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## Exchange

# The Neoclassical Economics of Consumer Contracts

Richard A. Epstein<sup>†</sup>

There is little doubt that the major new theoretical approach to law and economics in the past two decades does not come from either of these two fields. Instead it comes from the adjacent discipline of cognitive psychology, which has now morphed into behavioral economics. Starting with the path-breaking work of Amos Tversky and Daniel Kahneman in the 1970s, the field has asked one question in a thousand guises: do ordinary people obey the principles of rational choice in making their decisions?<sup>1</sup> The usual answer given in the field is that in at least some domains they do not.<sup>2</sup> The new law and economics literature uses these behavioral findings, especially in the study of cognitive bias, to open a new chapter in the long-standing debate over the extent to which market failures pave

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1. Cf. Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 3, 3 (Daniel Kahneman et al. eds., 1982) (“How do people assess the probability of an uncertain event or the value of an uncertain quantity?”).

2. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 263 (1979); Tversky & Kahneman, *supra* note 1, at 11. For applications, see GERD GIGERENZER ET AL., SIMPLE HEURISTICS THAT MAKE US SMART (1999) (detailing the use of heuristics to make “real world” decisions) and Cass R. Sunstein, *Hazardous Heuristics*, 70 U. CHI. L. REV. 751, 751–52 (2003) (reviewing HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT (Thomas Gilovich et al. eds., 2002)) (describing the use of heuristics in connection with litigation decisions).

the way for government regulation<sup>3</sup>—with the added twist that just about any market is now a plausible target for a new round of regulation.

The usual point of controversy is the neoclassical conclusion that competitive markets—markets with multiple, self-interested players on both sides, armed with relatively full information—will generate a mix of goods and services that is superior to those that can be generated with various forms of government regulation.<sup>4</sup> Conscious deviations from well-functioning competitive markets introduce either unwanted barriers or subsidies, both of which reduce overall output in the regulated sector, with spillover losses elsewhere in the general economy.<sup>5</sup> The state creation of monopoly by entry restrictions, for example, will not only have a negative effect on the quantities and prices of the goods and services available to buyers and their customers,<sup>6</sup> but will also provide an unwanted subsidy to the sellers of competitive technologies and services who operate in an unregulated segment of the market.<sup>7</sup>

There are, however, two sets of well-recognized circumstances in which the neoclassical theory accepts that some government intervention *may* make sense: private monopoly and

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3. See, e.g., Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 682 (1979) (“The existence of imperfect information is commonly thought to justify market intervention by courts and legislatures because of the predominant belief that an imperfectly informed buyer cannot make utility-maximizing purchase choices.”).

4. Cf. F. A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 530 (1945) (describing issues caused by imperfect and dispersed information).

5. See HENRY HAZLITT, *ECONOMICS IN ONE LESSON* 114–15 (3d ed. 1946) (“It is only the much vilified price system that solves the enormously complicated problem of deciding precisely how much of tens of thousands of different commodities and services should be produced in relation to each other. These otherwise bewildering equations are solved quasi-automatically by the system of prices, profits and costs. . . . [W]hereas bureaucrats would try to solve it by having made for the consumers, not what the consumers themselves wanted, but what the bureaucrats decided was good for them.”).

6. See *id.* at 127 (stating that holding a commodity’s price below market increases the demand for and reduces the supply of the commodity, leading to lower production levels).

7. Cf. *id.* at 131 (“If we ration one commodity, and the public cannot get enough of it, though it still has excess purchasing power, it will turn to some substitute. The rationing of each commodity as it grows scarce, in other words, must put more and more pressure on the unrationed commodities that remain.”).

imperfect information.<sup>8</sup> The first arises in industries that, for one reason or another, do not assume competitive form.<sup>9</sup> In some instances, the best solution is to mandate that the parties cease all cooperative efforts and operate in direct competition with each other.<sup>10</sup> At its best antitrust law seeks to neutralize the risk by prohibiting or terminating trusts and monopolies that restrict output, raise prices, or divide territories.<sup>11</sup> In some cases, however, competitive solutions are not attainable. Here direct forms of rate regulation may be adopted to cope with the problems of natural monopoly—when a single firm is the cheapest provider of any given level of output, as sometimes occurs with energy transmission, transportation, and communications.<sup>12</sup> The monopoly issue has been raised with respect to certain practices of credit card companies,<sup>13</sup> but I shall not consider it here.

The second topic—imperfect information—is more vast because it addresses the effects of misinformation on the operation of the full range of product and service markets. These difficulties can arise irrespective of the underlying market structure: both competitive and monopolistic markets fall within its scope.<sup>14</sup> The basic instinct here is both simple and power-

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8. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 369 (7th ed. 2007) (discussing the use of regulations in instances of natural monopoly); Schwartz & Wilde, *supra* note 3, at 682.

9. See POSNER, *supra* note 8, at 369 (“The traditional solution to the problem of natural monopoly in this country was public utility or common carrier regulation. . . . This type of regulation has three primary elements: (1) profit control . . . (2) entry control . . . [and] (3) control over price structure . . .”).

10. See 15 U.S.C. § 2 (2000) (prohibiting cooperation between parties in the furtherance of a monopoly).

11. See *id.* §§ 1–2 (prohibiting the formation of trusts and monopolies “in restraint of trade or commerce”). Note that actions under § 1 are typically directed to horizontal activities with clear negative impacts on markets. Section 2 cases are often directed toward exclusive practices by “dominant” firms in the market, whose social dislocation is much more difficult to determine or counteract. For a discussion of the difficulty with consent decrees, see generally RICHARD A. EPSTEIN, *ANTITRUST CONSENT DECREES IN THEORY AND PRACTICE: WHY LESS IS MORE* (2007).

12. See, e.g., Harold Demsetz, *Why Regulate Utilities?*, 11 J.L. & ECON. 55, 56 (1968); Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 570 (1969).

13. See, e.g., *In re Visa Check/Mastermoney Antitrust Litigation*, 280 F.3d 124 (2d Cir. 2001) (discussing an antitrust action brought by retailers against credit card associations).

14. Even in the competitive securities market, imperfect information creates difficulties, but it is highly debated whether the elaborate scheme of

ful: inaccurate calculations of expected benefits and/or costs of particular courses of action are likely to lead to the wrong choices.

Within the standard neoclassical field, no one doubts the existence of these structural or informational impediments to the operation of strong markets.<sup>15</sup> But an immense debate arises over whether—and if so, what types of—government regulation make sense in responding to these ills.<sup>16</sup> The neoclassical tradition establishes a presumption against regulation in both these areas for three simple and compelling reasons. First, all forms of public intervention cost money, so the proper question is not whether the current market operates imperfectly, but whether the costs of correcting the imperfections exceed the costs of allowing particular imperfections to remain.<sup>17</sup> Second, most neoclassical economists fear that regulation will be misguided because of some misidentification of the particular im-

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public disclosure reduces the risk of fraud or sharp practice. The early study on this point, George J. Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117, 124 (1964), finds that disclosure regimes have had little effect of the price and quality of new issues. And similarly skeptical results have been reached in Robert Daines & Charles M. Jones, *Mandatory Disclosure, Asymmetric Information and Liquidity: The Impact of the 1934 Act* 3–4 (Mar. 2005) (unpublished manuscript, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=686888](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=686888)), which finds little or no improvement in reducing asymmetrical information or promoting market liquidity, but some advantage in allowing issuers to make credible disclosures. There is an evident tension between the first and third findings, which suggests that the benefits of a disclosure regime are modest at best. More ambitious schemes are likely to prove even less successful. See POSNER, *supra* note 8, at 482 (“A careful study finds that [disclosure] securities law[s] . . . bring[] about a net improvement in the operation of stock markets, though more ambitious forms of public regulation of securities markets do not.” (citation omitted)).

15. See MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 13 (1962) (“The possibility of co-ordination through voluntary co-operation rests on the elementary—yet frequently denied—proposition that both parties to an economic transaction benefit from it, *provided the transaction is bi-laterally voluntary and informed.*”).

16. Compare Posner, *supra* note 12, at 635–36 (arguing for “sweeping” changes in the regulatory scheme for natural monopolies), with Schwartz & Wilde, *supra* note 3, at 671–73 (arguing for a restrained regulatory response to the problem of imperfect information).

17. See, e.g., HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS* 675 (6th ed. 2003) (“[I]f the government can *compel* people of all risk classes to purchase insurance, it is possible for everyone to be made better off. This is, on the face of it, a good case for intervention. On the other hand, there are costs to government intervention as well; economic decisions made by governmental decree may not be as cost-effective as those made by private firms.”).

perfection.<sup>18</sup> For example, it is easy to think that the minimum wage cures the problem of inequality of bargaining power when in fact it distorts labor markets, as by hurting nonunion competition to union firms.<sup>19</sup> Third, powerful political forces, with excellent private knowledge, often turn regulation to their own parochial ends by creating barriers to entry that block or hamper the emergence of strong competitive markets.<sup>20</sup>

This cautious approach applies both to information markets generally, and to the full range of inventive arguments that Professor Oren Bar-Gill has advanced for the increased level of regulation in credit card markets in particular.<sup>21</sup> Information breakdown comes in all forms, from deliberate fraud to inadvertent mistake. Without question the first order of public business is the control of fraud, which is limited in scope and serious in consequences.<sup>22</sup> Simple mistakes are far more pervasive, but at the same time far more difficult to prevent. It is possible to take some simple steps that will reduce the rate of error, such as requiring standardized disclosures, without imposing heavy burdens on regulated parties.<sup>23</sup> Here, it is never quite clear whether the sensible forms of regulation duplicate the protections that would exist anyway in voluntary markets. But even if we put the prospect of sensible self-regulation to one side, there is little reason to quarrel with the disclosure of Annual Percentage Rates (APRs) under Truth in Lending Act (TILA), even if other provisions of the same statute are far too intrusive.<sup>24</sup> That one targeted intervention eliminates countless errors by ordinary consumers and aids comparison shopping by

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18. See, e.g., Hayek, *supra* note 4, at 519–21 (discussing the problems of central regulation in a market with imperfect information).

