

Consumer Sovereignty: The Australian Experience

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Abstract: Consumer sovereignty is a vital assumption in the economics and law of consumer welfare and market participation. Australia's recent credit reforms present a challenge towards the traditional 'thin' neoliberal perceptions of consumer sovereignty and non-interventionist policies. The legislative developments are 'thick' versions of consumer sovereignty. They recognise the need to intervene in consumer affairs to enable consumer participation. The thicker concept of consumer sovereignty is used as a comparative standard to critically evaluate present reforms. The paper uses the thicker concept of consumer sovereignty to evaluate present reforms. The evaluation determines if reforms enhance consumer market participation through greater financial inclusion or whether, conversely, consumer participation is unduly hindered. Recent payday lending reforms diverge from both the thin and thicker concepts of consumer sovereignty, due to their incomplete and atypically decontextualised nature.

Neoliberalism supports a non-interventionist approach towards consumer markets. To do this, the theory relies upon the assumption that consumers are sovereign, innately rational and therefore the superior decision makers as well puppet masters of the market mechanism. Insights from the school of behavioral economics have placed doubt on the assumption by painting a slightly dimmer, picture of the consumer as an 'imperfectly rational' market participant.¹ However, consumer sovereignty is capable dual of classification as both an 'descriptive observation' and 'normative standard.' In its normative capacity, consumer sovereignty serves as an ethical standard against which consumers' interest are to be assessed. The consumer finance market is used as a paradigmatic example of how consumer sovereignty, as a normative concept, can better achieve both ethically and economically favorable outcomes. Accordingly, the paper will discharge two objectives. First, it argues that neoliberalism and consumer sovereignty as a descriptive observation offers ineffective framework for achieving consumer interests. Secondly, the paper proposes to introduce the recent Australian credit law

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¹ To explain deviations from the 'rational' standard, the author employs terms such a 'bounded rationality' and 'imperfect rationality,' see generally: Russell B Korokobin and Thomas S Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 *California Law Review* 1051, 1082.

reforms as viable normative frameworks, which seek to effectively reinstate consumers' interests.

I. DUAL CONCEPTION OF CONSUMER SOVEREIGNTY

For the purposes of the foregoing argument, it is important to appreciate that the phrase 'consumer sovereignty' is capable of dual classification.² In its 'descriptive sense' it refers to the factual situation of consumer as 'the sovereign' responsible for deciding what is to be produced and at what price.³ In this sense, it is basically assumed that the market revolves around the consumer. As famously put by Ludwig Von Mises:

'[i]n the economic order based on private ownership in the means of production no special institution, such as political democracy has created for itself, are needed to achieve corresponding success. All production must bend to the consumer's will [...] from this point of view the capitalist society is a democracy in which every penny represents a ballot paper.'⁴

The empirical/descriptive variant rests on the *assumption* that consumers consistently engage in rational decision-making by fulfilling preferences that increase overall wealth. This comes with the caveat that the consumers may not choose rationally at all times but nonetheless it is not legitimate for one person to question the validity of another person's preferences.⁵ Hence, the consumers' *freedom of choice* remains the most prized commodity, regardless of the outcome.⁶ This view is championed by the neoliberalist⁷ school of thought, which favors deregulation and freedom of consumer choice.

² David Lowery, 'Consumer Sovereignty and Quasi Market Failure' (1998) (8) *Journal of Public Administration Research and Theory* 137, 140.

³ Lowery, above n 2, 139; F Knox, 'The Doctrine of Consumer's Sovereignty' (2005) *Review of Social Economy* 383, 393.

⁴ Ludwig Von Mises, *Socialism* (Jonathan Cape, 1936) 443.

⁵ AJ Duggan, 'Some Reflections on Consumer Protection and the Law Reform Process (1992) 17 *Monash University Law Review* 252, 254.

⁶ W Duncan Reekie, 'Consumer Sovereignty Revisited' (1988) 9 *Managerial and Decision Economics* 17, 24.

⁷ The author employs the term 'neo' liberalism which connotes the 'temporal succession from the 19th-century economic liberalism to social democracy and socialism, and then to a new form of economic liberalism.' Heikki Patomaki, 'Neoliberalism and the Global Financial Crisis' (2010) *New Political Science* 431, 434.

In its normative sense ‘consumer sovereignty’ is used ‘as a criterion for evaluating the social desirability of different social situations and, through these, the desirability of the various public policies or institutional structures which give rise to them.’⁸ In this sense, the concept of consumer sovereignty is ethically infused by considering what best achieves the so-called ‘good life’ of consumers.⁹ This approach is resonant of the earlier political theorists, such as Aristotle, who considered political and economic activity from an ‘ethical-practical’ point of view, concerning themselves with the instrumental role of the economy in its ability to further the ‘good life’ and ‘just coexistence of human beings.’¹⁰ Indeed, ‘[i]n its normative sense consumers’ sovereignty asserted the performance of an economy should be evaluated in terms of the degree to which it fulfills the wants of consumers.’¹¹ Therefore, consumer interests are not merely signaled and protected by what the consumer is willing to pay, but rather, additional ‘equity considerations’ which play a role in determining the best course for consumer welfare.¹² The measures espoused by the normative concept of sovereignty would warrant ‘distributive justice’ in the form of tax laws, interest rate ceilings imposed on certain lenders and a limitation on the remedies a lender may seek against her or his consumer borrower.¹³ To use a common example, this approach would justify product safety laws for consumer goods. Indeed, although some ‘risky’ goods would appear preferable to consumers owing to their affordability, the law excludes goods deemed ‘unsafe.’ This may deviate from actual consumer choice, but nevertheless it instills a sense of ‘rationality’ to purchasing decisions, albeit through paternalistic means. Although, theorists have grappled with the exact parameters of the normative content of consumer sovereignty,¹⁴ it bears an essentially ‘paternalistic’ nature in the sense that it focuses on the ‘outcomes,’ of choice, rather than the freedom to exercise choice.¹⁵ Being normative in character, this approach would allow for interventionist policies to achieve the wealth maximisation goal.¹⁶

⁸ Jerome Rothenberg, ‘Consumers’ Sovereignty Revisited and the Hospitability of Freedom of Choice’ (1962) 52 *American Economic Review* 269, 269.

⁹ Lowery above n 2, 140.

¹⁰ Peter Ulrich, ‘Ethics and Economics’ in Laszlo Zsolnai (ed) *Ethics in the Economy: Handbook of Business Ethics* (Peter Lang, 2007) 13.

¹¹ Jerome Rothenberg, ‘Consumers’ Sovereignty Revisited and the Hospitability of Freedom of Choice’ (1962) 52 *American Economic Review* 269, 269-70.

¹² AJ Duggan, ‘Some Reflections on Consumer Protection and the Law Reform Process’ (1992) 17 *Monash University Law Review* 252, 256.

¹³ Duggan above n 5, 260.

¹⁴ Knox above n 3, 393.

¹⁵ Duggan above n 5, 263.

¹⁶ William Redmond, ‘Consumer Rationality and Consumer Sovereignty’ (2000) 58 *Review of Social Economy* 177, 182.

II. THE CONSUMER 'IS' SOVEREIGN

Following the 1980s era of deregulation in consumer credit markets, provenance was given to the descriptive conception of consumer sovereignty.¹⁷ Hence, it was taken for granted that the consumer, as the *Homo Oeconomicus* prototype, was naturally 'rational' and self-expedient: an effective puppet master of market dynamics.¹⁸ Under this descriptive conception of consumer sovereignty, however, 'rationality' becomes somewhat of an ambiguous standard. Theorists in this area hotly contest the exact parameters of 'rational choice theory.'¹⁹

A 'thin conception' of rational choice is relatively undemanding, as it deems all subjective preferences of the consumer, rational.²⁰ This conception cannot be falsified by empirical evidence of consumer choice and thus serves no semantic value. On the other hand, a 'thicker conception' of rational choice is infused with more substantive assumptions, such that the consumer acts to further their economic well being through the satisfaction of rational, wealth-maximising preferences.²¹ This view can readily be falsifiable by market research.²² In the current context, it is the latter view of rationality that has gained traction. This is evidenced by the minimal moral content of neoliberalism, which is its promise of market efficiency through increased competition.²³ In fact, the promise of greater efficiency is commonly cited as a drive towards greater deregulation.²⁴ Consequently, this *Homo Oeconomicus* model of consumers is both very persuasive and falsifiable.

