How Do We Regulate Contracts That We Need and Hate?

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Anne Fleming, **City of Debtors: A Century of Fringe Finance** (2018).

About fifteen years ago, Bruce Mann's *Republic of Debtors* offered an intriguing narrative about the origins of American bankruptcy law. Among other claims, Mann suggested that debt became respectable when respectable people found themselves in debt. When debt moved in from the fringe, our legal treatment of debt softened.

Anne Fleming tells a related story in our treatment of debt, but her focus is on poor debtors in New York City. Although the small sum loans that she studies may be on the fringe of finance, her account makes clear that the debtors who have relied and continue to rely on fringe finance are many, and together constitute a large, struggling class of workers. They are not outliers to our economic model but an integral part of it. We rely on their low wage labor and their debt-fueled consumption. And we have not devised any alternative to debt, no large-scale method by which low-income people can survive adverse events—at least not one that imposes lighter costs than perpetual debt.

While early reformers and policymakers may have been as critical of debtors for irresponsible behavior as of their creditors, most of Fleming's story, which starts almost a century after Mann's, takes place in a time when debtor, creditor and regulator have all ceased to regard debt in the severe moralistic terms in which it was regarded at the dawn of the republic. Debtors seem to know that they are dealing with unscrupulous lenders and regard their debt as well as its evasion as unfortunate aspects of their economic position. Creditors are the bad guys, if there are any; lenders are not in a position to moralize about debt. Regulators too understand that the working class poor often have no choice but to take out loans in order to tide themselves over when there is an unexpected expense or an interruption in earnings. The system is designed that way, or at least, it has not been designed to avoid the phenomenon of small sum, high-interest loans.

The history of how cities, especially policy leaders like New York City, have dealt with the small-sum lending industry is an illuminating but frustrating lesson in how we can (try to) regulate contracts that are oppressive but unavoidable for a segment of the population without better options. It may be true of most contracts that a choice to optimize regulation of the transaction for the median consumer comes at the expense of those with minority preferences, or outlier circumstances. But small loans pose a still deeper challenge because most borrowers both need the loans and face serious risks from them. A regulation that operates to the benefit of a borrower at one time will operate against the interests of that same borrower at a different time. Target borrowers for these loans cannot borrow without risk, but they are ill-equipped to bear those risks.

Fleming conveys the difficulties in regulating these loans. She describes the industry's tactics of creative regulatory evasion. For example, loans were sometimes structured as salary purchases rather than debt contracts; debtors granted power of attorney to creditors in order to move transactions out of New York state, and; creditors purported to charge fees rather than interest in order to avoid usury laws. Fleming also explores the dynamics of regulation in a federal system, with states at once learning from and impeding each other, and the federal government slowly and inconsistently intervening in the industry. Although most of the action is in the executive and legislative branches, because lenders

avoided going to court to collect, there are a few court cases in which courts are surprisingly solicitous of regulation even in the Lochner era. They seem to understand very early the hard choices surrounding small loans. The early consensus that the industry must be regulated makes it one of the oldest "regulated industries."

One of the most interesting and surprising aspects of Fleming's narrative is the political economy of regulation. Employers like Erie Railroad Corporation and Gimbel Brothers played a critical role in the courts and behind the scenes in resisting attachments on their employees' wages. Relatively reputable lenders sided with regulators and favored uniform laws across states in order to disadvantage more fringe lenders. Reform entities like the Russel Sage Foundation aligned with the industry in favor of a uniform small loan law. Reformers' support for weak regulation made them suspect in the eyes of those, like Fiorello La Guardia, who continued to see the industry as wholly nefarious.

Fleming ably guides us through the vicissitudes of regulating the small loan industry. We do not emerge with any clear sense of a regulatory solution. Instead, we learn the limits of bettering a transaction by way of contractual limitations. Neither regulations tailored to the transaction-type nor judicial application of general contract principles are sufficient to make small loans savory. Some debt contracts cannot be made better without giving borrowers better options altogether.

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