19. See Richard A. Epstein, *On Wal-Mart: Doing Good by Doing Nothing*, 39 CONN. L. REV. 1287, 1300–04 (2007) (stating that minimum wage laws are set to price out nonunion workers without pricing out union workers).

20. See POSNER, *supra* note 8, at 382 (“Regulation is more plausibly viewed as a product . . . that is demanded by and supplied to the members of political pressure groups rather than to the general consuming public. . . . Coalitions between special-interest consumer groups . . . and members of an industry may be especially effective in manipulating the regulatory process.”).

21. See Oren Bar-Gill, Exchange, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749 (2008) [hereinafter Bar-Gill, Exchange, *Behavioral Economics*].

22. Cf. Schwartz & Wilde, *supra* note 3, at 671–73 (arguing for more relaxed regulation of imperfect information when fraud is not involved).

23. See POSNER, *supra* note 8, at 482 (discussing the use of securities regulations as a means of preventing asymmetrical information).

24. Truth in Lending Act, 15 U.S.C. §§ 1604, 1606 (2000) (describing the definition and disclosure requirements for annual percentage rates).

standardizing interest rate calculations.<sup>25</sup> The question is how much further the law ought to go. The correct answer, I think, is not very much further at all. Disclosure regimes are freely praised in the abstract, and at some level they work.<sup>26</sup> But the law is littered with expensive disclosure regimes, such as those administered by the Securities and Exchange Commission,<sup>27</sup> that have ever more dubious utility as they expand in scope and ambition. The best approach is to harvest the low-hanging fruit and then put the ladder away.

On this basic question, it is not surprising to find a good deal of separation between the behavioral approach championed by Bar-Gill<sup>28</sup> and the neoclassical approach to which I gravitate. The cognitive bias literature generally favors expanding the range of government regulation to address a wide variety of business practices that exploit the bias of consumers, or at least some consumers.<sup>29</sup> I have resisted this regulatory impulse in a number of recent papers that deal with this issue.<sup>30</sup> One of these articles argues that in general, light-handed regulation such as APR disclosure is all that is required for the

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25. See generally William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400, 404 (identifying the purposes of disclosure regulations, "including the goal of inducing consumers to become more careful shoppers").

26. For an example of useful disclosure rules in the securities market, see *supra* note 14 and accompanying text.

27. See, e.g., William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private,"* 55 EMORY L.J. 141, 147–49 (providing empirical evidence of the costs of compliance with Sarbanes-Oxley disclosure rules).

28. See, e.g., Oren Bar-Gill, *Bundling and Consumer Misperception*, 73 U. CHI. L. REV. 33 (2006) [hereinafter Bar-Gill, *Bundling and Consumer Misperception*]; Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004) [hereinafter Bar-Gill, *Seduction by Plastic*].

29. See, e.g., John D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1554–55 (1999) (arguing that enterprise liability is needed to correct the effects of market manipulation and consumer underestimation of product risks).

30. See, e.g., Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111 (2006) [hereinafter Epstein, *Behavioral Economics*] (discussing consumer mistakes and maturation and noting the corrective sufficiency of existing legal and market remedies); Richard A. Epstein, *The Regulation of Interchange Fees: Australian Fine-Tuning Gone Awry*, 2005 COLUM. BUS. L. REV. 551 [hereinafter Epstein, *Interchange*] (analyzing the effects of interchange fee restrictions imposed on the credit card industry by the Reserve Bank of Australia); Richard A. Epstein, *Second-Order Rationality*, in BEHAVIORAL PUBLIC FINANCE 355 (Edward J. McCaffery & Joel Slemrod eds., 2006) (examining the limitations of rational choice theory and behavioral economics).

burgeoning consumer credit card market.<sup>31</sup> More ambitious efforts to combat cognitive mistakes by direct regulation or disclosure provisions do not, in my view, overcome the strong presumption of error under which they should be evaluated.

In his present Article, Bar-Gill takes explicit issue with my point of view.<sup>32</sup> In a well-turned phrase drawn from antitrust law, he announces himself a believer in the “rule of reason” with respect to various regulatory approaches to these consumer contracts.<sup>33</sup> He places that position in opposition to my own, which he accurately describes as favoring, with only limited exceptions, a per se rule of no regulation beyond such narrow matters as the APR.<sup>34</sup> He has marshaled an impressive array of theoretical and empirical evidence to support his position, but in the end his extensive critiques do little to undermine my earlier position. As the focal point for his recent analysis is my University of Chicago paper, I was happy to accept his kind invitation to write a critique of his position.

My position, as articulated in prior articles, rests on several assumptions. First, the voluntary actions by individual consumers and their advisors, as well as by competitive sellers, tend to close an information gap in credit card and other markets with standardized products.<sup>35</sup> Incidentally, in preparing this Article, I took a look at many retail websites on a variety of industries and came away with the clear impression that pricing clarity is more widespread now than it has ever been.<sup>36</sup>

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31. Epstein, *Behavioral Economics*, *supra* note 30, at 125, 128 (arguing that credit regulations beyond the disclosures mandated by the TILA are unnecessary).

32. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 753–54.

33. *Id.* at 754.

34. *Id.* at 753–54.

35. See generally Epstein, *Behavioral Economics*, *supra* note 30, at 123–32.

36. A Google search with the term “compare price” will yield numerous sites that offer prices for similar goods from different sellers. See, e.g., Buyer’s Edge, <http://www.buyersedge.com> (last visited Nov. 30, 2007) (offering a venue for comparing products and prices from various sellers); eBay, Buying Resources, <http://pages.ebay.com/buy/resources.html> (last visited Nov. 30, 2007) (providing buying resources for comparing prices in primary and secondary markets across a range of products and services); Insurance.com, Compare Auto Insurance Quotes from Top Auto Insurance Companies, <http://www.insurance.com> (last visited Nov. 30, 2007) (facilitating the comparison of insurance premiums and coverage plans offered by various companies); LendingTree Home Loans, <http://www.lendingtree.com> (last visited Nov. 30, 2007) (allowing consumers to compare lending offers from numerous banks and providing advice for borrowers); Nextag, <http://www.nextag.com> (last visited Nov.

Second, any one-size-fits-all regulation will not perform well in markets characterized by extensive consumer heterogeneity. And third, the regulation will often backfire by creating market distortions or barriers to entry.

It will, however, serve little purpose to repeat those arguments here. Rather the focus shall be on Bar-Gill's critique of my own position. Accordingly, Part I of this Article deals with the interaction between mistakes and standardization in consumer markets. I conclude that Bar-Gill overstates the level of consumer error by underestimating the corrective powers already at work, chiefly because he relies on an unduly cramped definition of a "standardized" good or service. Part II then critiques some of the key illustrations that Bar-Gill offers to show how credit card companies and other firms exploit these systematic biases. I conclude that his oversimplified description of these markets leads him, and the behavioral economists on whom he relies, to ignore more traditional explanations that better account for the apparently irrational behavior that they observe. Part III then examines his more global case for regulation, and concludes that it offers no blueprint for advancing beyond the extensive forms of regulation (some of which we could well do without) that are now in force. Credit markets are not perfect, but the introduction of new technologies, especially on the Internet, has vastly improved their operation and remains the most powerful way to combat all sorts of consumer misperceptions.

## I. MISTAKES IN STANDARDIZED MARKETS

Bar-Gill and I both start from the same initial premise that cognitive mistakes are endemic to human behavior.<sup>37</sup> Individual capacities to calculate the odds by formal methods are quite limited, for it is easy even for the educated to fall into the mathematical traps that have long delighted the examiners who set problems for the College Boards. People's ability to learn by experience supplies a useful counterweight, but experience only prepares us for some the decisions we face; there are many other contingencies for which a diploma from the school of hard knocks does not help. Any argument in favor of markets, therefore, cannot realistically rest on any assumption of strong rationality, whereby everyone gets their sums (and double inte-

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30, 2007) (facilitating comparison shopping for products, mortgages, and real estate, among other things).

37. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 749.

grals) right all the time. Indeed, if they could, state regulation would be far more reliable than it typically is, given that even regulators cannot transcend the various biases that plague ordinary individuals.

