Consumer Bankruptcy as Development Policy

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I. INTRODUCTION

Consumer lending has surged in countries across the globe in recent years. Not surprisingly, consumer financial markets have expanded most dramatically in developed economies, especially in the United States and the European Union.[1] Some of the most dramatic changes in consumer borrowing, however, have occurred in the developing world. In recent years, modern consumer financial markets have emerged or have begun emerging in nearly all middle-income and many lower-income countries as these countries have experienced significant per capita growth in recent years.[2] Total financial liabilities of households in India, for example, have increased nearly

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1 Between 1981 and early 2008, consumer lending in the United States increased from $353 billion to approximately $2.6 trillion, excluding loans secured by real estate. FEDERAL RESERVE, FEDERAL RESERVE STATISTICAL RELEASE G.19 CONSUMER CREDIT (2008), http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.html (last visited Dec. 28, 2008). Over the last two decades, household indebtedness in developed countries has increased at rates faster than growth in household incomes; as a result, debt-to-asset ratios have increased significantly across these economies. Guy Debelle, *Household Debt and the Macroeconomy*, BIS Q. REV., Mar. 2004, at 52.

2 According to the World Bank, gross domestic product per capita nearly doubled in Brazil in the period between 1986 and 2006, increasing from $4854 to $9054; in India, GDP per capita nearly quadrupled, increasing from $993 to $3827; and in China, that figure rose seven-fold in that period, increasing from $918 to $7660. See World Bank, World Development Indicators, at http://data.un.org/Data.aspx?d=CDB&f=srID%3a29922.

six-fold between 2000 and 2006.[3] In Brazil, consumer lending more than doubled between 2003 and 2007, from $238 billion to $530 billion.[4] Outstanding consumer credit in Mexico has grown by approximately thirty-five percent per year in recent years.[5] Some of this global increase in consumer or household debt is due to the expansion of microfinance in developing countries,[6] but most appears to be the product of expanding conventional lending in nascent formal credit markets. Consumers in developing countries are increasingly financing purchases of household durables and automobiles,[7] and credit card penetration has surged across most of Western Europe, Asia, Russia, and South America.[8] While total consumer lending in developing countries is relatively modest compared to similar lending in countries with more advanced economies, these emerging consumer financial markets are increasingly significant, and they appear likely to continue growing at dramatic rates in coming years.

While some writers have expressed concern about rising levels of indebtedness in developing countries,[9] there has been surprisingly little scholarship assessing the overall effects of the deepening of con-

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[3] RESERVE BANK OF INDIA, CHANGES IN FINANCIAL ASSETS / LIABILITIES OF THE HOUSEHOLD SECTOR (2006), *available at* http://www.rbi.org.in/scripts/publications view.aspx?id=8561. Household liabilities during 2000 through 2001 were rupees (Rs.) 31,779 crore; in 2005 through 2006, the liabilities were Rs. 182,539 crore. *Id.* A crore is the Indian numbering equivalent of 10 million. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 540 (1993). As of January 2008, one dollar is worth approximately forty-eight rupees.

[4] *See* Jack Chang, *Banking, Consumer-Credit Boom Transforms Brazil*, MCCLATCHY NEWSPAPERS ONLINE, Feb. 13, 2008, http://www.mcclatchydc.com/161/story/27564.html.

[5] *See* Anna Gelpern, *Wal-Mart Bank in Mexico: Money to the Masses and the Home-Host Hole*, 39 CONN. L REV. 1513, 1515 (2007) (citing Jos J. Sidaoui, *The Mexican Financial System: Reforms and Evolution 1999–2000*, *in* 28 BIS PAPERS 277, 289 (2006)).

[6] *See infra* notes 46–51 and accompanying text.

[7] *See, e.g.*, ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT 2008, BRAZIL (2008), 31–32; Akash Gupta & Rahul Agarwal, 'The Consumer Financing Business in India'—Building Blocks for the Future 4–5, 7 (Dec. 8, 2004) (unnumbered working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=619721.

[8] *See, e.g.*, Mark Landler, *Credit Cards Tighten Grip Outside U.S.*, N.Y. TIMES, Aug. 9, 2008, at A1.

