675/12 § 1(4).

<sup>124</sup> See, e.g., *Doc. parl.* Chambre no. 1073/1, 44 (1996–1997).

<sup>125</sup> See C/JGW art. 1675/13 § 1. The Belgian constitutional court held in 2003 limiting relief to a “partial” discharge was unconstitutional under certain circumstances, so in reality, a full discharge is apparently now available. See Order No. 38/2003 (Apr. 3, 2003), available at <http://www.arbitrage.be/public/f/2003/2003-038f.pdf>.

debtors. On one hand, the law directs the mediator to develop a plan that will allow for maximum payment of debt while preserving for the debtor's family "a life in conformity with human dignity."<sup>126</sup> On the other hand, if the matter has to go before the court, the law in two separate places reminds the judge she can demand the debtor make payments even from exempt income<sup>127</sup>—a source the German law and even the French law now hold inviolate. Of course, such extreme demands must be "specially motivated," and the law reminds the judge the debtor should, in any event, be left with at least the legally guaranteed "existence minimum."<sup>128</sup> The law presently guarantees only about €7450 per year to singles living alone and about €9950 per year to most other debtors including all married couples, regardless of the number of children in their households.<sup>129</sup> Thus, Belgian law creates the same potential for trouble as the pre-1999 French law.<sup>130</sup> Demanding that debtors live at the poverty line to receive at most a *partial* discharge benefit seems like an "unfair" offer that any player of the Ultimatum Game might well reject.<sup>131</sup>

### B. Hyperbolic Discounting and the Impact of Plan Duration

Hyperbolic discounting suggests longer plans are not necessarily more effective than shorter ones at deterring excessive borrowing. Behavioral research suggests a "priority of the present," which mean debtors will most likely view a five-year plan as only about twice as onerous as a one-year plan,<sup>132</sup> as the later months of a term are hyperbolically discounted. Not only are longer plans not necessarily *more* effective, behavioral economics suggests they may be even *less* effective if "fairness" and consumer acceptance are important goals.

Hyperbolic discounting exacerbates the "unfairness" effect of overly demanding payment plans. While debtors weigh the very real and immediate costs of a period of deprivation and subsistence living, they are likely to

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<sup>126</sup> See CJ/GW, *supra* note 105, arts. 1675/10 § 2 & 1675/3.

<sup>127</sup> See CJ/GW, *supra* note 105, arts. 1675/12 § 4 & 1675/13 § 5.

<sup>128</sup> See CJ/GW, *supra* note 105, arts. 1675/12 § 4 & 1675/13 § 5.

<sup>129</sup> See Law of 26 May 2002, art. 15, M.B. 31 July 2002, 33610, 33613; Royal Order of 3 Sept. 2004, arts. 1-2, M.B. 27 Sept. 2004, 69308, 69309.

<sup>130</sup> In fact, this "potential trouble" has evidently not materialized. One prominent study indicated that judicial plans offering a discharge outnumbered those without a discharge by three to one, and the budgets allocated to debtors in most plans seem quite reasonable. Kilborn, *Belgium & Luxembourg*, *supra* note 10, at 39.

<sup>131</sup> See *supra* notes 97–101.

<sup>132</sup> See Jolls et al., *supra* note 26, at 1540 (using the five-year and one-year example in terms of the deterrent effect of prison sentences).

discount the benefit of a discharge more and more as its benefits are placed farther and farther away in the future.<sup>133</sup> The future benefits of debt relief are likely to be overwhelmed by the perceived burdens of spending even a moderately long time living at a subsistence level. When this happens, consumers are more likely to sense the system is “unfair.”<sup>134</sup> The Ultimatum Game predicts consumers may then act in a way that harms both themselves and their creditors,<sup>135</sup> for example, by rejecting the benefits of the system by hiding in the underground economy or by manipulating the system through false statements about assets or income. Once again, of central importance to European policymakers, consumer perceptions of “unfairness” undermine the potential for positive interaction with the system and inculcation of financial and social responsibility.