Instead of serving as a normative standard, however, consumer sovereignty has remained a taken-for-granted description of how the market supposedly

¹⁷ Martin Buscher, 'Ethics of the Market' in Laszlo Zsolnai (ed) *Ethics in the Economy: Handbook of Business Ethics* (Peter Lang, 2007) 214.

¹⁸ Ibid 215.

¹⁹ Russell B Korokobin and Thomas S Ulen, above n 1, 1055.

²⁰ Ibid 1060.

²¹ Ibid 1060-1. See also: Laszlo Zsolnai, 'The Moral Economic Man' in Laszlo Zsolnai (ed) *Ethics in the Economy: Handbook of Business Ethics* (Peter Lang, 2007) 43.

²² Behavioral economics is the school generally credited for falsifying the central neoliberal assumptions. The studies typically rely upon empirical data and psychological insights in various market contexts. Kahnemann and Tversky are generally credited for pioneering this form of study. The author relies upon various studies throughout this paper. See generally: D Kahneman and A Tversky, 'Prospect Theory: An Analysis of Decision Under Risk' (1979) 47 *Econometrica* 263.

²³ David Harvey, *A Brief History of Neoliberalism* (Oxford University Press, 2005) 61-2.

²⁴ A Tyree and P Weaver, *Weerasooria's Banking Law and The Financial System in Australia*, 2006 8-9; S Wallis, *Financial Systems Inquiry Final Report* 1996. For the US context, see: Mary Spector, 'Payday Loans: Unintended Consequences of American Efforts to Tame the Beast' in Michelle Kelly-Louw, James Nehf and Peter Rott, *The Future of Consumer Credit Regulation* (Ashgate, 2008) 115.

works. Scholars such as Ulrich have observed a progressive ‘disembedding’ of ethics from the market and economy.²⁵ This is because the neoliberal ideal considers a market mechanism fuelled by deregulation and unbridled consumer choices, as an end in itself, free from the shadows of ‘morality.’²⁶ Consumer sovereignty is an essential component of this intervention-free model. Each consumer participant seeks a material increase in wealth in exchange for her purchasing preference²⁷ such that consumers’ consumption coerces the suppliers’ production.²⁸ It is assumed that the *majority* of consumers’ subjective choice will correspond to rationally preferred outcomes.²⁹ With this, the market mechanism presents a scientific, self-sufficient rationale for distribution.

A. Responding to Consumer Interests Through Contract

The preceding economic exposition neatly translates into the legal concept of ‘freedom to contract.’³⁰ In similar vein the legal equivalent of neoliberalism, classical contract theory, argues that contracts between parties ought to be upheld as consequences of choice or the results of self-expedient negotiation.³¹ Intervention is only justified to uphold the bargains so reached,³² save for some exceptions.³³ Added intervention into the terms negotiated threatens the freedom of the contracting parties’ choice.³⁴ The concept of contractual freedom of choice is similarly an end in itself, which promises an evolution of choice culminating in the most efficient terms.³⁵ For example, it is argued that unfair terms will lose appeal and eventually be purged from the market place through the evolutionary process of market competition.³⁶

There are several legal avenues through which the neoliberalist approach to market failure is upheld. In Australia, the common law action of

²⁵ Ulrich above n 10, 14.

²⁶ Ibid.

²⁷ Knox above n 3, 385.

²⁸ WH Hutt, *Economists and the Public* (Jonathan Cape, 1936) 290.

²⁹ Michael Faure and Hanneke Luth, ‘Behavioral Economics in Unfair Contract Terms’ (2011) 34 *Journal of Consumer Policy* 337, 353

³⁰ Korokobin et al above n 1, 1055.

³¹ Nicola Howell, ‘Catching up with Consumer Realities: The Need for Legislation Prohibiting Unfair Terms In Consumer Contracts’ (2006) 34 *Australian Business Law Review* 447, 449.

³² Ibid.

³³ In addition to ‘unconscionability’ there are other avenues through which a contract can be set aside, for example: through misinformation (mistake, misrepresentation and misleading practices) or an abuse of power (duress, undue influence and unconscionable dealing).

³⁴ Howell above n 31, 459.

³⁵ Ibid.

³⁶ Ibid.

misrepresentation and its statutory equivalents, promote transparency in dealings with the consumers generally.³⁷ Considerations of ‘fairness’ have traditionally been enlivened in narrow circumstances by the courts where ‘unconscionability’ is thought to exist.³⁸ The principle of unconscionability under the common law has traditionally allowed the courts to set aside contracts for ‘procedural unfairness’ only.³⁹ In Australia, this has meant that the stronger party to the contract has knowingly exploited the weaker party’s disability when entering into or negotiating the contract.⁴⁰ ‘Procedural unfairness’ however focuses narrowly on whether the weaker party was somehow coerced or that the weaker party’s ‘disability’ (old age, state of drunkenness, lack of language skills)⁴¹ was knowingly used by the stronger party. The action was not concerned with whether or not the terms reached by the party were ‘substantively unfair’ by favoring one party over the other in terms of allocating risks and costs, for example.⁴² The US equivalent is found in the *Uniform Commercial Code* § 2-302. This provision is similarly hindered by narrowness in scope and effect,⁴³ though the ‘unconscionability’ in the US is colored by different considerations of consumer expectation and surprise.⁴⁴ In both jurisdictions, varying the terms of the contract is not permitted, as this would ultimately offend against the consumer’s rationality.⁴⁵ The courts do not perceive alterations of the substance of a contract as being their task, instead this task is often relegated to the legislature.⁴⁶

³⁷ Louise Sylvan, ‘Activating Competition: The Consumer – Competition Interface’ (2004) 12 *Competition and Consumer Law Journal* 191, 192.

³⁸ David Harland, ‘The Statutory Prohibition of Misleading or Deceptive Conduct in Australia and Its Impact on the Law of Contract’ (1995) *Law Quarterly Review* 100, 111.

³⁹ The distinction between ‘procedural’ and ‘substantive unfairness’ was first championed by Leff in the context of contracts. It has since proved to be a popular distinction in contract law: Arthur A Leff, ‘Unconscionability and the Code: The Emperor’s New Clause’ (1967) 115 *University of Pennsylvania Law Review* 485.

⁴⁰ *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, 474.

⁴¹ *Blomely v Ryan* (1956) 99 CLR 362.

⁴² *Maynard v Mosely* (1676) 3 Swans 651, 655. The best way to understand ‘procedural unfairness’ is by contrasting it with ‘substantive unfairness,’ the latter is occupied with the outcome of contracting (being the terms), whereas the former concerns the process utilised to reach the outcome. The two may merge at times and the exact boundary of each has been the subject of scholarly debate.

⁴³ J J White and R S Summers, *Uniform Commercial Code* (West Publishing Co 2000, 5th ed) 155.

⁴⁴ R A Hillman and J J Rachlinski, ‘Standard Form Contracting in the Electronic Age’ (2002) 77 *New York University Law Review* 429, 459.

⁴⁵ Rick Bigwood, ‘Conscience and the Liberal Conception of Contract: Observing Basic Distinctions Part I’ (2000) 16 *Journal of Contract Law* 1, 20.

⁴⁶ *Ibid* 22.