[9] *See generally* José Reinaldo de Lima Lopes, *Consumer Bankruptcy and Over-indebtedness in Brazil*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 85 (Johanna Niemi-Kiesilainen et al. eds., 2003); Xian-Chu Zhang, *Development of Consumer Credit in China and Concerns about the Underlying Legal Infrastructure*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra*, at 105; Claudia L. Marques & Antonio H. Benjamin, Consumer Over-indebtedness in Brazil and the Need of a New Consumer Bankruptcy Legislation 1 (July 25, 2007) (unnumbered working paper), *available at* http://www.allacademic.com/meta/p_mla_apa_research_citation/1/7/7/5/4/p177540_index.html; Soogeun Oh, Portrait of Personal Bankruptcy in Korea (2008) (on file with author).

sumer financial markets in the developing world. There has been little focus, for example, on whether and when expanding consumer financial markets might promote growth and development, whether some types of lending promote growth and development more than others, and whether or how policymakers should promote or restrain consumer lending in their countries. This is particularly surprising because there is a rich and growing body of literature that explores the links between law, financial markets, economic growth, and development.[10] The various strands of this literature are broadly accepted as having established that legal institutions promote the deepening of financial markets, which can in turn promote economic growth and development.[11] This literature has been highly influential among policymakers in developing economies around the globe and within the international financial institutions that influence policies in the developing world, such as the International Monetary Fund and the World Bank.[12] Yet this literature has not addressed the question of whether deepening of consumer financial markets might promote such growth. As Karlan and Zinman note, while there is consensus that financial deepening in general promotes growth and development, "[t]here is less consensus on the role of consumer credit in expansion initiatives."[13] This literature has also failed to address whether regulation of consumer finance is part of the observed relationship between law, finance, and development.

This Article argues that consumer financial markets, if effectively regulated, can play an important role in promoting growth and development, especially in countries with rising per capita incomes. By

[10] *See infra* notes 32–34 and accompanying text.

[11] *See infra* Part II.A.

[12] *See* Joel M. Ngugi, *The World Bank and the Ideology of Reform and Development in International Economic Development Discourse*, 14 CARDOZO J. INT'L & COMP. L. 313, 313–23 (2006); *see also* John K. M. Ohnesorge, *Developing Development Theory: Law and Development Orthodoxies and the Northeast Asian Experience*, 28 U. PA. J. INT'L ECON. L. 219, 243 (2007). "References [in the 1990's] to economist Douglass North's designation of law as an "institution" with important economic implications helped justify legal reform initiatives that went far beyond the scope of prior . . . initiatives, and the rule of law became the umbrella concept used to rhetorically unify a wide range of legal development initiatives." *Id.* at 253 (discussing the impact of law and finance literature on the World Bank); World Bank, About Us, http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20040565~menuPK:1696892~pagePK:51123644~piPK:329829~theSitePK:29708,00.html (noting the importance of implementing "legal and judicial systems that encourage business, protect individual and property rights, and honor contracts") (last visited Dec. 28, 2008).

[13] Dean S. Karlan & Jonathan Zinman, *Expanding Credit Access: Using Randomized Supply Decisions to Estimate Impacts* 1 (Ctr. for Global Dev., Working Paper No. 108, 2007) (emphasis omitted), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=982921.

way of illustration, it proposes that consumer bankruptcy can, under some circumstances, contribute to beneficial regulation of consumer finance in developing economies. As Part II explains, there are good reasons to believe that the deepening of consumer financial markets can promote growth and development. Most obviously, it can enable individuals and households to consume more of goods and services that directly improve their welfare. The availability of consumer credit can make it easier for individuals to pursue self-employment or to become entrepreneurs; it can enable individuals to purchase durable goods, which may serve as a form of investment at the household level; it can provide individuals with a way to smooth consumption across income gaps, which should reduce private and social costs of income shocks; and it can increase demand for domestic goods and services. Finally, borrowing may increase individuals' personal investment in the overall performance of their country's economy, thereby deepening consumers' commitment to domestic development policies.

Despite such potential beneficial effects, however, there are also costs and risks associated with consumer borrowing. These include reduced domestic savings, inflation, and results of over-indebtedness. It is entirely possible that these costs might outweigh the benefits described above in any particular context. Moreover, while the benefits of expanding consumer lending are debatable, it is almost certain that at least some of these costs will accompany increasing consumer indebtedness. This Article focuses on risks and costs associated with over-indebtedness. Individuals who are over-indebted must allocate increasing amounts of income to servicing their obligations. This undermines their ability to finance otherwise productive activity and, perhaps, their incentives to earn additional income. They may experience acute emotional and physical stress, which can create a variety of other costs. They may also be at increased risk for needing social assistance. To the extent that consumers anticipate the risk of such results of indebtedness, they may be much less willing to borrow money in the first place, which will slow the deepening of financial markets. Finally, as recent events in financial markets indicate, under some circumstances, widespread default and delinquency by over-indebted individuals can weaken financial institutions and financial markets.