### 1. Germany

The German system has incorporated elements from the beginning that (probably inadvertently) reduce the effects of hyperbolic discounting. Recent revisions have furthered that effort. The German system originally delayed relief until after debtors had turned over most nonexempt income for seven years.<sup>136</sup> Indeed, given the duration of the several preceding stages of the German proceedings, debtors had to wait for relief for up to eleven years in some instances.<sup>137</sup>

From the beginning, the German parliament was quite conscious of the need to enhance debtors' flagging motivation to reach a distant benefit. It therefore instituted so-called “motivation rebates” in the years preceding the final discharge benefit offering debtors “rebates” of 10% of their nonexempt income at the end of the fourth year, 15% at the end of the fifth year, and 20% at the end of the sixth year.<sup>138</sup> Quite insightfully, these “motivation rebates” offset the hyperbolic discount that debtors would apply to the seventh year delayed benefit.<sup>139</sup>

In addition, in 2001 the German parliament ultimately acceded to demands to reduce the total delay between filing and relief. As of January 2002,

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<sup>133</sup> See *supra* Part I.C.

<sup>134</sup> See *supra* notes 97–101.

<sup>135</sup> See *supra* notes 97–101.

<sup>136</sup> See Kilborn, *German Approach*, *supra* note 10, at 285.

<sup>137</sup> See *id.*

<sup>138</sup> See *id.* at 283–84.

<sup>139</sup> See *supra* Part I.C.

German debtors are forced to wait (and to cede nonexempt income) for only six years, and that period begins at an earlier stage to avoid a longer wait.<sup>140</sup> It is impossible to gauge the psychological effects of these motivation rebates or the reduction of the payment plan period, but these are further aspects of the German system that seem to respond positively to pitfalls identified by the insights of behavioral economics (again, most likely without explicitly taking into account behavioral economics).

## 2. France

Once again, the French system seems to be evolving hesitantly in a direction consistent with behavioral economics. A recent limitation on the length of out-of-court plans—the cornerstone of the French system and the end result of approximately 70% of all cases<sup>141</sup>—appears to address the problem of hyperbolic discounting. This revision does not, however, address the “real” problem. Before February 2004, out-of-court plans sometimes stretched fifteen years into the future.<sup>142</sup> Now, out-of-court plans are limited to ten years in duration.<sup>143</sup> Even ten years is an extremely long time, leading to an extremely powerful potential for hyperbolic discounting. The problem with these plans is not hyperbolic discounting of a delayed benefit. Few of these plans offer a discharge at the end of the plan, but rather include immediate benefits of simple payment extensions and interest rate reductions.<sup>144</sup> The problem with out-of-court plans is not necessarily length, but paltry benefits.

The French legislature has moved in the opposite direction with respect to court-imposed plans, theoretically exacerbating the hyperbolic discounting problem. Originally, a court-imposed plan could not exceed five years in duration, but that limit rose to eight years in 1999, and as of 2004, court-imposed plans are subject to the same ten-year limit as out-of-court plans.<sup>145</sup> Here again, hyperbolic discounting is not the major concern. Like out-of-court plans, court-imposed plans do not delay a substantial benefit because they cannot forcibly discharge most debts.<sup>146</sup>

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<sup>140</sup> See Kilborn, *German Approach*, *supra* note 10, at 284–85.

<sup>141</sup> Kilborn, *French Law*, *supra* note 10, at 640 & n.150.

<sup>142</sup> See *id.* at 641.

<sup>143</sup> See *id.* at 641–42; C. COM. art. L.331-6.

<sup>144</sup> See Kilborn, *French Law*, *supra* note 10, at 641 & n.154.

<sup>145</sup> See C. COM. art. L.331-7.

<sup>146</sup> Court-imposed plans can discharge an unsecured deficiency remaining after forced sale of a mortgaged home, but only this type of debt can be discharged, *see id.*, and I have found no evidence of the frequency of this type of relief.

For the most economically troubled debtors, the two most recently developed procedures in the French system offer quick and effective relief, although such relief thus far has been practically available to few debtors. French debtors can obtain a discharge of debt if one of the “commissions” that administer the system makes one of two recommendations. First, since 1999, the commission can recommend the “extraordinary” measure of a global delay of payments of up to two years, followed by a reexamination of the debtor’s situation and possibly an imposed partial discharge of any remaining debt.<sup>147</sup> Alternatively, since February 2004, the commission can recommend a U.S.-style “personal recovery” procedure, which discharges all unpaid debts upon liquidation of the debtor’s nonexempt assets, if any, after only a few months and requires no dedication of the debtor’s future income to creditors.<sup>148</sup> These innovations seem to overcome the problem of hyperbolic discounting quite powerfully, bringing the future benefit of discharge quite close to the filing decision and calling for very little immediate countervailing burden on the debtor.