Against this background, the neoclassical case for markets rests on the more qualified assumption that learning actually matters. To the extent that the issues that truly matter to them, people develop, if they do not already have them, good feedback mechanisms that lower the risk of loss, especially in standardized transactions where consumers are repeat players. People do so because they pay the price for their own error. Some evidence for this result comes from a recent study of consumer behavior in six different kinds of credit markets—home equity loans, home equity lines of credit, credit cards, auto loans, small business lines of credit, and late fees for credit cards—prepared by Sumit Agarwal, John Driscoll, Xavier Gabaix, and David Laibson,<sup>38</sup> which investigates the relationship between age and cognitive performance.<sup>39</sup> What I regard as most valuable about this study is that it does not rely on looking at studies of college students' behavior, but tries to organize extensive data about the behavior of real people of all ages in credit markets.<sup>40</sup>

The relationship they posit is identical to that which applies to everything from mathematics to athletics. The researchers note that people in their early twenties have powerful analytic and memory skills, but are weak in experience.<sup>41</sup> As they grow older, the basic mental skills slowly begin to depreciate, but those losses are offset, usually more rapidly, by gains in experience, so that the life-cycle pattern, which nets out these two effects, shows first improvements in performance and thereafter a slow decline that intensifies toward the end of life.<sup>42</sup> By the researchers' account, these effects are more or less constant across the different kinds of credit markets.<sup>43</sup> Peak

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38. Sumit Agarwal et al., *The Age of Reason: Financial Decisions over the Lifecycle* (Mass. Inst. of Tech. Dep't of Econ. Working Paper Series, Working Paper No. 07-11, 2007), available at <http://ssrn.com/abstract=973790>.

39. *Id.* at 2.

40. *Id.* ("This paper documents cross-sectional variation in the prices that people pay for financial services.")

41. *Id.* ("We hypothesize that financial sophistication depends on a combination of analytic ability and experiential knowledge.")

42. *Id.* at 2–3.

43. *Id.* at 6–29 (noting a consistent pattern in the relationship between age and financial sophistication in ten separate contexts).

performance—after controlling for income, education, credit-worthiness, and other observable variables—comes around age fifty-three.<sup>44</sup> In addition, the researchers' work reports limited variation across consumers of any given age; for example, in the home equity market, people who avoid familiar traps in borrowing (called rate-changing mistakes) are charged roughly the same interest rate by lenders in a given situation regardless of their ages.<sup>45</sup> Rate-changing mistakes, meanwhile, decline sharply—from about 70% at age twenty to under 10% at age fifty—with the sharpest declines coming before age thirty.<sup>46</sup>

The results of these studies should be encouraging because they show that learning really does matter in these contexts, and lead, in my view, to the conclusion that education on how loans work is often the best protection against various kinds of dangerous credit practices. In addition, the study does not cover the important (but difficult to measure question) of which persons in the various cohorts are most likely to make mistakes.<sup>47</sup> Thus, it would be useful to see how the rate of error varies with educational levels across age, where the prediction is that the curve would be flatter and lower for those with more education at any given age.<sup>48</sup> It would also be useful to know how the frequency of various rate-changing mistakes varies with the ability to get advice from parents (when young) or children (when older) on how to conduct these transactions.

Learning in this form is likely to have powerful effects, both in life generally and in credit card transactions. With experience, people can become familiar with, or learn to specialize in certain types of transactions. Either way, people can increase the fraction of their decisions over which they have or can acquire effective expertise. It does not, therefore, matter if they are unable to generalize from their experiences to the larger scientific or decisional principles that lie behind their lo-

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44. *Id.* at 30.

45. *Id.* at 15.

46. *Id.* at 14 (charting rate-changing mistakes by age in the context of home equity loans and home equity lines of credit).

47. *Id.* at 2 (speculating that cohort effects may also contribute to some of the observed findings).

48. For example, higher-educated borrowers are likely to act on better advice, since the information asymmetries between them and their advisors are less acute than they would be for lower-educated borrowers. *See id.* at 43 ("Advice markets may not function efficiently because of information asymmetries between the recipients and the providers of advice." (citing Uwe Dulleck & Rudolph Kerschbamer, *On Doctors, Mechanics, and Computer Specialists: The Economics of Credence Goods*, 44 J. ECON. LIT. 5, 6 (2006))).

calized choice. The Inuit build heat-efficient igloos because survival is at stake, not because they are versed in the advanced principles of thermodynamics.<sup>49</sup> For those events on which people have little direct knowledge, they need not rely solely on the input from potential transactors on the other side of the market. Often they seek advice either informally from friends or for hire from professionals who know more than they do. People who cannot figure out complex financial choices are not unaware of their own limitations. Knowing what they do not know, they hire in droves financial advisors or invest in mutual funds.<sup>50</sup> And they may turn to different professionals if they need help in coping with depression or picking a mate. These common-sense checks against mistakes do not work in all cases; nor does their use reduce the error rate to zero. But their consistent tug protects most people most of the time. No one could claim that no consumer will fall for the same marketing ploy twice. Yet by the same token, there is little hard evidence that consumers are impervious to knowledge, and studies like Agarwal's suggest that even in credit markets, people usually learn both from their own errors, and from the errors of others—bad news travels fast.<sup>51</sup> We should not expect an epidemic of horror stories just because the law of large numbers guarantees that some inexcusable incidents will occur in markets that feature billions of transactions involving millions of people each day. Given that people are anxious to avoid financial losses, the widespread availability of protective devices<sup>52</sup> makes it unwise to assume that an additional layer of public regulation will perform any useful protective function. To the contrary, the danger is that the added complexity interposes yet another barrier to effective decision making.

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49. See Frank James Tester, *Iglu to Iglujuq*, in *CRITICAL INUIT STUDIES: AN ANTHOLOGY OF CONTEMPORARY ARCTIC ETHNOGRAPHY* 230, 230–42 (Pamela Stern & Lisa Stevenson eds., 2006).

50. Typing in “financial advisor” in Google’s search engine, [www.google.com](http://www.google.com), draws over 29 million entries.

51. Hence the sharply declining error rates from ages twenty to fifty. Agarwal et al., *supra* note 38, at 14.

52. See, e.g., ConsumerReports.org Home Page, <http://www.consumerreports.org> (last visited Nov. 30, 2007) (providing independent, expert information and reviews on numerous goods and services, including personal finance); Federal Trade Commission Home Page, <http://www.ftc.gov> (last visited Nov. 30, 2007) (providing FTC publications on numerous consumer goods and services); myFICO, FICO Credit Scores, <http://www.myfico.com> (last visited Nov. 30, 2007) (assisting consumers in understanding and obtaining credit scores).

In evaluating the effectiveness of these self-help strategies, Bar-Gill is right to draw a distinction between standardized and nonstandardized products.<sup>53</sup> The likelihood of mistake with standardized products is much lower than with nonstandardized ones.<sup>54</sup> Standardized products are easier to understand, because the party who sets the standard has an incentive to make the needed information available to potential customers in order to decrease their cost of doing business.<sup>55</sup> People will invest more in mastering standardized devices because they can spread the cost of their investments over multiple transactions. Examples include computers and cell phones. Put otherwise, it is easier to gain, and to share with others, useful experience about a standardized product than a nonstandardized one. Bar-Gill writes: "if a consumer makes toast only once a month and there is a 1/100 chance that the toaster will explode when used, it can take the consumer several years before she learns about the risk of toaster explosion."<sup>56</sup> Not if she has neighbors or reads consumer reports, given that, in Bar-Gill's hypothetical, virtually every toaster made will explode under standard use within six months of purchase. (It is worth noting that the probable fire risk for a consumer product, apart from tampering, is today less than one part in a million.)<sup>57</sup> No one, of course, can get similar levels of assurance in choosing marriage mates or even colleges.

But these problems do not generally afflict modern consumer markets, namely because the use of web-based information has increased transparency so greatly<sup>58</sup> that it is hard to

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53. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 749, 756–57.

54. *Id.*

55. *Id.*

56. *Id.* at 756.

57. See U.S. CONSUMER PROD. SAFETY COMM'N, HAZARD SCREENING REPORT: HOUSEWARES AND KITCHEN APPLIANCES 1, 11 (2005), available at [http://www.cpsc.gov/library/hazard\\_housewares.pdf](http://www.cpsc.gov/library/hazard_housewares.pdf). In 2000, there were 367 reports of death from all types of housewares and kitchen appliances, of which the single most common cause of death was candle-related fires (108 deaths). *Id.* at 8. Most burn victims were over the age of seventy-five. *Id.* Most of the minor injuries from housewares and appliances that warranted an emergency room visit were attributable to mechanical defects. *Id.* Very few of these injuries appear to be due to defective products of any sort, although the study does not elaborate on this. *Id.* at 9.

58. For examples of websites that enable consumers to simultaneously research and shop for various products, see Amazon.com, <http://www.amazon.com> (last visited Nov. 30, 2007) (offering shoppers a variety of products, often accompanied by consumer feedback); Cars.com Home Page, <http://www.cars.com>

recall the tedium of obtaining information for routine business transactions before the web. For all the constant fretting about imperfect information, people do many tasks at their own desks for which they previously hired expensive and experienced professionals. The travel agent for routine flights is gone. And for good reason: who could conceive of a better way to present information about pending flights than the Southwest Airlines's website?<sup>59</sup> This naïve consumer goes there first because I know that it works better than the sites of its rivals.<sup>60</sup> The improvement in transparency in this market (where payment is made by credit card) is a thousand-fold greater than it was in the old days of waiting in line to book tickets with real time travel agents who struggled to collect and transmit the information on prices and schedules. That systematic improvement is equally characteristic of modern credit markets. The ability to access credit card statements online has done more good for consumers than any form of regulation imaginable. The information is always up-to-date, and the options on payment are complete, so even if everyone does not know all the consequences of tardy payment, it is easy to stay ahead of the curve and make a payment at the last minute, without being dependent on the vagaries of the U.S. Postal Service. Behavioral economists duly fret about sticky default provisions,<sup>61</sup> but online credit card transactions offer no reason to worry. On some accounts, including mine, Chase puts the default button for payment on the current credit card balance, and not on the amount owing on the last monthly statement.<sup>62</sup> That choice suggests that Chase is more

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.com (last visited Nov. 30, 2007) (providing a venue for buying, selling, and researching automobiles); and Cnet.com Home Page, <http://www.cnet.com> (last visited Nov. 30, 2007) (providing reviews and purchasing opportunities for cutting-edge electronic items).