Effective regulation of consumer finance can promote the beneficial effects associated with consumer lending and reduce the attendant risks and costs. Part III argues that legal rules and legal institutions can help expand consumer lending in emerging economies, just as they can promote commercial lending and investment. Basic legal institutions—high-quality judicial systems, stable property rights, and mechanisms to enforce contracts—are all presumably important preconditions for consumer finance, as they are for corporate finance. More elaborate legal regimes enabling secured lending and debt collection may also help make consumer-lending relationships more predictable, thereby making consumer finance more accessible and less costly. A wide range of laws and regulations affecting banks and other financial institutions can also help expand consumer lending. These include increasing opportunities for bank branching, reducing interest rate regulations, and liberalizing limits on foreign investment in the financial sector.

Part III also argues that regulation of consumer finance should be especially concerned with limiting the costs of consumer financial distress and over-indebtedness. A variety of legal regimes and policies are designed to address these costs, including, most notably, usury laws, disclosure requirements, financial education, laws prohibiting particular transactions or terms, limits on debt collection, and debt relief.[14] Some of these rules and institutions may have more ambiguous welfare effects than commercial investor or lender protections. For example, most substantive regulations of consumer lending, such as usury laws or property exemptions, are likely to increase the cost and/or reduce the availability of credit.[15] In this respect, such regulations have the potential to slow the development of consumer financial markets. Such rules and regimes are thus desirable only if their beneficial welfare effects outweigh their costs.

This Article therefore implies that there is an optimal framework of regulation of consumer finance in developing economies. It does not, however, aim to define such a framework. Rather, in Part IV, this Article evaluates consumer bankruptcy as a particular form of

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[14] Such regimes and policies are discussed *infra* at notes 88–91 and accompanying text.

[15] *See, e.g.*, Jeremy Berkowitz & Richard Hynes, *Bankruptcy Exemptions and the Market for Mortgage Loans*, 42 J.L. & ECON. 809, 811–27 (1999); Reint Gropp, John Karl Scholz & Michelle White, *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. ECON. 217, 245 (1997) (finding that more generous property exemptions are positively correlated with higher interest rates); Richard M. Hynes, *Credit Markets, Exemptions, and Households With Nothing to Exempt*, 7 THEORETICAL INQ. L. 493, 504–17 (2006) (exploring the fact that exemptions affect the cost of credit for households that cannot take advantage of those exemptions); *see also* Richard Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 170–97 (2002) (reviewing the literature on the effects of regulations of consumer finance on credit markets). *See generally* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981).

regulation of consumer finance that may promote growth and development. It claims that an effective consumer bankruptcy regime can, under some circumstances, help reduce the costs of consumer lending ex post and can perhaps promote beneficial consumer lending ex ante. Consumer bankruptcy law generally regulates debt collection by, among other things, staying at least some collection efforts once a debtor enters the bankruptcy system and by restructuring or discharging some of the debtor's obligations. These aspects of bankruptcy law can reduce direct private or public costs of delinquency and default as well as psychological or physical costs associated with debtors' attempts to repay their obligations. Restructuring or discharging obligations effectively provides consumers with a form of insurance against income shocks (like unemployment), expense shocks (like acute health care costs), or poor forecasting of obligations and income.[16] This insurance can ideally support the use of consumer credit to smooth consumption across periods of variable income and expenses and can improve the productivity of individuals who become heavily indebted.[17] It may also limit the dislocating effects of a rapidly evolving economy on individuals and households, which may help secure and maintain political support for a broader array of development policies.[18]

Less obviously, consumer bankruptcy also has the potential to promote financial deepening in a variety of ways. As an initial matter, a consumer bankruptcy regime with even limited debt relief can make risk-averse consumers more willing to borrow, which should expand demand for consumer lending. Furthermore, depending on details of institutional design, a consumer bankruptcy regime may increase creditors' insolvency-state returns by enhancing their collective ability to enforce the obligations of their insolvent debtors.[19] Even if a bankruptcy regime exposes creditors to the risk of discharge, it may still have a beneficial effect on consumer financial markets. It can do so, for example, if it causes lenders to make more efficient decisions

[16] *See, e.g.*, Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 129 n.2 (2005) (reviewing literature on the insurance function of consumer bankruptcy); Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 97–109 (1986).