B. Responding to Consumer Interests Through ‘Responsibilisation’

In addition to the common law interventions, neoliberalism is upheld by some regulatory approaches, too. Neoliberalism acknowledges that consumers have less information than traders and consequently find difficulty in making decisions that reflect their rational preferences. This is sometimes referred to as ‘market failure’ due to ‘information asymmetry’ and serves to legitimise government intervention.⁴⁷ Market failure occurs because the asymmetry between consumers’ and traders’ knowledge leads to a situation where uninformed consumers base their purchasing decisions on price, as a result of which higher quality goods and contractual terms are driven from the market and the unfavorable goods and non-core contractual terms become standardised.⁴⁸

To provide an illustration, both Service A and Service B operate within the same market, offering substantially similar consumer goods/services. However, owing to unfavorable contract terms (for example, contractual terms which shift the risk of loss to the consumer, away from the service provider) or poor quality, Service B is much cheaper. Service A, on the other hand, is the favorable, albeit a more expensive option. In a market where information asymmetry prevails, Service A will be driven out of the market. While the popularity of Service B will ensure that unfavorable contractual terms become standardised to the detriment of consumers. The correction of information asymmetry is based on the assumption that the consumer will utilise and act upon the information, rationally.⁴⁹ Hence, the law may legitimately intervene in these circumstances to create incentives for traders to disclose relevant information. The intervention is restricted to ‘responsibilisation’ of the consumer.⁵⁰ Responsibilisation concerns the education of the consumer through increased disclosure of information. This has at times been referred to as ‘soft paternalism.’ Because it merely increases transparency within market transactions, rather than distorting outcomes, it is largely synonymous with preserving the status quo of free consumer choice.⁵¹ With increased deregulation and choice, responsibilising consumers has become an essential component of empowering consumers to make choices and regulate

⁴⁷ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 43.

⁴⁸ GA Akerlof, ‘The market for “lemons”: quality uncertainty and the market mechanism’ (1970) 84(3) *Quarterly Journal of Economics* 488–500.

⁴⁹ Faure et al above n 29, 343.

⁵⁰ Faure et al above n 29, 341. See generally: Therese Wilson, ‘The Responsible Lending Response’ in Therese Wilson (ed) *International Responses to Issues of Credit and Over-Indebtedness in the Wake of Crisis* (Ashgate, 2013).

⁵¹ P Cartwright, *Banks, Consumers and Regulation* (Hart Publishing, 2004) 62.

themselves.⁵² Within the context of consumer finance markets, it has become imperative for consumers to ‘learn the appropriate norms of credit and savings behavior’ in order to become ‘financially literate.’⁵³ Questions pertaining to the cost relative to the use of the information, are at times raised,⁵⁴ however it remains that this is the most favorable policy approach.⁵⁵ Once disclosure is provided it is assumed that consumers can protect their interests by fulfilling preferences. Harm will be reduced, and market competition increased, by ensuring goods and services are more likely to be in line with realistic consumer expectations based on reliable information.⁵⁶

Several regulatory legislative enactments create disclosure obligations for traders, giving effect to neoliberalism’s permissible market interventions. In the Australian consumer finance market, three main examples include:

- The *National Consumer Credit Protection Act 2009* (*NCCPA*) Key Factsheets:⁵⁷ The factsheets are provided with respect to home loans and credit cards, they are intended to be concise and portable, to enable consumers to compare alternative products. The factsheet are designed to cover relevant facts only in tabular form using ‘Schumer Boxes’;⁵⁸
- The *NCCPA* Compulsory Licensing Regime, Credit Guide: The licensing regime requires license holders (defined as ‘credit providers’ and ‘credit assisters’) to provide disclosure through a ‘Credit Guide.’⁵⁹ The ‘Credit Guide’ must be provided as soon as the licensee realises that they will be providing a ‘credit service’ in relation to a ‘credit contract’ to the consumer/borrower. The content of the Credit Guides is extensive, ranging from 16 different items that must be disclosed to the consumer/borrower.⁶⁰ These include: fees payable, the credit providers acted for, commission paid, membership of dispute resolution schemes, the consumer’s entitlement to receive a copy of the preliminary credit assessment, and the statement of prohibition on providing an ‘unsuitable credit contract’ (this is a more substantive

⁵² Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 10.

⁵³ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 10.

⁵⁴ Faure et al above n 29, 341-342.

⁵⁵ Geraint Howells, ‘The Potential Limits of Consumer Empowerment by Information’ (2005) *Journal of Law and Society* 349, 356; Florencia Marotta-Wurgler, ‘Does Contract Disclosure Matter?’ (2012) *Journal of Institutional and Theoretical Economics* 94, 97.

⁵⁶ Geraint Howells, ‘The Potential Limits of Consumer Empowerment by Information’ (2005) *Journal of Law and Society* 349, 355.

⁵⁷ This initiative was introduced by: *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2009* (Cth).

⁵⁸ *National Consumer Credit Protection Act 2009* (Cth) Pt 3-2A – 3-2B.

⁵⁹ *National Consumer Credit Protection Regulations 2010* reg 26A.

⁶⁰ *National Consumer Credit Protection Regulations 2010* reg 26A; *National Consumer Credit Protection Act 2009* (Cth) ss 113, 126, 158.

concept which is analysed under ‘consumer financial products generally’)

- The *Uniform Consumer Credit Code Disclosure*: This disclosure mechanism operated prior to the Credit Guide, considered above. The regime required the disclosure of an ‘annual percentage rate’ (‘APR’)⁶¹ of interest, the total interest chargeable and similar other fees payable information to be disclosed prior to the entry into a loan.⁶²

The reforms mirror similar developments in the United States. The US *Truth in Lending Act* (‘*TILA*’), enacted in 1968, was aimed at ‘a meaningful disclosure of credit terms’ to ‘protect the consumer against unfair credit billing and credit card practices.’⁶³ The ‘responsibilisation’ approach assumes that once the borrower is properly informed of the terms of the loan, such as the actual rates charged, they will draw upon their inherent rationality and bargaining power to seek credit elsewhere or change the terms of the credit contract.⁶⁴ Hence, it is assumed that ‘responsible lending’ practices will eventuate through increased disclosure.⁶⁵ Increased disclosure is certainly a worthy interventionist measure. However disclosure’s effect on consumer choice depends on how the information provider regards its audience.

For instance, where the mode of disclosure recognises that consumers may only be ‘imperfectly rational,’ better results are achieved. Brief and relevant disclosure mechanisms (such as the key factsheets approach in Australia) are likely to yield more favorable results in terms of consumer understanding and preference fulfillment rather than for instance a more detailed disclosure method (such as the ‘Credit Guide,’ approach in the Australian context).⁶⁶ US commentator Bar-Gill argues the most effective disclosure in lending scenarios would confront consumer shortcomings directly, by for instance, disclosing how much the average consumer of that particular credit product pays in late fees.⁶⁷ The struggle between effective and complete disclosure

⁶¹ Whereas flat rates of interest can be misleading, the APR approach makes comparison shopping easier by consolidating the total cost of the loan, the length of the term and the size of repayments.

⁶² *Uniform Consumer Credit Code* (Qld) ss 14, 15.

⁶³ *Truth in Lending Act* 15 USC § 1601.

⁶⁴ Rashimi Dyal-Chand, ‘From Status to Contract: Evolving Paradigms for Regulating Consumer Credit’ in Michelle Kelly-Louw, James Nehf and Peter Rott, *The Future of Consumer Credit Regulation* (Ashgate, 2008) 56. Oren Bar-Gill, ‘Consumer Contracts: Behavioral Economics vs Neoclassical Economics’ (2007) *New York Centre for Law and Economics* 1, 35.

⁶⁵ Iain Ramsay, ‘Consumer Law, Regulatory Capitalism and the ‘New Learning’ in Regulation’ 9 (2006) *Sydney Law Review* 9, 13.

⁶⁶ See for example: Queensland Law Society, Submission on the Commonwealth Treasury, *Draft National Consumer Legislation*, 21 May 2009, 10.

⁶⁷ Oren Bar-Gill above n 64, 39. Other examples of this approach to disclosure include the United Kingdom’s ‘minimum credit card’ repayments disclosure, which requires credit

against brief and relevant disclosure is a difficult balance to accomplish.⁶⁸ Working on the assumption, as neoliberalism does, that all consumers are rational diminishes the effectiveness of disclosure. Usually, this assumption allows for detailed and unscrupulous disclosure mechanisms.⁶⁹

Despite the relative success of some disclosure methods over others, disclosure suffers from some fundamental handicaps in terms of reinstating consumer sovereignty. The standardisation of unfavorable contractual terms cannot simply be remedied by disclosure.⁷⁰ This is because most consumers will either be deterred from considering the disclosed material due to time costs, or even when the disclosed information is considered consumers are likely to underestimate the risk inherent in the transaction owing to their limited rationality.⁷¹ This has led scholars to question the rationality assumption and consequently introduce a more substantive variant of consumer sovereignty under the guise of substantive legal interventions.⁷² The school of behavioral economics better explains how the disclosure approach to consumer interests is an ineffective and partial measure.