59. See Southwest Airlines Home Page, <http://www.southwest.com> (last visited Nov. 30, 2007) (providing a clear, simple format that allows fliers to begin the processes of booking, checking-in, and changing airline flights all from the Southwest homepage).

60. See Carol Sottili, *Airline Web Sites, Poised for Takeoff?*, WASH. POST, May 29, 2005, at P01 (reporting on a consumer survey and study of airline websites which concluded that Southwest "possessed the industry's best online booking process").

61. See, e.g., Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1201 (2003). "Libertarian default rules" is the more accurate, but less provocative term.

62. For a demonstration of the Chase online payment process, see Chase Credit Cards, <http://www.chase.com/PFSCreditCardHome.html> (last visited Nov. 30, 2007) (follow "Try Paperless Statements" hyperlink; then follow "View a demo of Chase Online" hyperlink; follow "Platinum Visa (...6789)"; se-

concerned about savvy customers taking advantage of the float than wringing out extra interest payments from the revolvers (i.e. those who carry their balances over).<sup>63</sup> To be sure, it appears that American Express puts the default down at minimum payment,<sup>64</sup> which suggests that there is a competition in strategies, and it would be instructive to see just how many people still maintain minimum balances just because the options are presented in that fashion. Probably not that many, if the American Express client base is sufficiently sophisticated. Not to worry, one click on the radio button restores the other option. Chase likely knows that it will be more likely to keep its customers if it makes clear the payment options. What system of regulation will do as well?

Bar-Gill, however, does not seize on the dynamic movements inside markets, here driven by Internet technology. Rather, his static approach begins with the difficulties that consumers face in using nonstandardized products.<sup>65</sup> But the right first question asks whether the innovations in information technology have upset the older ratio between standardized and nonstandardized products, in ways that favor the former. Speaking generally, standard products win out because they reduce the costs of transactions on both sides of the market, whether we speak of loan securitization or standard rental car agreements.<sup>66</sup> Let the critics of markets denounce commodification of markets in sex or kidneys.<sup>67</sup> But in most markets, the

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lect "Pay credit card" hyperlink; without selecting a specific payment amount, follow "Next" hyperlink). The default payment for the Chase Visa is the current account balance, while default for the Chase MasterCard is the less than the account balance, but more than the minimum payment. *Id.*

63. See, e.g., Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHI. L. REV. 63, 77–86 (2006) (analyzing empirical data regarding consumer payment decisions *vis-à-vis* credit and debit cards and concluding that the supply and demand characteristics of the industry do not support the contention that credit cards are harmful to consumers).

64. For a demonstration of the American Express online payment process, see American Express, <https://www.americanexpress.com/home/fallback.shtml?axphpqs=1> (select "Personal Cards"; select "Learn About Managing Your Account" hyperlink under "Manage Your Account"; select "Pay Your Bill"; select "View Demo"; select "Pay Your Bill"; select "How to Pay Your Bill"; the default amount appears in frame three as "minimum due").

65. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 756–57.

66. This is because standard contracts reduce transaction costs (e.g., bargaining costs) and the possible information asymmetries are gradually mitigated by "learning"; that is, repeated play and information-sharing between consumers.

67. For an example of an attack on commodification, see generally Elizabeth S. Anderson, *Is Women's Labor a Commodity?*, 19 PHIL. & PUB. AFF. 71,

ability to turn odd assemblages of value into standardized commodities is the key to success, as in securitization markets.<sup>68</sup> People in any mainstream business call something a “commodity” because imitation and dissemination have sucked out all the monopoly rents from the project.<sup>69</sup>

Given the virtues of standardization, it is useful to have some sense of what the term means. Predictably, Bar-Gill gives a narrower definition than do I, with the express intention of shrinking that category. Bar-Gill thus points to complex products that often provide potential customers with offers that vary in two or more dimensions.<sup>70</sup> This, he claims, expands the opportunity for strategic firm behavior.<sup>71</sup> But by the same token, the use of these multipart tariffs also helps sophisticated consumers by allowing them to tailor any transaction to their needs. Put differently, varying offers simply allow customers to choose among a wider array of baskets of goods; so customers avoid the additional costs of modifying some single basket to suit their varying needs.

In any event, there are two reasons why it is a mistake to treat the presence of any options as incompatible with the use of standardized agreements. First, that approach is neatly falsified by countless examples, including the payment options that are set up on the Chase credit card sites.<sup>72</sup> Whether or not one thinks that additional disclosure is needed, there is no reason to impose an *external* restraint on the number of permissible options that can be embedded in a standard form contract. Standardization of terms helps to facilitate management oversight and to preserve essential parity between customers.<sup>73</sup>

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73 (1990) (“If the thing is to be valued appropriately, its production, exchange, and enjoyment must be removed from market norms and embedded in a different set of social relationships.”).

68. Securitization is defined as the process of “[p]ooling loans for various purposes into standardized securities backed by those loans.” *ENCYCLOPEDIA OF FINANCE* 243 (Cheng-Few Lee & Alice C. Lee eds., 2006). Note that the arrangements must be standardized in order for the pooling to take place; otherwise valuation is too difficult to work.

69. Definitions of commoditization typically describe the “process of prices moving substantially lower because of strong competition” and the consequential decrease in large returns for competitors. *WEBSTER’S NEW WORLD FINANCE AND INVESTMENT DICTIONARY* 67 (Barbara J. Etzel ed., 2003).

70. Bar-Gill, *Exchange*, *Behavioral Economics*, *supra* note 21, at 751, 769–76.

71. *Id.*

72. *See supra* note 62 and accompanying text.

73. *Cf.* Epstein, *Behavioral Economics*, *supra* note 30, at 120–21 (noting that “no real long-term market distortion” exists for standardized products be-

Second, an additional advantage of using standardized options is that it makes comparisons across products offered by the same, or different, firms more transparent.<sup>74</sup> One competitor could claim that for any given price it gives a longer warranty than the current supplier. Transferring that information seems easy when it is directed toward only one term of the arrangement. Of course, costs impact the ability of rivals to follow suit. If one seller has an inferior product, then either its warranty coverage will have to shrink or its price will have to rise. There is in effect no real answer to the competitive disadvantage. Just ask Detroit.<sup>75</sup>

On the second of these issues, it is possible to imagine, as Bar-Gill imagines, that firms will opt out of the competitive game. He thus writes: "But when a flaw is pervasive in the industry, each seller must choose between correcting the flaw and educating consumers, or just going with the flow. It is not at all clear that the former correction strategy will always prevail."<sup>76</sup> That observation seems highly implausible in any industry that is not highly concentrated. For this speak-no-evil approach to work, it has to be followed by all players. Once a single player deviates from this collective strategy, the information that is divulged will make it hard for any player to stick with the older approach.<sup>77</sup>

To illustrate, assume five players in an industry. If there is only a 50% chance that any one of these will deviate from the cooperative mode, then the odds are only 1 in 32 that the collusive equilibrium will stick. Even that low figure is likely to be significant, so long as the first firm to deviate from that solution gains some first-mover advantage, which its own marketing expertise should help it obtain. Nor is any firm likely to

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cause the market will naturally correct any mistake in information).

74. For an illustration, see, for example, Insurance.com, *supra* note 36. A consumer wishing to buy insurance can fill out a standardized form about his car, insurance history, and insurance needs. *See id.* Based on the responses to this standardized form, the site returns price comparisons for a variety of potential insurers. *See id.* (enter zip code and current insurance status; then follow "Get Quotes Now" hyperlink to complete a standardized form).

75. *See, e.g.,* Micheline Maynard & Nick Bunkley, *Foreign Automakers Pass Detroit in Monthly Sales*, N.Y. TIMES, Aug. 2, 2007, at C4 ("Detroit auto companies' grip on the American automobile market ended in July [2007] ...").

76. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 751.

77. Unless the party that seeks to press its advantage is unable to make clear what it is offering to consumers. This is an unlikely scenario given the skills of modern marketers.

succeed by adopting some evasive strategy when others have told the straight story. Customers will migrate from the firm that gives poorer information. Therefore, so long as built-in options are part of the standard-form game, the dominant strategy is for firms to move ever-more transactions into standardized categories, and not to develop costly, elaborate ways of coping with breakdowns in nonstandardized products. Most web-based transactions reflect this shift towards standard forms.<sup>78</sup>

Bar-Gill next argues that these forms are really not standardized at all, because the conditions that surround their use depend, for example, not only on what the issuing bank supplies, but also on the distinctive patterns of product use:

[W]hen the nature of the product is more broadly defined to include the potential uses of the product, then the group of standardized products shrinks. The value of a product does not depend only on the product's intrinsic features. It depends also on the potential uses of the product. And if different consumers use the product differently, then an otherwise standardized product becomes functionally non-standardized. And this can inhibit learning. If one consumer uses the product one way and through this use learns some information about the product, there is less reason to believe that another consumer who uses the product in a different way will find this information relevant.<sup>79</sup>

This caveat about distinctive uses of standardized products surely proves too much. By this account, no product is ever standardized, for if people choose to spend their cash in different ways, or to drive identical cars in different ways, then they pose insurmountable problems for regulators. Regulators find it difficult to draft sensible regulations for the myriad of unknown end uses for a given product. But in most contexts, these supposed differences just do not matter. In supermarket transactions the price, type, and quality of milk are all that need to be known. The buyer can decide whether to drink fresh skim milk or use it for preparing French toast.