The commissions seem to be recommending such timely relief in more and more cases. From 2001 to 2004, the proportion of cases in which the commissions recommended “extraordinary” global payment delays rose from about 10% to about 13%.<sup>149</sup> Over the same period, the percentage of these cases in which the commission ultimately recommended discharge of debt rose from about 18% to about 30%.<sup>150</sup> Moreover, in the first several months of availability of the new “personal recovery” procedure, the commissions have diverted about 14% of all administered cases to that new process.<sup>151</sup> The French system seems to be moving in the “right” direction to overcome hyperbolic discounting, albeit at a carefully moderated pace.

### 3. *Benelux*

The newest consumer debt relief laws on the European continent minimize the negative effects of hyperbolic discounting more effectively. Under Luxembourg’s new law on collective consumer debt regulation, in force since October 2001, court-imposed payment plans cannot exceed seven years,

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<sup>147</sup> See C. COM. art. L.331-7-1.

<sup>148</sup> See C. COM. arts. 332-5 to 332-12; Kilborn, *French Law*, *supra* note 10, at 655–61.

<sup>149</sup> Kilborn, *French Law*, *supra* note 10, at 654.

<sup>150</sup> See *id.*

<sup>151</sup> See *id.* at 660.

though in practice many plans are concluding in three or fewer years.<sup>152</sup> The Belgian and Dutch laws also offer only mildly delayed gratification. Belgian plans can delay relief for debtors for only three to five years—down from a maximum of seven years in the early draft law.<sup>153</sup> In the Netherlands, a long tradition of voluntary plans had established three years as the standard period for payment demands and delayed relief for consumers.<sup>154</sup> Now, the new Dutch *Wet schuldsanering natuurlijke personen* (Law of Debt Rehabilitation of Natural Persons), codified in the Bankruptcy Act and in force since December 1998, extends that tradition by limiting court-imposed plans to three years.<sup>155</sup> The recent trend in Europe seems to be reducing the length of payment plans. Behavioral economics lends one more argument to support this trend: reducing the effects of hyperbolic discounting maximizes the educational potential of a shorter but more meaningful period of ceded income.

### C. Local Legal Culture Fosters Feelings of “Unfairness”

If the demands of payment plans from area to area fluctuate widely, individuals are likely to resist such “unfair” variations in treatment. In the democratic societies of the United States and Europe, equal treatment for all is the “norm” against which consumers will undoubtedly measure “fairness.” Even if different debtors receive slightly different treatment, if an objective standard applies to all, debtors are more likely to feel that their experience with the system was “fair.” If the demands of plans vary from district to district based apparently on nothing more than geography, debtors and non-debtors alike are likely to view the system as “unfair.” This again is likely to produce consumer antagonism, loss of respect, and a conclusion that the system represents an untrustworthy source of education and social guidance.<sup>156</sup> Unfortunately, most of the European systems seem to be falling into this trap of excessive “discretion” and unequal treatment of debtors.<sup>157</sup>

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<sup>152</sup> See Law of 8 Dec. 2000, Mémorial A, p. 2972, art. 14; Kilborn, *Belgium & Luxembourg*, *supra* note 10, at 42.

<sup>153</sup> Compare CJ/GW, *supra* note 105, arts. 1675/12 § 2 & 1675/13 § 2 with *Doc. parl.* Chambre (1996–1997) no. 1073/1, 42, 46.

<sup>154</sup> See, e.g., Nick Huls et al., *Can Voluntary Debt Settlement and Consumer Bankruptcy Coexist? The Development of Dutch Insolvency Law*, in CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 303, 304 (Johanna Niemi-Kiesiläinen et al. eds., 2003).

<sup>155</sup> See *id.* at 305.

<sup>156</sup> See *supra* notes 97–101.

<sup>157</sup> Other scholars have already observed and warned about the dangers of this trend in Europe. See, e.g., Jay Lawrence Westbrook, *Local Legal Culture and the Fear of Abuse*, 6 AM. BANKR. INST. L. REV. 25 (1998).