III. INSIGHTS FROM BEHAVIORAL ECONOMICS

Behavioral economists, relying on an intersection between psychology and economics, question the empirical foundations of neoliberalism's claims and responses to market failure.⁷³ To this end, the behavioralist method commences with the observation that disclosure and information is itself

providers to warn credit card holders about the dangers accompanying minimum payments on their credit cards, regulations enacted under: *Consumer Credit Act 1974* (UK) s 78(4)(a). The US approach to minimum payments includes a more explicit mathematical example, by warning: 'making the minimum only the typical 2% minimum monthly payment on a balance of \$1 000 at an interest rate of 17% would take it 88 months to repay the balance in full:' *US Bankruptcy Abuse Prevention and Consumer Protection Act 2005* s 1301.

⁶⁸ Oren Bar-Gill above n 64, 35.

⁶⁹ Lynden Griggs, 'Intervention or Empowerment – Choosing the Consumer Law Weapon!' (2007) 15 *Competition and Consumer Law Journal* 111, 119. (Providing an example of disclosure of commissions earned in consumer insurance contracts).

⁷⁰ The process of unfavorable contract terms becoming standardized, was briefly illustrated above in the Service A and Service B example.

⁷¹ Iain Ramsay, 'Consumer Credit Regulation as "The Third Way"?', Keynote Address, 2nd National Consumer Credit Conference, Melbourne, November 2004.

⁷² Duggan A, 'Economic Analysis of Standard Form Contracts: An Exposition and a Critique' in Cranston, R and Schick A (eds), *Law and Economics* (Department of Law, Research School of Social Sciences, 1982) 152.

⁷³ Joel Waldfogel, 'Does Consumer Rationality Trump Consumer Sovereignty?' (2005) 87 *The Review of Economics and Statistics* 691, 691.

premised upon two vital assumptions. Namely, that the consumer will read the disclosed information and, as a result, will modify purchasing behavior to better reflect preferences.⁷⁴ Several insights militate against these assumptions. Firstly, as mentioned in the above discussion, there may be cognitive limits to human comprehension. From the outset it must be acknowledged, quite ironically, consumers may ‘rationally’ decide to forgo reading disclosed information on the basis of complexity and the anticipated time costs.⁷⁵ Assuming consumers do consider the disclosed information, empirical studies show little benefit is gained, as the information is often poorly understood.⁷⁶ Today’s consumers are faced with a multiplicity of difficulties when comparing different goods and services, not least of which is the sheer complexity that accompanies some contractual terms.⁷⁷

Compounding this, the producer/lender may not have the incentive to simplify information for consumers.⁷⁸ On the contrary, traders/lenders may be incentivised to exploit cognitive limitations by ‘manufacturing confusion.’⁷⁹ This approach can be evidenced by producers increasing the costs of comparison-shopping through ‘bundling’ different aspects of a product or service.⁸⁰ In fact, consumer financial products can essentially be described as a bundle of complex and interrelated contractual provisions, rather than a tangible consumer item susceptible to quick detection, comparison and judgment.⁸¹ Credit card pricing is ‘multidimensional,’ as issuers do not offer a single-price interest rate reflective of the risk assumed.⁸² Instead, issuers may employ different charges including late payment fees and rewards schemes, which add to the confusion and cost of switching between providers.⁸³

Secondly, personal biases may negate the effectiveness of an otherwise satisfactory objective understanding.⁸⁴ Thus assuming the consumer achieves a good understanding of what is disclosed, there are several additional

⁷⁴ Florencia Marotta-Wurgler above n 53, 95.

⁷⁵ Howells above n 55, 356.

⁷⁶ See for example: Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 11.

⁷⁷ Vijaya Nagarajan, ‘Reconceiving Regulation: Finding a Place for the Consumer’ (2007) 15 *Competition and Consumer Law Journal* 93, 96.

⁷⁸ Howells above n 55, 359-60.

⁷⁹ Vijaya Nagarajan above n 77, 95.

⁸⁰ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 54.

⁸¹ Griggs above n 69, 119.

⁸² Oren Bar-Gill above n 64, 17.

⁸³ *Ibid* 17-18.

⁸⁴ Howells above n 55, 360. Oren Bar-Gill, ‘Consumer Contracts: Behavioral Economics vs Neoclassical Economics’ (2007) *New York Centre for Law and Economics* 1, 35.

shortcomings, which lead to irrational decision-making. Relevantly, these include:⁸⁵

- Hyperbolic discounting: This finding contradicts the neoliberal assumption that consumer rationality includes the ability to consider present and future benefits using consistent and rational discount rates. For instance, people may choose to delay ‘pain’ in preference for present satisfaction.⁸⁶ This helps explain why consumers in the payday lending market are attracted to instantaneous small amount loans, despite high rates and fees;⁸⁷
- Over-optimism: People tend to over-estimate their own capacities, including the ability to avoid risk. For example, borrowers are more likely to believe they will not incur any late fees on their credit repayments, despite empirical trends showing that late fees are common and statistically likely;⁸⁸
- Fairness: Research shows that consumers are influenced by considerations of ‘fairness’ and are likely influenced by social norms over what would otherwise be rational, atomistic behavior.⁸⁹ This may, it has been commented, support legislative reforms which seek to control the maximum rates charged on certain types of high-risk consumer lending, such as payday lending;⁹⁰
- Emotions: A more sophisticated study of consumer behavior links consumption to emotion rather than rational choice. A classic example would be the incessant ‘shopaholic,’ whose purpose is to feed an emotional dependency rather than organise life according to rational purchasing decisions;⁹¹

In the consumer finance markets, the practices of automatic increases in borrowing limits, reductions in minimum payment amounts and low-interest introductory ‘teaser rates’ foster a ‘culture of indebtedness.’⁹² Typically, consumers are prone to overestimating their willpower and underestimating

⁸⁵ Different scholars choose different labels/classifications for the findings, however the notions are largely consistent. For a different categorization altogether, see: Korokobin above n 1, 1116.

⁸⁶ When asked to complete a painful 7 hour task in either the 1st of April or the 15th, people naturally choose the earlier date. However, as the time to complete the task looms, people are inclined to take advantages to put off the task: Gans (2005) p 2.

⁸⁷ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 57.

⁸⁸ Oren Bar-Gill above n 64, 37.

⁸⁹ Korokobin above n 1, 1128.

⁹⁰ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 22.

⁹¹ Iain Ramsay above n 45, 61.

⁹² Iain Ramsay above n 45, 64.

future spending, by placing undue reliance on their ‘ability to resist the temptation to finance consumption by borrowing’ credit thus opens the ‘door to the seductiveness of ‘incremental irresponsibility.’⁹³ In essence, lenders tend to take advantage of cognitive shortcomings to further their agenda, with little to no incentive to compete with other lenders.⁹⁴ Clearly, a policy, which seeks to expand disclosure, is an insufficient measure.

IV. THE CONSUMER ‘OUGHT TO BE’ SOVEREIGN

How does the foregoing discussion amount to a policy framework? Most economists, it has been suggested, ‘shudder’ at the thought of integrating conflicting and confusing behaviorist findings into a coherent framework.⁹⁵ Proponents argue neoliberalism offers a superior method of predicting behavior.⁹⁶ Behavioralism may indeed be questioned in terms of providing a viable policy framework.⁹⁷ How can policy makers be sure that regulation, which has the effect of ‘reigning in’ consumer choice, will not end up causing more harm than good?⁹⁸ Furthermore, should policy makers inhibit ‘tough love’ responsabilisation in preference for paternalistic measures, which further entrench consumer irrationality and vulnerability?⁹⁹

Although, these queries are worthy of consideration, they do not necessarily provide a basis for rejecting market regulation. By seeking to explain the irrational nature of the everyday consumer and the ways in which producers/suppliers utilise these shortcomings to foster an anti-competitive market. The behaviorist findings not only debunk consumer sovereignty in the ‘descriptive’ sense, but also make a real case for re-instating the consumer as sovereign in the ‘normative’ sense. Rather than advocating for laws that respond strictly to consumer biases, the behaviorist school offers a better-informed view of the limits consumer characteristics.¹⁰⁰ It recognises consumer protection laws must stem from a complex matrix of politics,

⁹³ Oren Bar-Gill, ‘Seduction By Plastic’ (2004) 98 *Northwestern University Law Review* 1373, 1395.