[17] *See* Feibelman, *supra* note 16, at 140–41.

[18] Assuming that such insurance is generally efficient, it might be justifiable as a mandatory form of social insurance if consumers will fail, or will be unable, to insure themselves privately. *See, e.g.*, *Id.* at 138.

[19] *See infra* text accompanying notes 104–06.

in extending credit ex ante, thereby reducing the chances of default and insolvency in the first place.

Assuming that consumer bankruptcy law has these potential benefits, it is puzzling that many developing countries have been slow or hesitant either to adopt consumer bankruptcy regimes or to modernize existing ones. In fact, some of the largest, most dynamic developing economies do not have consumer bankruptcy regimes at all or have outdated regimes.[20] Over the last decade or so, many countries have adopted or modernized domestic consumer bankruptcy regimes, but most of these are countries with advanced economies. While some developing countries have recently modernized their consumer bankruptcy regimes or adopted new ones, most of these countries did so in response to disturbing levels of household over-indebtedness. Policymakers in these countries apparently believed—rightly or wrongly—that consumer bankruptcy is an effective way to address the effects of such over-indebtedness ex post.

The question remains why developing countries generally do not put such a regime in place before over-indebtedness becomes a salient problem or before a crisis occurs. This may reflect weakness in the theoretical claim that there is an ex ante benefit to consumer bankruptcy. It may reflect that such a regime will not help expand consumer financial markets because, for example, creditors may not actually recover more from insolvent consumers under a bankruptcy regime than they would absent one. Perhaps more significantly, it may suggest that policymakers are concerned that a bankruptcy regime with debt relief would harm nascent credit markets more than help them. Policymakers may believe that creditors will be too hesitant to lend to borrowers who can obtain relief from their obligations, especially if they think that borrowers may not try as hard to repay obligations subject to discharge.[21] If that is the case, such a regime would be unlikely to help expand consumer credit markets, even if it made borrowers more willing to borrow.

Even if policymakers in developing countries are inclined to adopt or reform consumer bankruptcy laws, there may be practical obstacles to doing so. Political factors, for example, may lean heavily against such regulatory innovation. Powerful existing creditors may oppose extending bankruptcy relief to consumers regardless of whether doing so would help expand consumer financial markets. These creditors may do so, for example, if they cannot capture a sig-

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[20] *See infra* notes 117–29 and accompanying text.

[21] The potential moral hazard associated with debt relief is discussed *infra* at notes 108–09 and accompanying text.

nificant amount of the potential benefits of the new regime or if an expanding market would strengthen their competitors. If such opposition arises, there is unlikely to be any organized constituency to counter-balance these interests. Consumers and households are unlikely to clamor successfully for effective bankruptcy laws in the absence of widespread over-indebtedness. Furthermore, at the current time, international financial institutions and other international actors are not pressuring policymakers in developing countries to consider adopting or improving consumer bankruptcy regimes.

Alternatively, policymakers in countries without a modern consumer bankruptcy regime might believe that their societies are not institutionally or socially receptive to such a regime.[22] This is a general challenge for law reform efforts around globe. Legal rules or institutions that are effective in one context or that hold promise in theory do not always work in new or different environments. This may be due to a lack of necessary judicial or administrative infrastructure or to a lack of social demand for the reforms. Thus, while the law and finance literature has generally established that investor and lender protections are correlated with higher rates of economic growth, many recent efforts to adopt or transplant such institutions have arguably failed to yield beneficial results.[23] This could easily be the case with respect to consumer bankruptcy law. Judicial or administrative capacity in some countries simply may not support a consumer bankruptcy system. This is especially true in countries that have struggled to create basic legal institutions and where administration of justice is very slow, unpredictable, or lacking legitimacy. Also, a modern consumer bankruptcy system may fail to serve its functions in some societies because of insufficient social demand for the institution. This may be due to the fact that debt relief or debt itself is disfavored or stigmatized in those societies.[24] If individuals do not incur credit in the first place, or if they are not willing to utilize a bankruptcy regime, such a regime is unlikely to serve its potentially beneficial functions.