### 1. Germany

Once again, the German system stands as a model of “fairness.” It equalizes treatment of debtors and avoids substantial disparities among districts. In Germany, every debtor is called upon to make the same predictable sacrifice—turning over six years of nonexempt income, with rebates of portions of that income after the fourth and fifth years.<sup>158</sup> The calculation of each debtor’s contribution is based on an objective, universally known scale of exempt income.<sup>159</sup> While this scale demands slightly less of low-income debtors than higher-income debtors, at least the effect is uniform across the country.<sup>160</sup> The German system leaves very little discretion in the hands of local authorities to alter the balance of costs and benefits each debtor can expect.<sup>161</sup> At least in terms of consistency across cases, the German system seems most likely to earn a consumer evaluation of “fair” and a reputation as a legitimate source of social education.

### 2. France

Wide variations in treatment of debtors from district to district plague the French system. Broad discretion marks the French system from beginning to end, despite recent efforts to set uniform boundaries.<sup>162</sup> The commissions are in charge of drafting and negotiating payment plans, and local political functionaries comprise a majority of each commission.<sup>163</sup> This understandably leads to differences of opinion and approach, and to wide variances across districts. First, despite imposition in 1999 of a minimum “floor” of exempt income that must be left to debtors, the budgets that commissions and courts impose on debtors in payment plans continue to vary widely.<sup>164</sup> Second, commissions differ sharply in their willingness to propose effective measures of relief in these plans.<sup>165</sup> Similarly, access to the “extraordinary” relief of partial discharge, as well as to a total discharge through the new process of

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<sup>158</sup> See Kilborn, *German Approach*, *supra* note 10, at 283–84.

<sup>159</sup> See *id.* at 266–68, 285–86.

<sup>160</sup> See *id.*

<sup>161</sup> Even the German system allows some discretion, as creditors can request denial of the debtor’s discharge if the debtor has made “insufficient” efforts to find and hold gainful employment during the six-year plan period. See *id.* at 290–91. I have found no evidence that such creditor challenges are common, so the potential for variances across districts does not seem to have materialized in any event. See *id.*

<sup>162</sup> See Kilborn, *French Law*, *supra* note 10, at 642–45, 663–64.

<sup>163</sup> See *id.* at 636–39.

<sup>164</sup> See *id.* at 644–45.

<sup>165</sup> See *id.* at 664 & n.335.

“personal recovery,” is available only on the commissions’ discretionary recommendation.<sup>166</sup> These recommendations depend on vague standards; for example, the debtor’s financial situation qualifies as “irremediably compromised.”<sup>167</sup> With no centralized control over these standards, differing approaches in different geographical areas are inevitable. Although the French legislature has made inroads into the broad discretion of system administrators, it seems inevitable that lingering inequalities will result in a feeling of unfairness among debtors and non-debtor observers. This threatens to rob the French system of legitimacy and educational impact.

### 3. *Belgium and the United States*

The newest and the oldest players in the consumer bankruptcy arena appear to be among the worst offenders in terms of the consistency element of “fairness.” Wide discretion creates the potential for serious “local legal culture” problems in the new Belgian system, as it does in chapter 13 practice in the United States.

For the approximately one-third of all consumer bankruptcy cases filed under chapter 13 in the United States, the law vests broad discretion in the bankruptcy court to reject “wage-earner” payment plans that propose “insufficient” payments to creditors. The U.S. Bankruptcy Code requires chapter 13 debtors to propose a payment plan in “good faith” and to devote all of their “disposable income” to creditors for three to five years.<sup>168</sup> Courts in different districts—sometimes within the same state—have seized on the inherent ambiguity in these standards to impose widely varying requirements for “good faith” proposals and measures of “disposable” income.<sup>169</sup> United States scholars have clearly identified and critiqued the problem of “local legal culture” that these and other provisions produce among U.S. bankruptcy courts.<sup>170</sup>

Similarly, the new Belgian system creates inevitable local variations. It vests the debt-mediators and courts with broad discretion to assign to debtors

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<sup>166</sup> See *id.* at 651–52, 658, 664 & n.335.