⁹⁴ I Ramsay, ‘Consumer Credit Regulation as “The Third Way”’, Keynote Address, 2nd National Consumer Credit Conference, Melbourne, November 2004.

⁹⁵ Ibid.

⁹⁶ Russell B Korokobin and Thomas S Ulen, ‘abpve n 1, 1071.

⁹⁷ Gerald Spindler, ‘ Behavioral Finance and Investor Protection Regulations’ *Journal Of Consumer Policy* 315, 326 (who argues that disclosure offers a better normative standard to setting out how we should be, i.e. we should be more rational and employ information provided).

⁹⁸ SG Corones, *The Australian Consumer Law* (Thomson Reuters, 2nd ed, 2013).

⁹⁹ Gillian K Hadfield et al, ‘Information-Based Principles for Rethinking Consumer Protection Policy (1998) 21 *Journal of Consumer Policy* 131, 154.

¹⁰⁰ Howells above n 55, 364.

psychology and the law.¹⁰¹ Trebilcock provides a critique of market deregulation, stating:

‘[f]or economists to claim that they are only concerned with maximising the total value of social resources, without being concerned about how the gains in the value of social resources are to be distributed and whether these gains are in fact making the lives of individuals better [...] reflects a highly impoverished view.’¹⁰²

On the other hand, interventionist measures based on behavioral findings provide potential for correction of market failures, which have resulted from over reliance on consumer rationality and partial, reactive measures.¹⁰³

To this effect, this section commences by considering the Australian consumer credit reforms generally and the ways in which they respond to specific consumer interests highlighted by the Global Financial Crisis (‘GFC’). Second, the paper considers the recent reforms as they relate to the ‘payday lending market’ and the ways in which they respond to the consumer interest in the context of high lending rates and ineffective market competition. These extensive reforms effectively transform consumer sovereignty to a normative standard requiring ‘institutions, both public and private, to wield influence over [consumer] preferences.’¹⁰⁴

V. REGULATORY EFFORTS TO RE-INTRODUCE THE CONSUMER AS SOVEREIGN

A. Consumer Financial Products Generally

The ‘Global Financial Crisis’ triggered several policy shifts away from the consumer rationality assumption. Ramsay observes that since the crisis the nomenclature of ‘consumer choice’ and reliance on consumer rationality has suddenly become unfashionable.¹⁰⁵ Briefly, one of the central causes of the Financial Crisis was the weakening of US consumer laws, allegedly for the

¹⁰¹ Griggs above n 69, 115.

¹⁰² Michael Trebilcock, ‘An Introduction to Law and Economics’ (1997) 23 *Melbourne University Law Review* 157, 158.

¹⁰³ Therese Wilson, ‘The Responsible Lending Response’ in Therese Wilson (ed) *International Responses to Issues of Credit and Over-Indebtedness in the Wake of Crisis* (Ashgate, 2013) 110.

¹⁰⁴ Joseph Perskey, ‘Retrospectives: Consumer Sovereignty’ (1993) 7 *Journal of Economic Perspectives* 183, 190.

¹⁰⁵ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 13.

purpose of increasing efficiencies in security markets nationwide.¹⁰⁶ As a result, loan repayments were easily bundled and on sold as bonds by lenders to investors. This had the effect of superficially removing the default risks from the lenders' balance sheets, and hence removing the incentive to ensure that borrowers had the ability to repay the loans granted.¹⁰⁷ The lenders were ignorant of consumers taking on credit they could not afford as 'that was their choice and their problem,' and instead 'the market's job was to offer consumers choices, and the consumers' job was to take personal responsibility for the choices made.'¹⁰⁸ Following the crisis, legislators around the world sought to reform their respective markets, giving preference to more interventionist methods. Wilson notes that the responses onset by the Crisis, remain simply as response, myopic and *reactive* (rather than proactive) in nature.¹⁰⁹ Regardless, the message provided by the Crisis was loud and clear: it is no longer feasible to simply describe the consumer as sovereign and hope for innate rationality. Consumer sovereignty is a worthy normative and ethical ambition, which requires regulatory support.

In Australia, the modern consumer law agenda is epitomised by the Unfair Contract Terms, as enacted under the Australian Consumer Law ('ACL') Parts 2 – 3. The Act applies exclusively to 'standard form',¹¹⁰ 'consumer contracts',¹¹¹ which are 'unfair.'¹¹² While, the ACL has superseded the limited concept of 'unconscionability'¹¹³ as it applies to consumers. The provisions are far reaching and are not limited to narrow categories of procedural unfairness.¹¹⁴ To an extent the protection regime for consumer credit mirrors the general reforms pertaining to consumer contracts generally.¹¹⁵ For instance:

¹⁰⁶ James Nehf, 'Consumer Credit Regulations and International Financial Markets: Lessons from the Mortgage Meltdown' (2011) *Indiana University School of Law* 1, 5.

¹⁰⁷ Wilson above n 103, 122.

¹⁰⁸ Kathleen Engel and Patricia McCoy, *The Subprime Virus: Reckless Credit, Regulatory Failure and Next Steps* (Oxford University Press, 2011) 17.

¹⁰⁹ Wilson above n 103, 110 (labeling it 'neoliberal reactivity').

¹¹⁰ *Competition and Consumer Act 2010* (Cth) Sch 2 s 23(1)(b).

¹¹¹ *Competition and Consumer Act 2010* (Cth) Sch 2 s 23(1) (see s 28 for exclusions).

¹¹² *Competition and Consumer Act 2010* (Cth) Sch 2 s 24.

¹¹³ This concept was considered above. It is used by contracting parties as a basis of relief where a stronger party takes an advantage of the weaker party's disability/vulnerability to procure the contract (i.e. procedural unfairness). Though the concept is limited in various ways, including the fact that it does not consider the fairness of the terms (substantive unfairness). This limited concept of unconscionability does not apply to consumers any longer given the abovementioned reforms.

¹¹⁴ *Australian Competition and Consumer Commission v Lux Pty Ltd* [2004] FCA 926 [18].

The section is deliberately unrestricted by the unwritten law s 21(4) ACL. This means that both the outcome of the contracting process (substantive fairness) and the ways these terms were procured (procedural unfairness) are both relevant to the court's inquiry.

¹¹⁵ Denise McGill et al, 'Regulating the Cost of Small Loans: Overdue or Overkill?' (2012) 30 *Company and Securities Law Journal* 149, 156-159.

- The *National Credit Code* (which was enacted as Schedule One of the *NCCPA*) ‘hardship’ provisions, which allow a debtor to apply to have loan repayments restructured.¹¹⁶ This occurs where the borrower can prove ‘hardship’ would result from complying with the terms of the loan.¹¹⁷
- In addition, the ‘unjust transactions’ (also under the *NCCPA*) provisions allow the court to ‘re-open’ a credit transaction where it was entered into in circumstances of ‘unconscionability, harshness and oppression.’¹¹⁸ The injustice warranting a re-opening can stem from substantive qualities of the financial contract,¹¹⁹ such as its terms as well as procedural qualities relating to the unfair methods employed to enter into the contract.¹²⁰ A separate but similar regime exists for financial services.¹²¹

The more proactive and innovative approach is found in Chapter 3 of the *NCCPA*, which imposes ‘responsible lending obligations,’ to contracts for the provision of credit or the process for seeking to enter into a ‘credit contract.’¹²² Under the provisions:

- All ‘credit providers,’¹²³ who engage in a ‘credit activity’ must hold an ‘Australian Credit License.’
- Amongst other obligations,¹²⁴ the licensees must ensure that reasonable inquiries are made 90 days before the provision of credit or credit assistance, concerning the product’s suitability to the consumer’s

¹¹⁶ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 72. Ultimately, where the creditor does not respond, the courts are empowered to alter the contractual terms, however the principal sum owed cannot be reduced: see s 74(2).