Despite the apparent lack of enthusiasm for consumer bankruptcy law in the developing world, this Article proposes that such a regime can benefit most countries with rising per capita incomes and at least nascent consumer financial markets. It proposes that these benefits are likely to be underestimated and that most practical obstacles to implementing an effective regime are surmountable. In

[22] *See infra* note 148 and accompanying text.
[23] *See infra* note 148 and accompanying text.
[24] *See infra* notes 149–50 and accompanying text.

sum, on the broadest level, this Article aims to locate the regulation of consumer finance within the scope of scholarship on law, finance, and development by arguing that there is an important relationship between law, consumer finance, economic growth, and development. In particular, it argues that consumer bankruptcy with meaningful debt relief can under some circumstances be a key component of development policy. In theory, an effective consumer bankruptcy system can both promote the beneficial expansion of consumer lending and reduce the costs of over-indebtedness. Reforming or adopting consumer bankruptcy law is perhaps most beneficial in the wake of widespread over-indebtedness, but an effective bankruptcy regime might also help developing economies avoid at least some of these problems in the first place and help them build productive markets for consumer finance.

II. CONSUMER FINANCE, GROWTH, AND DEVELOPMENT

There is a significant body of literature on the relationship between financial deepening and economic growth, but this literature does not directly explore the effect of consumer finance on economic growth and development. Evaluating this effect is an extremely difficult enterprise, but it is a very important one as consumer lending increases dramatically across the globe. This Part examines these questions directly, locating consumer finance within the scope of the existing literature on finance, growth, and development. It proposes that deepening of consumer-financial markets has the potential to promote growth and/or development as well as the potential to create significant private and social costs. These claims, if correct, suggest that development policy should directly address these potential costs and benefits of consumer borrowing.

A. *Finance and Growth*

Over the last two decades or so, scholars have become increasingly interested in the link between deepening of financial markets and economic growth. It has been somewhat challenging to confirm this link and even more challenging to show that financial deepening has a causal effect on growth.[25] In recent years, however, a number of

[25] *See, e.g.*, RAGHURAM RAJAN & LUIGI ZINGALES, SAVING CAPITALISM FROM THE CAPITALISTS 109 (2006); Robert G. King & Ross Levine, *Finance and Growth: Schumpeter Might Be Right*, 108 Q.J. ECON. 717, 717 (1993) (citing JOAN ROBINSON, *The Generalization of the General Theory*, *in* THE RATE OF INTEREST AND OTHER ESSAYS 67 (1952) and Robert E. Lucas, Jr., *On the Mechanics of Economic Development*, 22 J. MONETARY ECON. 3 (1988)). It is certainly possible to accumulate capital and assets without borrowing

economists have successfully established a correlation between financial deepening and broad indicators of economic growth.[26] King and Levine, for example, found that financial development is "positively associated with faster rates of economic growth . . . ."[27] More significantly, they identified a relationship between financial development and subsequent rates of economic growth, leading them to conclude that finance has a causal effect on such growth.[28] Rajan and Zingales reached similar conclusions by examining the growth of industries that are dependent on external financing.[29] Such results provide strong evidence that financial development can fuel economic growth.[30] The explanation for these results, however, is not self-evident, and economists have endeavored to describe the mechanism by which finance can lead to growth. According to Rajan and Zingales, for example, financial deepening promotes growth in large part because it supports new market entrants and non-incumbents in an economy.[31]

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money from intermediaries or obtaining it from investors. Advancing economic growth could lead to increased savings, which could result in financial deepening (as savings are intermediated for investment and lending). *See, e.g.*, Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559, 559 (1998). Firms can finance expanding activities and innovations through cash flows or existing wealth. *See* RAJAN & ZINGALES, *supra*, at 108. The recent dramatic economic growth in China, which has not enjoyed significant financial deepening, arguably provides anecdotal evidence that such deepening is not a necessary condition for growth. *Id.* at 113. Furthermore, there are reasons to think that some aspects of financial deepening can actually be a drag on growth. Financial services can be costly. They can also increase a society's exposure to general economic risk and increase the potential for misallocation of resources. *Id.* at 93–108, 122.