The same principle holds in credit card markets. Just use the APR for all credit transactions, whether people borrow money for installing a home office or for a trip to Las Vegas. No workable system of credit card regulation can respond to a high

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78. eBay's site, for example, requires users to register by completing a standardized form that includes personal information. Once registered, a user can access a series of standardized forms to search for, bid on, and purchase products. See eBay.com Home Page, <http://www.ebay.com> (last visited Nov. 30, 2007).

79. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 757.

rate of foolish purchases, if such they be. For those issues, the only plausible form of regulation must hone in on permissible end uses by allowing, perhaps unwisely, people to return certain specified goods sold by door-to-door salesmen, within three days of purchase.<sup>80</sup> Bar-Gill cannot wiggle out of the following dilemma. The transactions that qualify as nonstandardized under his definition are precisely those for which any system of direct credit card regulation will fail, even if his reforms are adopted. The more appropriate cure for imprudent purchasing is not paternalistic credit card regulations, but rather lifestyle consultants and personal finance managers. For some people, a succession of unwise purchases may be a sign that they need personalized help, which no lender could sensibly provide.

The regulation of nonstandardized markets also invites further difficulties. Just how is this done? Repeatedly, Bar-Gill stresses that the empirical nature of the underlying problems calls for a case-by-case or market-by-market response.<sup>81</sup> Factor in the cost of public regulation, and the likelihood of a successful outcome seems slim. The “proper” market does not magically present itself, even if we ignore the endless variations in user markets. One example of the difficulty arises with the Australian Reserve Bank’s decision to control interchange fees in four-party credit transactions of the sort used by Visa and MasterCard, but not the three-party transactions used by American Express.<sup>82</sup>

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80. The relevant social judgments are hard to make because there are no good estimates of the rate of return in these transactions or the reasons for the returns that do take place. One recent estimate places the rate of return for all consumer goods at around 6%, but that includes much higher rates for Internet and catalog sales where there is no opportunity for inspection at the time of purchase. See Steven A. Matthews & Nicola Persico, Information Acquisition and Refunds for Returns 1 (Penn Inst. for Econ. Research, Working Paper No. 07-021, 2007), available at <http://pier.econ.upenn.edu/Archive/07-021.pdf>. Presumably the rate of return for items sold at the door would be lower. In some cases, one should expect for the return privilege to be voluntarily extended at which point it should be noncontroversial. It is much harder to make any judgment about those returns that are made solely pursuant to a statutory guarantee, where the dangers of consumer opportunism may raise the price for other consumers who do not avail themselves of the return privilege. Note that the argument for a cooling-off period in a loan is far weaker for money presents no risk of unknown or defective characteristics.

81. See Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 751, 768.

82. In four-party transactions, a merchant presents a credit card payment to its bank, which then is paid by the customer’s bank, which in turn charges the customers. Visa and MasterCard charge an “interchange fee” that lops off part of the repayment to the merchant bank. American Express is an inte-

The Australian Reserve Bank thought that both consumer misperceptions about credit cards and the strong chokehold position of Visa and MasterCard justified cutting interchange fees, erroneously in my view.<sup>83</sup> But even if the bank read the situation correctly, it limited its intervention to the four-party arrangements of Visa and MasterCard to the exclusion of the three-party system of American Express.<sup>84</sup> Unfortunately, then, Bar-Gill's case-by-case approach opens the door to selective regulation that distorts the competitive processes, which could easily offset any supposed gains of direct regulation.<sup>85</sup> Sure enough, in the Australian market, the differential system of regulation did create a competitive advantage for American Express.<sup>86</sup> In sum, there seems to be little reason to think that the costs of additional regulation will be cost effective, and much reason to fear that selective regulation of credit card markets will introduce other distortions of far greater magnitude.

## II. EMPIRICAL STUDIES: A QUESTION OF PERSPECTIVE

The situation does not become more palatable when we look at the particular cases of consumer misperception on which Bar-Gill relies. At the outset, his accounts do little with the notion that distinctive downstream uses create nonstandardized products. Rather, the cases that he presents all deal with misestimates of the future use or value of the product sold.<sup>87</sup> As an initial matter, it is important to note that these risks rank far below other credit card hazards, such as fraud, which has become a more important risk as of late.<sup>88</sup> Historical-

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grated outfit that deals with both merchants and cardholders. It charges no interchange fee between banks, but keeps a fraction of the amount owed for payment, which often exceeds that charged in the four-party systems. For accounts of these systems, see DAVID S. EVANS & RICHARD SCHMALENSEE, *PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING* 1–21 (2d ed. 2005) and Epstein, *Interchange*, *supra* note 30, at 553–54.

83. See Epstein, *Interchange*, *supra* note 30, at 556.

84. *Id.* at 560–61.

85. See *id.* at 556.

86. See *id.* at 560–61.

87. See, e.g., Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, 763 (citing various studies to suggest that “consumers are optimistic about their future credit needs; about their future will power; about the likelihood that they will switch to a new card with a new, low introductory rate; or all of the above”).

88. See, e.g., United States Secret Service, Criminal Investigations, <http://www.secretservice.gov/criminal.shtml> (last visited Nov. 30, 2007) (“Financial

ly, fraud includes the activities of persons who incurred credit card debt that they did not intend to repay, and the practices of people who use stolen credit cards for personal gain.<sup>89</sup> Today, the biggest risk by far is the systematic theft of credit card information by people, often operating outside the United States, who hack into credit card databases that are maintained by retailers and data processors.<sup>90</sup> Fraud of this sort can result in losses in the billions of dollars each year, for which individual prudence is no real protection.<sup>91</sup> Second on the list is the panopoly of monopolization charges brought against various companies, where billions more are at risk.<sup>92</sup> The cost implications of these risks—fraud and monopoly rents—easily dwarf the small and speculative wealth transfers that might occur right now from consumers' cognitive biases. Put differently, if we adopted Bar-Gill's regulatory approach, we should fall prey to our own biases by spending large sums of money to prevent small speculative losses, when these dollars are better spent in controlling losses from schemes and machinations that cause a thousand-fold greater loss.

In comparison to these issues, the supposed ability of credit card companies and other firms to manipulate various terms of their agreements looks like small potatoes. Its behavioral component is only a small part of the overall story. Other more traditional efficiency-based explanations play a far larger role.

In this Part, I shall deploy the neoclassical economic perspective to critique Bar-Gill's behavioral explanations in six contentious areas: (1) teaser rates, or low introductory interest rates offered by lenders; (2) hyperbolic discounting, or the practice of buying more than one should when prices are low; (3) universal default, whereby lenders will raise interest rates on one loan because of a default on an unrelated loan; (4) the so-called credit card debt puzzle, whereby some customers keep

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industry sources estimate annual losses associated with credit card fraud to be in the billions of dollars.”).

89. For further discussion of these issues, see Richard A. Epstein & Thomas P. Brown, *Cybersecurity in the Payment Card Industry*, 75 U. CHI. L. REV. (forthcoming Mar. 2008).

90. For an illustration of this process, see *id.* at 12 (recounting the theft of data from TJX Co. in 2006).

91. United States Secret Service, *supra* note 88.

92. See, e.g., *In re Visa Check/Mastermoney Antitrust Litigation*, 280 F.3d 124, 129–30 (2d Cir. 2001); see also EVANS & SCHMALENSEE, *supra* note 82, at 267–96 (discussing antitrust disputes among card companies, merchants and the federal government).

money in the bank that might be better used to pay off the card; (5) various non-credit-card-related issues; and (6) health club memberships. I will show how in each of these contexts, it is far likelier that most consumers are acting strategically rather than irrationally.

#### A. TEASER RATES

Bar-Gill's first example of how "consumers make systematic mistakes" involves teaser, or low-interest introductory rates.<sup>93</sup> The supposed mistake comes from consumers who do not switch to other teaser rates offered by other banks, once their initial low-rate period runs out, especially since the consumers maintain about the same credit card balances as before.<sup>94</sup> The implicit premise of his argument, which rests on the empirical research of Haiyan Shui and Lawrence Ausubel, is that the transactions costs to switch are less than the expected gains from shifting, at least for these nonrevolvers.<sup>95</sup> (Revolvers, who pay off their loans regularly, do not care about these rates.)

But that conclusion hardly seems obvious. Switching a credit card company involves more than filing a new application. There may be lag in getting the response, and furthermore, canceling an existing card can be risky if there are disputed or outstanding charges, or if the credit card is used to pay off certain monthly bills on a regular basis.<sup>96</sup> Any shift in card companies goes on the general credit record, which could lead other companies to turn down an applicant who is known regularly to switch.<sup>97</sup> In addition, the game is a bit trickier for the people who keep multiple credit cards, as it is not easy to juggle six or so cards at one time. Also, many people may think that this form of opportunism is not fair play, however legal. It is a bit like going to a reception to grab some food without staying to

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93. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 776, 779–80.

94. *Id.* at 779–80.

95. See Haiyan Shui & Lawrence M. Ausubel, Time Inconsistency in the Credit Card Market, 25–26 (May 3, 2004), (unpublished manuscript, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=586622](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=586622)).