¹¹⁷ For an analogous case of what hardship means in the circumstances, see: *Permanent Custodians Ltd v Upston* [2007] NSWSC 223.

¹¹⁸ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 76(8).

¹¹⁹ Justin Malbon, ‘Responsible Lending, Unjust Terms and Hardship’ in Justin Malbon and Luke Nottage (eds), *Consumer Law and Policy in Australia and New Zealand* (The Federation Press, 2013) 255.

¹²⁰ *Ibid* 255.

¹²¹ Owing to political reasons, the financial services and products are considered by different regulatory regimes: *Australian Securities and Investments Commission Act 2001* (Cth) s 12CB(1)(5) (unconscionable conduct), s 12BG(1) (unfair contractual terms).

¹²² These apply to a ‘credit consumer’ defined to mean a natural person or a strata corporation: *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 5. ‘Credit contract’ is defined to mean ‘a contract under which credit is or may be provided’: *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 4.

¹²³ Defined broadly under: *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 6 (to include ‘credit services’) s 7 (to include ‘credit assistance’) s 8.

¹²⁴ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 ss 113, 126.

financial position.¹²⁵ Credit must not be provided where the provider finds that the consumer is ‘unsuitable.’¹²⁶

- Furthermore, all credit contracts are capped to exclude an annual cost rate of above 48%.¹²⁷ The annual cost rate is determined according to formula in s 32B.¹²⁸

These requirements, in particular, mark a shift from consumer ‘responsibilisation’¹²⁹ to a proactive regime, whereby the lender is under a duty to make reasonable inquiries pertaining to the borrower’s suitability to a particular product.¹³⁰ However, the approach retains the benefits of a contextualised analysis, by requiring the lender to assess whether the loan product is ‘suitable’ in the *individual* circumstances of each prospective borrower.¹³¹ This in turn reduces the chances of ‘bright-line’ financial exclusion of particularly vulnerable borrowers.¹³² Financial exclusion refers to a consumers’ inability to seek safe, mainstream credit due to their poor credit history and/or economic situation.¹³³

The proactive Australian approach can be contrasted to the US position. The US *Dodd-Frank Act* requires only home loan lenders to assess the consumers’ ability to repay the loan.¹³⁴ Further, the US approach is less nuanced as it fails to consider whether, despite inability to repay, the loan is nevertheless suitable to that particular consumer.¹³⁵ At the same time the ‘ability to repay’ is assessed according to debt-to-income ratios, which could potentially

¹²⁵ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 ss 117, 130.

¹²⁶ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 129 (obligations). Failure to comply with the obligation may attract a civil penalty, the creditor must produce evidence of compliance without notice (s 132(1), (2)).

¹²⁷ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 32A.

¹²⁸ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 32B.

¹²⁹ Cf. *Uniform Consumer Credit Code* (Qld) ss 70(1)(l) (the obligations placed an onus on lenders to argue that the transaction was unjust). *National Consumer Credit Protection Act 2009* (Cth), Explanatory Memorandum, [3.15].

¹³⁰ Wilson above n 103, 125.

¹³¹ Denise McGill et al above n 115, 163. (emphasis added)

¹³² Wilson above n 103, 129.

¹³³ Financial inclusion has been defined as: ‘services and products in the mainstream market that are appropriate to [the consumers’] needs and enable them to lead a normal social life in society in which they belong.’ European Commission, DG Employment, Social Affairs and Equal Opportunity, *Financial Services Provision and the Prevention of Financial Exclusion* (Progress Program Overview Paper, EC 2007) 9.

¹³⁴ *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* §1411.

¹³⁵ This position was expressly rejected by the US legislators, see further: John Patrow, ‘Ability to Repay’ University of Michigan Law School Public Law and Legal Theory Working Paper no 237 (May 2011) <<http://ssrn.com/abstract=1844570>> (Accessed 23rd December 2013).

encourage strict adherence by lenders at the expense of financial *inclusion*.¹³⁶ The 48% cost cap remains a relatively uncontroversial price ceiling to mainstream credit providers.¹³⁷ In fact, the 48% cap is considered substantially generous and economically practical by mainstream banking institutions, therefore the possibility of decreased supply as a result of the cap is not an issue for these lenders. While at the same time it has been observed that, due to reputational interests within the mainstream credit market, lenders are generally deterred from raising their interest rates higher to closer reflect the price ceiling.¹³⁸

B. Payday Lending Practices

The ‘payday lending’ markets, offer a paradigmatic example of the limits to consumer rationality and the consequent need for interventionist policies to bolster the consumer interest. While the neo-liberal market is largely independent of any substantive moral or ethical dimensions, it does depend upon the ethics of consumer freedom and consequent market competition and efficiency.¹³⁹ With consumers being ‘rational actors, [that] gather information and actively participate in the market, demonstrating their presence by the choices they [make].’¹⁴⁰ These prerequisites are found wanting in the payday scenario.

For consumers of such loans, the speed and the convenience of services is the key factor such that they are unlikely to ‘shop-around.’¹⁴¹ As a corollary, lenders lack the incentive to lower interest rate and fee prices,¹⁴² which has the effect of creating a homogenous and uncompetitive market. Another commonly cited justification of high interest rates and fees (usually by the lenders) is the risky nature of the loans provided.¹⁴³ This has resulted in some homogeneity within the consumer finance market, fuelled by systematic consumer error, resulting in high profits earned by the payday industry.¹⁴⁴

¹³⁶ *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* §1412.

¹³⁷ Nicola Howell, Therese Wilson and James Davidson, ‘Interest Rate Caps: Protection or??’ (Centre for Consumer and Credit Law, December 2008) 114.

¹³⁸ *Ibid* 19.

¹³⁹ Buscher above n 17, 215.

¹⁴⁰ Vijaya Nagarajan, ‘Reconceiving Regulation: Finding a Place for the Consumer’ (2007) 15 *Competition and Consumer Law Journal* 93, 97-8.

¹⁴¹ Only 9.3% consumers reported making a decision based on cost in a recent study Zac Gillam above n 141, 66.

¹⁴² Nicola Howell, ‘Interest Rate Caps and Price Regulation in Consumer Credit’ in Justin Malbon and Luke Nottage (eds), *Consumer Law and Policy in Australia and New Zealand* (The Federation Press, 2013) 325.

¹⁴³ Nicola Howell et al above n 137, 17.

¹⁴⁴ Iain Ramsay, *Consumer Law and Policy* (Hart Publishing 2nd ed, 2012) 64. William J. Clinton and Arnold Schwarzenegger, Beyond Payday Loans, *The Wall Street Journal*, 24 January 2008. Check date.

Payday loans refer to small loans typically a few hundred to two thousand dollars in value, intended to be repaid within the borrower's next payday.¹⁴⁵ The typical payday borrower is especially vulnerable, comes from a low economic background and typically uses loan money for essential items and services.¹⁴⁶ It goes without saying that the borrowers do not qualify for typical financial products offered by mainstream lending institutions.¹⁴⁷ In isolation, the Annual Percentage Rate ('APR') of a payday loan is somewhat misleading as a \$25 fee on a \$100 loan to be repaid within 7 days can amount to an inflated APR of 10304.5%. However, as the lender does not anticipate that his or her high-risk borrower will repay the principal debt these fees are employed as 'sweat box' tactics to further 'entrap' the borrower into rolling over on the loan.¹⁴⁸ This often triggers a 'debt spiral,' where borrowers are prompted to make additional loans in order to keep up with the loan repayments.¹⁴⁹

Studies observe that debt spirals from payday lending can lead to consumer physical and psychological harm.¹⁵⁰ The popularity of the loans¹⁵¹ can be attributed to the stressful personal situations that motivate borrowers.¹⁵² Consumers take out the loans when faced with economically desperate situations. Studies show while consumers understand the loans are

¹⁴⁵ Denise McGill et al above n 115, 150.