[26] *See, e.g.*, King & Levine, *supra* note 25, at 734–35; Rajan & Zingales, *supra* note 25, at 584; Thorsten Beck et al., *Finance, Inequality and Poverty: Cross-Country Evidence* 2–3 (World Bank, Working Paper No. 3338, 2004); Felix Eschenbach, *Finance and Growth: A Survey of the Theoretical and Empirical Literature* 13–22 (Tinbergen Inst., Discussion Paper No. TI 2004-039/2, 2004); *see also* RONDO CAMERON, BANKING IN THE EARLY STAGES OF INDUSTRIALIZATION 2 (1967); Jith Jayaratne & Philip E. Strahan, *The Finance-Growth Nexus: Evidence from Bank Branch Deregulation*, 111 Q.J. ECON. 639, 640–41 (1996); Ross Levine, *Financial Development and Economic Growth: Views and Agenda*, 35 J. ECON. LITERATURE 688 (1997) (summarizing theories of the relationship between finance and growth); Ross Levine & Sara Zervos, *Stock Markets and Economic Growth*, 88 AM. ECON. REV. 537 (1998) (finding that bank lending to the private sector promotes economic growth).

[27] King & Levine, *supra* note 25, at 719.

[28] *See id.* at 730, 735.

[29] *See* RAJAN & ZINGALES, *supra* note 25, at 112–13; Rajan & Zingales, *supra* note 25, at 560, 584.

[30] *See* Rajan & Zingales, *supra* note 25, at 562.

[31] *Id.* at 560. According to this account, deepening of financial markets enables entrepreneurs and young firms to enter the marketplace and compete with more powerful, entrenched, and incumbent actors. RAJAN & ZINGALES, *supra* note 25, at

It is important to note that if financial deepening promotes economic growth, this does not necessarily mean that it also promotes broader indicators of development. Development in the broadest sense involves, among other things, reductions in poverty and inequality, increases in human capability, lowering of infant mortality rates, expansion of literacy, and improved protections for civil and human rights.[32] The relationships between growth, poverty, and inequality are complex. While there is some significant evidence that broad economic growth helps the poor,[33] growth can have lop-sided distributional effects, leading to more inequality within an economy.[34] Thus, the existing finance and growth literature provides only

121; Rajan & Zingales, *supra* note 25, at 579, 584; *see also* Beck et al., *supra* note 26, at 8. There is some evidence, however, that in early stages of financial deepening, credit is more likely to flow to incumbents. *See, e.g.*, *id.* at 9. Still, as a general matter, formal intermediaries are apparently more favorable to smaller, less experienced entrepreneurs than informal intermediaries. *See id.* at 8; *see also* RAJAN & ZINGALES, *supra* note 25, at 36; Mitchell A. Petersen & Raghuram Rajan, *The Effect of Credit Market Competition on Lending Relationships*, 110 Q.J. ECON. 407, 439–43 (1995). "[F]inance in an underdeveloped system tends to be clubby, uncompetitive, and conservative . . . ." RAJAN & ZINGALES, *supra* note 25, at 45. Develpoed systems disperse and allocate risk to those who are best equipped to hold it. *See id.*

[32] *See, e.g.*, James M. Cypher & James L. Dietz, The Process of Economic Development 30–57 (2d ed. 2004); Martha C. Nussbaum, Frontiers of Justice: Disability, Nationality, Species 273–324 (2006); Amartya K. Sen, Development as Freedom (1999); *see also* Human Dev. Report Office, United Nations Development Programme, Human Development Report 2006, *available at* http://hdr.undp.org/en/reports/global/hdr2006/ ("Human development is first and foremost about allowing people to lead a life that they value and enabling them to realize their potential as human beings.").

[33] *See, e.g.*, CYPHER & DIETZ, *supra* note 32, at 30; Beck et al., *supra* note 26, at 2, 4, 7; David Dollar & Aart Kraay, *Growth is Good for the Poor*, 7 J. ECON. GROWTH 195, 198 (2002); Aart Kraay, When is Growth Pro-Poor?: Evidence from a Panel of Countries 2 (Dec. 2004) (unnumbered working paper), *available at* http://siteresources.worldbank.org/INTPGI/Resources/15173_Kraay_PPG_Dec04.pdf); *see also* Philippe Aghion & Patrick Bolton, *A Trickle-Down Theory of Growth and Development with Debt Overhang*, 64 REV. ECON. STUD. 151, 151 (1997); Abhijit Banerjee & Andrew Newman, *Occupational Choice and the Process of Development*, 101 J. POL. ECON. 274, 274–77 (1993); Oded Galor & Joseph Zeira, *Income Distribution and Macroeconomics*, 60 REV. ECON. STUD. 35, 37 (1993); George Clarke et al., *Finance and Income Inequality: Test of Alternative Theories* 1–2 (World Bank, Policy Research Working Paper No. 2984, 2002).