<sup>167</sup> See C. COM. art. L.331-3.

<sup>168</sup> 11 U.S.C. § 1325(a)(3), (b)(1)(B) (2000).

<sup>169</sup> See, e.g., Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 532, 546–47, 550–51 (1993) (noting the bankruptcy court in San Antonio, Texas, requires 100% payment, in Cincinnati, Ohio, 70%, in Austin, Texas, 25–33%, and in Dayton, Ohio, 10%).

<sup>170</sup> Teresa A. Sullivan et al., *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL’Y 801 (1994).



varying levels of sacrifice and varying amounts of relief. A court-imposed plan *may* contain a wide variety of measures, up to and including partial discharge of debt.<sup>171</sup> But whether and to what extent such relief is offered is purely a matter of the unfettered discretion of the court.<sup>172</sup> Moreover, given the lack of guidelines, courts are free to demand greater or lesser payments from debtors.<sup>173</sup> The law seems to suggest debtors *generally* be left with all of their exempt income, but certain judges might decide by “specially motivated” decisions to cut deeper into debtors’ financial lives, so long as debtors retain the meager minimum existence guaranteed by law.<sup>174</sup> Some courts are likely to be more “specially motivated” to demand more from debtors than other courts. Discretionary systems like the new Belgian one are apt to rate low on the “fairness” scale, and the payment demands they impose are therefore apt to lose their moral imperative.

### CONCLUSION

Behavioral science has revealed systematic and persistent psychological biases and mental shortcuts that consumers use in making welfare-jeopardizing decisions and predictions about borrowing.<sup>175</sup> Behavioral economic analysis of the dangerous new world of consumer credit can therefore help us to be more sensitive to and understanding of the plight of today’s consumer. The consumer is psychologically overwhelmed and perhaps overpowered by the lure of buying now and paying later. If these forces cannot be controlled or counteracted, as behavioral economics suggests,<sup>176</sup> perhaps consumer bankruptcy systems can only offer effective *relief* as opposed to effective *treatment* of the problem of overindebtedness.

If social education and the inculcation of payment morality are important goals of the consumer insolvency system, behavioral economics further suggests payment plans might achieve these results, but certain tactics will jeopardize educational potential by souring debtors and perhaps others against systems perceived as “unfair.”<sup>177</sup> The behavioral economics perspective is certainly not “dispositive” of any question, but it does offer another compelling

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<sup>171</sup> See CJ/GW, *supra* note 105, arts. 1675/12 & 1675/13.

<sup>172</sup> See *id.*

<sup>173</sup> See *id.*

<sup>174</sup> See *supra* Part IV.A.3.

<sup>175</sup> See *supra* Part I.

<sup>176</sup> See *supra* Part II.

<sup>177</sup> See *supra* Parts III-IV.A.

vantage point from which to evaluate different efforts to enhance the educational value of one system or another. Given the returns to creditors in these systems (generally little or nothing),<sup>178</sup> it appears as though education is the most plausible goal of consumer bankruptcy, and European lawmakers seem to be focused on that goal.<sup>179</sup>

Neither legislative history nor subsequent commentary contains any evidence that any legislature has considered or is even aware of the behavioral economics implications of any chosen approach to consumer debt relief. But for what it might be worth, behavioral economics supports developments in, for example, the German system, while challenging the effectiveness of other European systems in achieving their goals of social education and inculcating payment morality.<sup>180</sup> I do not wish to overstate the ability of behavioral economics to identify the “best” system. But I do propose behavioral economics offers one useful, neutral perspective from which to judge and compare these systems.<sup>181</sup>

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<sup>178</sup> See, e.g., Niemi-Kiesiläinen, *Consumer Bankruptcy in Comparison*, *supra* note 10, at 501.

<sup>179</sup> See, e.g., *id.* at 498.

<sup>180</sup> See *supra* Part IV.

<sup>181</sup> On the role of economic analysis of law as an external baseline from which to evaluate comparative approaches to law, see UGO MATTEI, *COMPARATIVE LAW AND ECONOMICS* (1997); Catherine A. Rogers, *Gulliver's Troubled Travels, or the Conundrum of Comparative Law*, 67 *GEO. WASH. L. REV.* 149, 151, 153, 157–58, 163, 190 (1998).