¹⁴⁶ Mary Spector, 'Payday Loans: Unintended Consequences of American Efforts to Tame the Beast' in Michelle Kelly-Louw, James Nehf and Peter Rott, *The Future of Consumer Credit Regulation* (Ashgate, 2008) 109-110; Denise McGill et al, above n 115, 151-12; Nicola Howell, 'Interest Rate Caps and Price Regulation in Consumer Credit' in Justin Malbon and Luke Nottage (eds), *Consumer Law and Policy in Australia and New Zealand* (The Federation Press, 2013) 325. Cf. Durkin.

¹⁴⁷ Campbell Committee, *Australian Financial System: Final Report of the Committee of Inquiry into the Australian Financial System*, 1981.

¹⁴⁸ Luke Nottage and Souichirou Kozuka, 'Lessons from Product Safety Regulation for Reforming Consumer Credit Markets in Japan and Beyond' (2012) 34 *Sydney Law Review* 129, 137. Cf Richard A Epstein, 'behavioral Economics: Human Error and Market Corrections Symposium, Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice' (2006) 73 *University of Chicago Law Review* 111, 127.

¹⁴⁹ It has been reported, that typical payday consumer takes 9 -13 of such loans as a result of the debt spiral: Zac Gillam and The Consumer Law Action Centre, 'Payday Loans: Helping Hand or Quicksand?' (Consumer Law Action Centre, 2010) 126.

¹⁵⁰ Therese Wilson, 'Responsible Lending or Restrictive Lending Practices? Balancing Concerns Regarding Over-Indebtedness with Addressing Financial Exclusion' in Michelle Kelly-Louw, James Nehf and Peter Rott, *The Future of Consumer Credit Regulation* (Ashgate, 2008) 95.

¹⁵¹ For example in Australia, the National Financial Services Foundation has observed that payday loans comprised \$500 million in 2008, growing to \$800 million by 2011: The National Financial Services Foundation, Submission to *Financial Services and Credit Reform Green Paper* (2008) 2-3.

¹⁵² Zac Gillam and The Consumer Law Action Centre, 'Payday Loans: Helping Hand or Quicksand?' (Consumer Law Action Centre, 2010) 186.

unfavorable, they feel economically coerced to undertake the loans nonetheless.¹⁵³

Deregulation and an increase in consumer choice in the payday lending market has failed to deliver competitive choices for consumers.¹⁵⁴ In response, the Australian legislature seeks to restrict consumer choice. The recent Australian reforms appear to have considered the concerns of payday borrowers in ‘decontextualised’ or ‘bright-line’ manner by employing price caps/ceilings. This means the legislature assumes ‘that the community should not support the provision of loans above a particular cost point.’¹⁵⁵ Because the price caps in the context of payday loans are more stringent than in relation to the general loans (the generous 48% rate considered above), the ‘decontextualised’ nature of the reforms will be felt more by the payday lending industry. This ‘price cap’ approach also appears more ‘arbitrary’ than a contextualised/nuanced approach, which considers the particular borrower’s circumstances. However, a decontextualised approach has its advantages and disadvantages, which shall be discussed in turn.

In addition to the Australian Credit License reforms, considered above, reforms pertaining to payday lending enact even more pervasive obligations. Where the consumer applies for a ‘small amount credit contract’:¹⁵⁶

- It is presumed that the customer cannot fulfill the obligations of the loan without hardship, where at the time of the preliminary assessment, the customer is in default under a small amount credit contract or the customer has been a debtor under two or more small amount credit contracts, 90 days prior to the preliminary assessment.¹⁵⁷
- The provider of small amount credit contracts must, when assessing loan suitability, consider the account statements of the borrower.¹⁵⁸
- The provider must also display warning notices in their premises or online facilities for the perusal of prospective customers.¹⁵⁹

¹⁵³ Nicola Howell et al above n 137.

¹⁵⁴ Sylvan above n 37, 196. For a brief history of deregulation in the US context see: Mary Spector, above n 146, 112-115.

¹⁵⁵ McGill et al above n 115, 168.

¹⁵⁶ *National Consumer Credit Protection Act 2009* (Cth) s 5(1).

¹⁵⁷ *National Consumer Credit Protection Act 2009* (Cth) s 118(3A).

¹⁵⁸ Account statements from the previous 90 days must be checked, where the prospective borrower holds an account with an ADI, to which their income is transferred: *National Consumer Credit Protection Act 2009* (Cth) s 111(7), 130(1A).

¹⁵⁹ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 s 133CB (credit providers), s 124B (credit assistance providers), non-compliance is an offence: s 124B(2), 133CB(2). The warnings include: ‘Do you really need a loan today?’ and ‘Short-term loans are expensive and may not solve your money problems’ together with the provision of alternative solutions and

- Small amount credit contract ‘establishment fees’ are capped at a maximum of 20% in addition to the initial loan sum borrowed.¹⁶⁰ While monthly fees and fees chargeable upon default are similarly capped.¹⁶¹

In implementing more stringent price ceilings the Australian government seeks

‘the right balance between allowing a viable and regulated credit industry to provide consumers in need and at the same time providing safeguards to protect the interests of [...] consumers.’¹⁶²

In doing so, the maximum cost limits for establishment fees increased from the initial drafting stages, in preference for the lenders’ market viability from 10% to 20%.¹⁶³ The ceilings are also all-inclusive and are geared towards preventing ‘cat and mouse’ or evasion tactics employed by the payday lending industry.¹⁶⁴

The decontextualised approach seems necessary and inevitable. The neoliberal promise of increased efficiency has been broken. Although the payday industry is rapidly growing and the low barriers to entry exemplify a ‘textbook’ example of a competitive market, the consumer was missing from the equation.¹⁶⁵ Indeed, in the words of one commentator, the consumers were ‘losers’ of the ‘competition.’¹⁶⁶ In the payday situation, it appears there was no consumer sovereignty because the payday lender was sovereign.¹⁶⁷ The current reforms help remove unhelpful practices, paving the way for consumer

avenues for help: *National Consumer Protection Regulations 2010* (Cth) reg 28XXA(1)(c) (warning notices), reg 28XXB(c) (website warning notices).

¹⁶⁰ *National Consumer Credit Protection Act 2009* (Cth) Sch 1 ss 31A(2), 204.

¹⁶¹ *National Consumer Credit Protection Act 2009* (Cth) Sch 1: Permitted monthly fee of no more than 4% of the adjusted credit amount (s 31A(3)), permitted default recovery of no more than 200% of the adjusted credit amount (s 39B).

¹⁶² House of Representatives, Parliament of Australia, *Parliamentary Debates* (Bill Shorten, Minister for Financial Services and Superannuation, 26 June 2012) 71.

¹⁶³ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia *Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (Proof Committee Hansard, 24 August 2011) 22.

¹⁶⁴ Exploitation of legal loopholes is prevalent in this market: Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (Proof Committee Hansard, 24 August 2011) 26-27.

¹⁶⁵ See generally: Sylvan above n 37.

¹⁶⁶ Chris Field, ‘Competition, Consumer Protection and Social Justice – Providing a Consumers’ Voice’ (2005) 33 *Australian Business Law Review* 51, 54.

¹⁶⁷ Nicola Howell above n 132, 23.

and competition responsive approaches.¹⁶⁸ In all, the Australian reforms are advancing a ‘social justice’ agenda, typical of a normative conception of consumer sovereignty.¹⁶⁹

Price regulation is an imprecise science and potentially harmful to both lender businesses and consumers.¹⁷⁰ The ‘bright-line’ price regulation approach may pose significant issues for financial exclusion and consumer autonomy.¹⁷¹ It is anticipated that some payday loan providers will be driven out of the market, due to the economically impracticable/unviable price controls employed.¹⁷² Clearly, the decrease in market size will impact some borrower’s ability to gain credit, creating the potential for financial exclusion. It becomes important to emphasise that removing payday lending does not relieve the payday consumers from the structural inequities, which encourage the borrowing practices in the first place.¹⁷³ In similar vein, Morgan and Strain in a 2007 study observe that a total ban on payday lending increased household debt problems (analysed according to formal and informal bankruptcies, such as the prevalence of bounced checks and other indicators including complaints made against debt collectors).¹⁷⁴

Based on a (roughly) 3-year observation period,¹⁷⁵ the study claims the findings are not mere ‘withdrawal symptoms’ from the payday lending practice, but are permanent ramifications.¹⁷⁶ These findings certainly offer a valuable observation. However, arguably 3 years is not long enough to gain reliable results. Further, a careful observation of the charts indicates that most of the growth in consumer indebtedness is a feature of steady increase, suggesting that something structural, such as lack of social welfare provision coupled with increased living expenses, is the more likely cause.¹⁷⁷ In any case, it is worth noting the pricing structures utilised by payday lenders is economically justified, given the heightened risk most sub-prime borrowers

¹⁶⁸ S Ben-Ishai, *Regulating Payday Lenders in Canada: Drawing on American Lessons* (CLPE Research Paper, Osgoode Hall Law School, Toronto, 2008) 32-33.