96. But see EVANS & SCHMALENSEE, *supra* note 82, at 232 ("It is easy to switch cards, and people do so all the time.").

97. See myFICO, Improving Your FICO Credit Score, <http://www.myfico.com/CreditEducation/ImproveYourScore.aspx> (last visited Nov. 30, 2007) (warning against opening new accounts "too rapidly" because new accounts "can look risky" for a new user).

listen to the dinner speaker like others in attendance. And if it were done too often, then these rates would just dry up. Having read Bar-Gill's plea, I have no intention of changing my credit cards any time soon, with all the fuss and bother it entails.

## B. HYPERBOLIC DISCOUNTING

Bar-Gill relies on still another study that suggests that people are prone to "hyperbolic discounting," such that a commodity is more valuable today than the identical commodity in the near future.<sup>98</sup> It is no surprise that some individuals prefer a steeper discount for a shorter period to a higher one for a somewhat longer period. Thus if people know that they can accelerate their purchases—perhaps by timing the acquisition of a new card with large expenditures—then the purchase pattern makes sense. And if not, it remains unclear in dollar terms just how large the savings are.

In sum, an understanding of transaction costs and normal social practices explains why people hold on to their credit cards without invoking any hyperbolic discounting hypothesis, which assumes that people overweigh their losses in the immediate period as against potential gains down the road. "A consumer is said to be a hyperbolic discounter if her short-run discount rate is larger than her long-run discount rate."<sup>99</sup> Bar-Gill acknowledges that there is little evidence of hyperbolic discounting in long-term mortgage markets, where the typical balances are far higher than those on credit cards.<sup>100</sup> He then observes that "the fact that consumers make few mistakes in one market does not imply that they make few mistakes in all markets."<sup>101</sup> That proposition is surely right if an inference was drawn about markets in hosiery from markets in credits. But it packs lots less pop when the move is from credit cards to mortgages, especially since no credit card has the outsized interest rates that are reported in some experimental settings: up to

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98. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 765 (citing Stephan Meier & Charles Sprenger, *Impatience and Credit Behavior: Evidence from a Field Experiment* 5 (Fed. Reserve Bank of Boston, Working Paper No. 07-03, 2007), available at <http://www.bos.frb.org/economic/wp/wp2007/wp0703.pdf>).

99. See, e.g., Bar-Gill, *Seduction by Plastic*, *supra* note 28, at 1395–1401 (stating that imperfect self-control, optimism bias, and hyperbolic discounting cause excessive borrowing).

100. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 768.

101. *Id.*

345% for the first month, 120% for the year, and 19% for a ten-year wait, reported in the experimental literature.<sup>102</sup>

Bar-Gill never proposes specific regulation for this ailment, but he does try to make the case for some regulation by using his own estimates as a basis for computing social loss. Thus he writes that “the \$250 cost of failing to switch cards at the end of the introductory period is born by the 35% of borrowing consumers who chose cards with introductory offers—1.4 million consumers each year. This implies an aggregate annual cost of \$350 million.”<sup>103</sup> But the overstatement should be manifest in this conclusion. If the above criticisms of Bar-Gill’s account of teaser rates are correct, then some of these consumers, perhaps even most, have played it right, at which point the lost payments could easily plummet. In any event, the \$350 million only refers to an inflated estimate of transfer payments. It does not explain why the social losses that stem from these payments should be regarded as equal to the size of the transfer payments. And what should be done anyhow, given that it does not make sense to order people to take out new cards when the low rates end?

### C. UNIVERSAL DEFAULT

Yet another practice that Bar-Gill finds objectionable relates to the question of universal default, which was the topic of a recent Senate hearing.<sup>104</sup> Universal default refers to the practice whereby interest rates on credit card loans will be raised in the event of a default of some other, and unrelated, noncredit card bill.<sup>105</sup> The practice is not used uniformly throughout the industry,<sup>106</sup> which indicates that market pressures are at work.

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102. Shane Frederick et al., *Time Discounting and Time Preference: A Critical Review*, in ADVANCES IN BEHAVIORAL ECONOMICS 162, 172–75 (Colin F. Camerer et al. eds., 2004). For my critique, see Epstein, *Behavioral Economics*, *supra* note 30, at 129–31.

103. Bar-Gill, *Exchange*, *Behavioral Economics*, *supra* note 21, at 787.

104. See *Hearing on Credit Card Practices: Fees, Interest, and Grace Periods Before the Subcomm. on Investigations of the S. Comm. on Homeland Sec. and Gov’t Affairs*, 109th Cong. 1–5 (2007) (statement of Sen. Carl Levin, Chairman, S. Subcomm. on Investigations); see also Marcy Gordon, *Panel Reviewing Credit Card Practices*, CINCINNATI POST, Mar. 7, 2007, at A9.

105. See *2005 Credit Card Survey*, CONSUMER ACTION NEWS (Consumer Action, San Francisco, Cal.), Summer 2005, at 1, available at [http://www.consumer-action.org/downloads/english/CC\\_Issue\\_2005.pdf](http://www.consumer-action.org/downloads/english/CC_Issue_2005.pdf).

106. See *id.* (noting that banks with universal default policies exhibit a widespread variation in determining how consumers may reduce their high interest rates following a default); see also Gordon, *supra* note 104 (reporting

These are likely to have a strong impact if the increase comes without some form of advance notice to the individual cardholder that explains why the unrelated delinquency has altered interest rates. But some firms have persisted with the practice,<sup>107</sup> and with suitable disclosures early in the process, that decision does not appear to signal any form of cognitive bias or market failure. To the contrary, there is good reason to believe that defaults on unrelated loans are themselves positively correlated, such that a party who has defaulted on one occasion is more likely to do so on others. If so, then the universal default provision, even if modified to allow for delayed implementation, can be defended as a way of reducing the cross-subsidies from better to worse credit risks, a move that has obvious efficiency advantages. As so often is the case, the aggressive condemnation of controversial practices may make credit markets less and not more efficient. There is little reason to think that individual credit card holders will volunteer information about their present credit status. The use of comprehensive credit devices could be defended on the ground that it reduces that most ubiquitous of market failures—asymmetrical information.

#### D. CHECKING ACCOUNTS VERSUS CREDIT CARDS

I think that there is more merit to a study by David Gross and Nicholas Souleles, which notes that people keep money in their checking accounts at low rates of interest even as they do not pay off their credit card debt on which they have to pay a far higher rate of interest.<sup>108</sup> But at least one competing explanation demands attention. There are costs to running down checking account balances. The low average or minimum could trigger higher bank fees on accounts with minimum deposits.<sup>109</sup> Using checking account funds to pay off the credit card could also make it awkward to write checks. Keeping the credit card

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that the nation's largest financial company, Citigroup, recently announced plans to eliminate the practice of universal default).

107. See *2005 Credit Card Survey*, *supra* note 105, at 1 (noting that 44.68% of banks still maintain universal default policies).

108. David B. Gross & Nicholas S. Souleles, *Do Liquidity Constraints and Interest Rates Matter for Consumer Behavior? Evidence from Credit Card Data*, 117 Q.J. ECON. 149, 180 (2002).

109. See, e.g., Chase Personal Banking, Checking Overview, [http://www.chase.com/ccp/index.jsp?pg\\_name=ccpmapp/individuals/checking/page\\_checking\\_overview](http://www.chase.com/ccp/index.jsp?pg_name=ccpmapp/individuals/checking/page_checking_overview) (last visited Nov. 30, 2007) (indicating that in some Chase Checking products, such as "Chase Better Banking Checking," a monthly service fee may be charged if the account balance falls below a predetermined amount).

balance alive could preserve both options, so long as the card has not been maxed out. People are willing to pay for valuable options. But the price becomes too steep for large loans, at which point loan consolidations start to make sense. A close empirical study of who takes them out and when could help shed more light on the underlying problem.

Economists who have reviewed Gross and Souleles's paper have advanced three competing explanations.<sup>110</sup> One explanation suggests that lower-income households—or households with income uncertainty—are likely to run up their credit card debt, because they know that their debts accrued in this form are dischargeable upon bankruptcy.<sup>111</sup> At the same time, their liquid assets can quickly be converted into exempt property during the bankruptcy filing.<sup>112</sup> Accordingly, the empirical work finds that higher credit card debt is more common in states where bankruptcy exemptions are easily obtained, just as the rational choice theory would predict.<sup>113</sup> A second explanation is that the information revealed in connection with credit card purchases allows for intrafamily control on unwanted spending.<sup>114</sup> Assume that the wife were the only earner within the family. If her husband used her credit card to purchase high-end gizmos, she could decline to pay the card debt to check his behavior.<sup>115</sup> Finally, many people may prefer to keep cash in the bank if their regular expenditures—rent, cab rides, and sundries—cannot be paid through credit cards.<sup>116</sup> Many small towns and suburbs, including Hyde Park, are filled with shops and service providers that refuse to accept credit cards. Unlike Bar-Gill's explanation, all three of these explanations suggest

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110. See Irina A. Telyukova, *Household Need for Liquidity and the Credit Card Debt Puzzle* 2–3 (Nov. 16, 2006) (unpublished manuscript, available at [http://dss.ucsd.edu/~itelyuko/telyukova\\_ccdp.pdf](http://dss.ucsd.edu/~itelyuko/telyukova_ccdp.pdf)).

111. See Andreas Lehnert & Dean M. Maki, *Consumption, Debt, and Portfolio Choice: Testing the Effect of Bankruptcy Law* 1–2 (Fed. Reserve Board Fin. & Econ. Discussion Series, Working Paper No. 2004-12, 2002), available at <http://www.federalreserve.gov/Pubs/feds/2002/200214/200214pap.pdf>.