¹⁶⁹ Justin Malbon above n 114, 260.

¹⁷⁰ D Cayne and M Trebilcock, ‘Market Considerations in the Formulation of Consumer Protection Policy’ (1973) 23 *University of Toronto Law Journal* 396.

¹⁷¹ Denise McGill et al above n 115, 164.

¹⁷² Howell above n 142, 332.

¹⁷³ Nicola Howell, ‘National Consumer Credit Laws, Financial Exclusion and Interest Rate Caps: The Case for Diversity within a Centralised Framework’ (2009) 17 *Competition and Consumer Law Journal* 212, 220.

¹⁷⁴ Doanld P Morgan and Michael R Strain, ‘Payday Holiday: How Households Fare After Payday Credit Bans’ 2007 – 2008 (*Federal Reserve Bank of New York Staff Report*, No 309) 21.

¹⁷⁵ Ibid (See charts 2, 3, 4, 5A, 5B, 5C, 5D).

¹⁷⁶ Ibid 23.

¹⁷⁷ Justin Malbon, ‘Predatory Lending’ (2005) 33 *Australian Business Law Review* 224, 234.

present and that the high fees are explicable by the short-term nature of the loan borrowed, which means that the lenders do not have the benefit of accumulating interest over time to finance their business.¹⁷⁸

Despite this, the legislature has made a clear decision based on the need to remove harmful financial products from the market. Undeniably, the decision tests the parameters of a normative concept of consumer sovereignty. Although the reforms are limiting and paternalistic, on the whole, they are efficient, shelter a small group of vulnerable consumers and impact on an industry, which does not employ a vast majority of employees and provides nothing to the community. In fact, the decontextualised approach may prove to be an advantage.

Typically, consumers of this loan product are not in a position to pursue lengthy and costly legal actions against borrowers, through other potential legal avenues such as: unconscionable conduct,¹⁷⁹ unjust transactions unconscionable changes of fees and charges,¹⁸⁰ and relief for hardship¹⁸¹ and irresponsible lending.¹⁸² Even where individual actions are pursued they are too individual/specific to make a widespread impact on the lending practices in the industry.¹⁸³ In addition, a price control approach has had some positive impacts in the US payday market. The Centre for Responsible Lending observes that, the states, which impose a comprehensive, costs cap at around 36% ‘have solved the debt trap problem by realising a saving of USD \$1.5 billion for their citizens.’¹⁸⁴

More compellingly, a positive long-term consequence could be that consumers will be prompted to seek more viable alternatives at times of hardship.¹⁸⁵ The existence of market alternatives not only detracts from the bleak outlook painted by payday loan sympathisers, *it also shows that alternatives to high rates do exist* and that highly risky customers are capable of paying off their debt, when freed from the ‘sweat box.’¹⁸⁶ A decrease in the prototypical payday loan could lead to an increase in different financial products, catering

¹⁷⁸ Sally Andersen, ‘Mapping the Terrain: The Last Decade of Payday Lending in Australia’ (2011) 39 *Australian Business Law Review* 5, 8.

¹⁷⁹ *Australian Securities and Investment Commission Act 2001* (Cth) s 12CB.

¹⁸⁰ *National Consumer Credit Protection 2009* (Cth) Sch 2 s 78.

¹⁸¹ *National Consumer Credit Protection 2009* (Cth) Sch 2 s 72 (see above).

¹⁸² *National Consumer Credit Protection 2009* (Cth) s 129 (considered above).

¹⁸³ Zac Gillam above n 141, 173 (has observed that individual cases have not had an impact on industry practice).

¹⁸⁴ U King and L Parrish, *Springing the Debt Trap: Rate Caps are the Only Proven Payday Reform* (Centre for Responsible Lending, North Carolina, 2007) 4.

¹⁸⁵ Nicola Howell, ‘Interest Rate Caps and Price Regulation in Consumer Credit’ in Justin Malbon and Luke Nottage (eds), *Consumer Law and Policy in Australia and New Zealand* (The Federation Press, 2013) 333.

¹⁸⁶ Malbon above n 177, 233.

to the vulnerable consumer.¹⁸⁷ In 2006, for example, the Australian New Zealand ('ANZ') bank had trialed a 'progress loan' program in conjunction with Brotherhood of St Laurence. The program offered loans at 12.7% interest rates to select vulnerable consumers who could not otherwise obtain credit from the mainstream avenues.¹⁸⁸ In the US context, the North Carolina State Employee's Credit Union (SECU) provides another example. The SECU offers eligible members a 'salary advance loan' (SALO). Most SALO customers are economically vulnerable and fall within the subprime credit risk category.¹⁸⁹ Overall the program has low delinquency rates. While at the same time, the program seeks to eradicate structural problems underlying the borrowers economic situations by requiring that 5% of the SALO be deposited in a new member bank account.¹⁹⁰ On a broader level, the US legislature has encouraged mainstream lenders to provide safer alternatives to vulnerable borrowers, through *the Consumer Reinvestment Act 1977* ('CRA'). The Act seeks to incentivise mainstream providers to 'serve the credit needs of their (entire) communities, including low and moderate income neighborhoods.'¹⁹¹ Compliance with the Act requires the lender to provide small loans, typically offered by payday lenders, at lower interest rates, a reduction of principal in addition to financial counseling to the borrower.¹⁹² In exchange the loan provider receives a good 'CRA rating,' whereas a poor rating affects a bank's application for mergers and acquisitions, approval processes for opening and closing branches and the ability to engage in other financial activities such as the provision of insurance and securities.¹⁹³ The initiatives present an opportunity for consumer interests to be met through greater innovation and competition in this area.

CONCLUSION

Consumer sovereignty is central in free market and neoliberal economics. However, in its descriptive sense, as championed by neoliberalism, consumer sovereignty stands for the consumers' rational ability to fulfill wealth

¹⁸⁷ Nicola Howell above n 160, 222.

¹⁸⁸ ANZ and Brotherhood of St Laurence, *ANZ and Brotherhood of St Laurence Team up to Offer Small Loans for people on low incomes* (2006) <<http://www.bsl.org.au/main.asp?PageId=3935>> (Accessed 13th December 2013).

¹⁸⁹ Michael A Stegman, 'Payday Lending' *Journal of Economic Perspectives* 169, 183.

¹⁹⁰ *Ibid* 184.

¹⁹¹ W Apgar and M Duda, 'The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges' 9 (2003) *Economic Policy Review – Federal Reserve Bank of New York* 169, 169.

¹⁹² Center for Responsible Lending, FDIC Pushes for Affordable Loans: Regulator Offers CRA Incentive for 36% Interest Rate Cap and Other Measures, *Center for Responsible Lending NewsBrief* 2007.

¹⁹³ M Barr, 'Credit Where it Counts: The Community Reinvestment Act and Its Critics' 75 (2005) *New York University Law Review* 101, 115.

maximising preferences by manipulating the forces of supply and demand. Empirical observations have thrown much doubt on this observation. This paper argues that consumer sovereignty ought to be preserved as a 'normative standard.' In particular the current Australian reforms pertaining to the consumer credit market mark a clear and balanced shift towards consumer protection. These reforms, in turn, provide a basis for delivering greater competition and market participation, goals simply assumed by neoliberalism.