112. See *id.* at 31–32.

113. See *id.* at 3.

114. See Telyukova, *supra* note 110, at 2.

115. Carol C. Bertraut & Michael Haliassos, *Debt Revolvers for Self Control* 3–4, 24 (Univ. of Cyprus Dep't of Econ., Discussion Paper No. 2002-08, 2002), available at <http://www.econ.ucy.ac.cy/papers/0208.pdf>; see Telyukova, *supra* note 110, at 2.

116. See Telyukova, *supra* note 110, at 37 (suggesting that the “liquidity need hypothesis” may account for 79% of the households that take on additional credit card debt while having sufficient savings to pay this debt off).

that cardholders are acting strategically rather than irrationally.

#### E. NON-CREDIT CARD CASES

In addition to looking at studies from the credit card industry, Bar-Gill goes further astray to document the notion of “misperception-based pricing” that can arise whenever consumers are faced with a pricing regime with two or more dimensions.<sup>117</sup> Sellers, even in competitive markets, can manipulate terms to receive an undeserved rate of return. His example is a kitchen table that could sell for either \$100 or for \$110 with a \$20 rebate.<sup>118</sup> If consumers choose the rebate plan, they could end up paying more as a group by not cashing in 50% of the time.<sup>119</sup>

Bar-Gill has done his sums right, but not his economics. It is always risky strategy to play the rebate game, given the risk of adverse selection. The likely scenario is that buyers will self-select into two categories: those who are inattentive take the fixed price; those who are more disciplined take the rebate. Misperceptions have to be quite strong to counter that risk. We should look, therefore, elsewhere for asking why rebates are offered. In some markets, secret rebates are used where marginal cost pricing is highly inefficient, as with pharmaceuticals.<sup>120</sup> The impulse is to use the rebate as a sensible form of price discrimination. But most markets are not as complex as pharmaceuticals. Recently the website for Brother International Corporation displayed a \$20 rebate on the cheapest home consumer printer, but on no others.<sup>121</sup> No theory of misconception-based pricing can explain this *selective* rebate. A simpler explanation is that the rebate is one way to stimulate sales of slow-moving or discontinued models.<sup>122</sup> The skeptic should ask

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117. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 769–72.

118. *Id.* at 769–70.

119. *Id.* at 770.

120. See RICHARD A. EPSTEIN, OVERDOSE: HOW EXCESSIVE GOVERNMENT REGULATION STIFLES PHARMACEUTICAL INNOVATION 68–70 (2006) (discussing why “secret deals” are an “indispensable feature” of the pharmaceutical market).

121. See Brother, HL-2040 Laser Printer, <http://www.brother-usa.com/Printer/ModelDetail.aspx?ProductID=HL2040> (last visited Nov. 30, 2007).

122. See Matthew A. Edwards, *The Law, Marketing and Behavioral Economics of Consumer Rebates*, 12 STAN. J.L. BUS. & FIN. 362, 376 (2007) (“Firms use rebates to stimulate sales, obtain marketing information and engage in price discrimination.”).

why the rebate is preferable to a conspicuous price cut, for which I doubt marketing people would point to misperception pricing.

This discussion easily segues to one of Bar-Gill's favorite examples, the combined purchase printer and ink.<sup>123</sup> The two-part pricing schedule allows a vendor to undersell the printer in order to recoup revenues on the sales of the cartridges to customers who underestimate their use.<sup>124</sup> But Bar-Gill offers no evidence that people systematically underestimate or overestimate their use, when the most plausible assumption, especially in commercial markets with large accounts, is that the professionals get it right. Indeed, if small toner cartridges print 10,000 sheets for \$80, the cost of paper exceeds the cost of the toner: at \$6 per ream of 500 sheets, it equals, \$120, for which there is no tie.<sup>125</sup> So why worry about the ink? Nor is there any reason to worry if the price of paper is just ignored. The Hewlett-Packard website goes to enormous lengths to persuade consumers not to refill their empty cartridges with ink supplied from other suppliers.<sup>126</sup> That constant source of competition must exert at least some pressure on prices. The exclusive rights that the printing companies have over their own cartridges, which have been sustained against antitrust challenges,<sup>127</sup> do not block this distinct form of entry.

Other forces also limit the pricing freedom to printer manufacturers. Low printer prices bring the customer in while the toner price facilitates demand-based price discrimination, where the cost varies with the intensity of use. But monitoring does not imply extra high prices in light of the refill option, and the ability of customers to move elsewhere given the low printer prices. The enormous range of printer and toner choices hardly speaks to price manipulation but rather to vigorous competition in markets with sophisticated customers,<sup>128</sup> many

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123. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 773–74.

124. *Id.*

125. See Office Depot, Paper Depot-Office Supplies, <http://www.officedepot.com/browse.do?Nr=2-----&N=200878> (last visited Nov. 30, 2007) (showing the range of prices for reams of paper).

126. HP, The Truth About Remanufactured Ink and Toner Cartridges, [http://h71036.www7.hp.com/hho/cache/459406-0-0-225-121.html?jumpid=ex\\_r602\\_info/inkandpaper/printcartridges/refill-inkandtoner](http://h71036.www7.hp.com/hho/cache/459406-0-0-225-121.html?jumpid=ex_r602_info/inkandpaper/printcartridges/refill-inkandtoner) (last visited Nov. 30, 2007).

127. *Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 44–45 (2006) (requiring proof of a monopoly in the tying product market to attack the tie-in).

128. See, e.g., *id.* at 31–33, 46 (stating that selling a printing system with a patented printerhead, patented ink container, and unpatented ink does not

of whom are professional buyers for firms. In this market, ordinary consumers can free ride the sophisticated buyers' expertise. One look at the Office Depot website<sup>129</sup> should confirm that view. The dominant price movement is down, down, down while performance moves up, up, up. Regulation to insure cost-justified pricing for toner cartridges is a wild goose chase.

#### F. HEALTH CLUBS

The health club market reveals the same pattern. The problems of estimation are not dominant for folks with regular routines. Practically, one membership problem arises for people who live in one city for only part of the year, and so desire plans that suspend their monthly membership fees during periods of absence, for which the East Bank Club of Chicago makes allowances, at least for people over sixty-five.<sup>130</sup> But the real difficulty in these cases is strategic behavior by customers. Hence this warning: "There are never discounts or specials on membership, so it doesn't really matter when you join. You can cancel your membership at any time, but think hard first, because you won't be allowed to join again for nine months."<sup>131</sup> "The price? Not cheap but not as steep as I had anticipated: There is a \$500 enrollment fee and monthly fees range from \$115 to \$165."<sup>132</sup> The monthly pricing helps the clubs stabilize their earnings and to prepare for the anticipated use of their facilities. The multiple plans are needed to cope with customer heterogeneity. Quite sensibly East Bank Club commits itself to relative prices. The customer then decides which option generates the highest surplus. Pricing misperception does not look like a credible story.

There is, of course, no way to present results that indicate that all people are free of bias and error in their daily lives. But that is not the real issue that divides Bar-Gill and myself. I believe that mistakes are a part of life, but that people who suffer from them seek to avoid them. In examining their behavior, it

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create a presumption of the suppression of competition).

129. Office Depot, Ink Depot, [http://www.officedepot.com/inkTonerManuf.do;jsessionid=0000S\\_K\\_Q5V0pG3gV7v99CMksfs:11st68003](http://www.officedepot.com/inkTonerManuf.do;jsessionid=0000S_K_Q5V0pG3gV7v99CMksfs:11st68003) (last visited Nov. 30, 2007) (providing pricing and discount information on a wide variety of ink cartridges).

130. Telephone Interview by Damon Brinson with Andrew Koennecke, Senior Representative, East Bank Club, in Chi., Ill. (Oct. 5, 2007).

131. Centerstage Chicago, East Bank Club, <http://centerstagechicago.com/healthclubs/500NKingsbury.html> (last visited Nov. 30, 2007).

132. My Kind of Club, <http://fitsugar.com/118989> (Feb. 5, 2007, 02:00 EST).

is unsound methodologically to stress the errors in human behavior before gaining a full explanation of why some behaviors may be more rational than they appear. The six areas just reviewed give some hint of the general approach, for in each we can find some rational explanation which at the very least indicates that the behavioral anomalies to which Bar-Gill points should be regarded as second-order problems.

### III. THE FUTILITY OF (MUCH) MORE GLOBAL REGULATION

The last Part of Bar-Gill's Article contains his grand plea for further regulation, with due emphasis on both terms. As to the former, we both accept the use of the APR<sup>133</sup> and the "Schumer Box"<sup>134</sup> to convey relevant information. My guess is that firms are comfortable with both because they boost the overall willingness of consumers to acquire credit cards by lowering the costs of acquisition. But is there more low-hanging fruit that is worth harvesting? I doubt it. Bar-Gill has no specific proposal. Instead he tries to make out the case for further legislation by pointing to regular standbys: negative externalities<sup>135</sup> and adverse distributional consequences.<sup>136</sup> The former follow because credit card debt can take down families.<sup>137</sup> But on the other side of the ledger, the inability to gain credit has negative externalities as well, especially if parties are forced into the arms of shadier lenders who have higher costs and more uncertain collection and control procedures. So even if the stakes are higher, the choice between the status quo and further (or even less) regulation is unclear. On the distributional frontier, he notes that the consequences of error are more likely to fall on poorer persons with limited education.<sup>138</sup> He might have also mentioned, first, that the ability of poorer families to get credit cards will, on average help their position.<sup>139</sup> Second, the current forms of disclosure offer their greatest advantage to the least educated—since educated customers self-protect bet-

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133. See Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, 795–97.

134. *Id.*

135. *Id.* at 788–89.

136. *Id.* at 789–90.

137. See *id.* at 788.

138. See *id.* at 789.

139. Cf. Epstein, *Behavioral Economics*, *supra* note 30, at 128 ("Nor are bankrupt parties necessarily victims of some underlying cognitive bias. Credit cards allow purchase of expensive equipment needed to start a new risky business venture.").

ter—even if the costs of regulatory compliance are spread across a wider population. Broad considerations such as these hardly tell us what to do next.

Bar-Gill also espouses the view that self-regulation within the industry helps guard against extending credit to those who are not in a position to use it wisely.<sup>140</sup> My position is that the prospect of serious losses explains why credit card companies turn down some applicants and impose financial limitations on others. Bar-Gill counters that credit card companies might jettison self-regulation to adopt a “sweat box” model whereby the high fees along the way more than compensate for the inability to recover anything in bankruptcy.<sup>141</sup> That approach requires credit card companies to live dangerously, especially if the risks of default among customers are positively correlated.

In truth, the real difficulties are not in consumer credit markets, but in the subprime mortgage markets, which has received extensive coverage as of late.<sup>142</sup> But it is very difficult to attribute this problem to consumer misperceptions when the big losers in these transactions tend to be the mortgage institutions and hedge funds that were prepared to make high-risk loans at what turned out to be favorable rates.<sup>143</sup> As of March 2007, around 14% of monthly payments were sixty days late, up by about 100% in the past year.<sup>144</sup> One major lender, New Century Financial, has had to restate earnings for three quarters and is under criminal investigation.<sup>145</sup> A second, Fremont General, announced its intention to sell off its subprime portfolio.<sup>146</sup> Federal regulators under their present powers are thinking about imposing tighter standards,<sup>147</sup> and on August 17,

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140. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 784–86.

141. *Id.* at 785–86.

142. See, e.g., Nelson D. Schwartz & Vikas Bajaj, *Credit Time Bomb Ticked, but Few Heard*, N.Y. TIMES, Aug. 19, 2007, at A1.

143. See *id.*

144. James R. Hagerty et al., *Subprime Troubles Grow*, WALL ST. J., Mar. 3, 2007, at A3.

145. Vikas Bajaj & Julie Creswell, *Authorities Investigate Big Lender*, N.Y. TIMES, Mar. 3, 2007, at C1.

146. See Greg Morcroft, *New Century, Fremont Sink on Subprime Woes*, MARKETWATCH, Mar. 5, 2007, <http://www.marketwatch.com/news/story/new-century-fremont-general-suffer/story.aspx?guid=%7B7E98AAA5-94B9-4DCC-BBA4-704F72A977FE%7D>.

147. See Alistair Barr, *Panic Takes Hold as Subprime Lenders Slump*, MARKETWATCH, Mar. 5, 2007, <http://www.marketwatch.com/news/story/subprime-panic-takes-hold-investors/story.aspx?guid=%7B75E1EE31%2D0F63%2D422D%2D8715%2D2CB945DFF410%7D>.

2007 lowered the discount rate on loans it charged to member banks in order to calm a jittery market.<sup>148</sup> But it is hard to see what the behavioral finance literature contributes to this discussion. Certainly its concerns have not been featured in the extensive commentary on the matter, and for good reason. As for the high-risk lenders, the simplest explanation remains the best. They took large risks on their loan portfolio and now have to pay the price when the market turned bad. The reversal does not suggest any irrationality. No one gets something for nothing, and the high failure rate is consistent with the high rates of return earlier on. None of their activity is driven by the ability of these mortgage companies to exploit pricing misperceptions, which could be handled under the current laws. Rather, the recent flurry stems from the bets that subprime lenders made on the housing market,<sup>149</sup> which turned bad when that market turned weak. These lenders did not make up through high interest rates what they lost on principal.<sup>150</sup>

The irony on this point lies in the position of the borrowers, many of whom stand to lose their homes. In dealing with these cases, their position is probably better than that of the lenders. They may have had little or no equity in their homes.<sup>151</sup> Some of them may well be able to repurchase their own liens for a fraction of the value, thereby reducing after the fact the cost of acquiring their own properties.<sup>152</sup> Others may have actions against various subprime lenders for misrepresentation, concealment, or fraud.<sup>153</sup> If anything we have a situation where lenders turn out to be more vulnerable than borrowers.

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148. See Schwartz & Bajaj, *supra* note 142.

149. See *id.*

150. See *id.*

151. See Alan Reynolds, *Subprime Economics*, WASH. TIMES, Mar. 25, 2007, <http://www3.washingtontimes.com/commentary/20070324-100652-2256r.htm> ("Subprime borrowers who made no down payment already have a terrible credit rating, so they have nothing to lose if they can't sell their homes at a profit.").

152. See John M. Berry, *There May Be an Out for Some Subprime Borrowers*, BLOOMBERG.COM, Oct. 11, 2007, [http://www.bloomberg.com/apps/news?pid=20601170&refer=special\\_report&sid=anxOH4nv1deE](http://www.bloomberg.com/apps/news?pid=20601170&refer=special_report&sid=anxOH4nv1deE) (analyzing ways subprime borrowers might be able to refinance their mortgages at better rates in order to keep their homes).

153. For an overview of some of the existing remedies, see U.S. DEP'T OF HOUS. & URBAN DEV. & U.S. DEP'T OF TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 53-56 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (discussing some of the various remedies already available against predatory lenders).

Judged by the standards of the subprime market, the credit card market stands as a tower of strength. At one level, they are less exposed because they make smaller loans for shorter periods.<sup>154</sup> But these credit lenders face some long-term risks.<sup>155</sup> Fortunately, it looks most unlikely that any of them are following policies that are inconsistent with their own card limits and credit scoring devices. The risks of default are hard to offset by sustainable increases in interest rates. Suppose that a company collects 30% interest for two years on average balances of \$2000, with another 10% in fees. It is now up \$800. It is hard to see how that sum compensates for a bankruptcy that results in a loss of that outstanding balance after two years. Even a five-year run looks very dicey. It is far more plausible for a bank to adopt the tried-and-true two-part strategy. First, try to accurately classify and limit the risk, and then charge the right rates for the risks that remain. Self-regulation still matters, and where it does not, the problem is not with credit card companies that exploit the innocent. It is with those who let themselves get exploited by foolish credit card decisions. Yet there is no way to help through regulation once the usual disclosures have been made. Rather, individualized attention to look at the entire earning and spending pattern is far better, and far more targeted. There is no reason to bring down people who know how to use credit cards in the futile effort to help those who would be in as much trouble with pay-day loans as with credit cards.

In the end, the most that one could contemplate are modest emendations of what goes into the Schumer Box. One candidate could concern unexpected increases (fully disclosed at the time) in annual fees after the initial honeymoon period. Bar-Gill thinks that *Rossman v. Fleet Bank (R.I.) National Association*<sup>156</sup> leaves too much play in the joints.<sup>157</sup> But the whole point is little more than a tempest in a teapot. The major fear is that the bank could impose an annual fee of not \$35 but \$350, but

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154. See Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79, 120 (2000) (pointing out that credit card loans differ from other types of loans since they “require the lender to process a large volume of relatively small transactions”).

155. See Epstein, *Behavioral Economics*, *supra* note 30, at 128; Zywicki, *supra* note 154, at 123–27.

156. 280 F.3d 384 (3d Cir. 2002). For a discussion of this case in the context of behavioral economics, see Epstein, *Behavioral Economics*, *supra* note 30, at 125–27.

157. Bar-Gill, Exchange, *Behavioral Economics*, *supra* note 21, at 796–97.

there is no evidence that this maneuver has ever been attempted, or that any bank could survive the din once that information became common knowledge. Perhaps, just perhaps, we might require shifts in fees not to exceed \$100 per annum, to pick a number. The point here is to prohibit that which will not happen anyhow. So why bother? Tinker if we must. Yet that said, I think that it is plain why the disclosure issues for credit card regulation have no political traction today, even with the advent of the behavioral approach. No one is quite sure what additional disclosures should be made, or has any confidence that they could alter these behaviors if they are as ingrained as Bar-Gill and others presuppose. Or that if people do substitute away from credit cards, they will take a straight and narrow path instead of some other ruinous choice.

The overall picture seems clear. Proposed systems of regulation may have some games. But these are likely to provide at most ephemeral gains at best to the bottom end of the distribution, but only at a high price for everyone else. Truth be known, most people like credit cards for their unparalleled convenience.<sup>158</sup> Most people would rather have higher limits than lower ones. The ability of the vast majority of the population or more to use these cards well cannot be ignored.<sup>159</sup> The ex ante costs of regulation fall on good and bad consumers alike, which means that it won't pass if most people are comfortable with the system they have. In the end, we shall see at most marginal changes on this frontier unless and until some widespread scam hits the marketplace. The real issues have to do with industry structure and the security of credit card information. Behavioral economics comes in a distant third place, and there for the foreseeable future, it will happily remain.

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158. See Epstein, *Behavioral Economics*, *supra* note 30, at 124 (discussing reasons why credit cards are widely perceived as desirable).

159. See EVANS & SCHMALENSEE, *supra* note 82, at 102–03.