[34] *See, e.g.*, CYPHER & DIETZ, *supra* note 32, at 28–56; *Gender Issues in Economic Adjustment Discussed at U.N. Conference on Women*, INT'L MONETARY FUND SURV., Sept. 25, 1995 at 286–88. In fact, under some circumstances, economic growth can exacerbate existing problems, especially those related to inequitable distribution of wealth. *See* CYPHER & DIETZ, *supra* note 32, at 53–56; Beck et al., *supra* note 26, at 2–3; *see also* Timothy Besley & Robin Burgess, *Halving Global Poverty*, 17 J. ECON. PERSPS. 3, 7–9 (2003); Martin Ravallion, *Growth, Inequality and Poverty: Looking Beyond Averages*, 29 WORLD DEV. 1803, 1808–10, 1812–13 (2001); Francois Bourguignon, The Pace of

indirect evidence that deepening financial markets promote important factors of development.

B. Consumer Finance

While there is a growing consensus that financial deepening can promote economic growth, it is surprisingly unclear whether and when deepening of consumer financial markets can have this effect as well.[35] In the studies noted above, financial deepening generally refers to the scope and depth of saving, investment, and extension of credit within an economy.[36] Thus, these studies measure financial deepening as a function of the overall amount of capital intermediated by financial institutions. There is no attempt made in the existing literature to isolate credit extended to consumers and its effect on economic growth. It is thus possible that deepening of corporate financial markets is exclusively, or almost exclusively, driving the positive effects of finance on growth that these studies observe. In fact, economists and development theorists tend to be ambivalent about the broad effects of consumption and consumer finance on an economy. Under some circumstances, consumption can act as a drag on a developing economy, primarily by undermining domestic saving.[37] Unfortunately, there has been surprisingly little empirical study of consumer finance in this context.[38]

Economic Growth and Poverty Reduction 14–15 (Dec. 2000) (unnumbered working paper), *available at* http://www.lacea.org/meeting2001/bourguignon.pdf.

[35] *See, e.g.*, Michael S. Barr, *Microfinance and Financial Development*, 26 MICH. J. INT'L L. 271, 273–74 (2005); Karlan & Zinman, *supra* note 13, at 2–3.

[36] King and Levine measure financial development as a function of the size of a country's financial intermediary system, credit extended by banks, and credit allocation to private firms. King & Levine, *supra* note 25, at 718. In other words, their measures for financial depth are bank liabilities (savings), bank assets (loans), and loans to private firms. *See id.* at 720–21. Beck and his coauthors measure financial development as "the amount of savings intermediated to private borrowers relative to GDP." Beck et al., *supra* note 26, at 5. More specifically, they use "the value of credit by financial intermediaries to the private sector divided by GDP" as a measure of financial deepening. *Id.* at 10.

[37] As noted above, financial deepening leads to growth by intermediating domestic savings and productive investment. *See supra* Part II.A. If individuals use all or most of their disposable income to fund consumption, whether through cash or financed purchases, the domestic savings rate may drop, leaving less capital available for productive investment. Similarly, if savings are intermediated to finance household consumption, those resources may not expand the productive capacity of an economy to their fullest potential.

[38] *See* Rakesh Mohan, Deputy Governor, Reserve Bank of India, Address at Annual Bankers' Conference 3–4 (Nov. 3, 2006), *available at* http://www.bis.org/review/r061121e.pdf (noting that the literature on law, finance and development emphasizes corporate finance but applying the insights to consumer finance).

Setting aside concerns about reduced domestic saving and increasing inflation, there are many ways that lending to individuals and households can plausibly promote growth and development. And there is evidence that policymakers in some developing countries have adopted policies specifically designed to expand consumer borrowing for that purpose.[39] If one measures development in terms of consumption of basic goods and services like food, education, healthcare, and transportation, then increasing the availability of consumer credit can promote such development directly.[40] Without credit, a consumer would need to save the amount necessary to purchase goods or services before doing so. Some people may purchase goods and services with available credit that they would not purchase with savings because, for example, they may not have the discipline to save enough to do so. Obtaining credit may help some individuals commit themselves to applying future income to making such purchases.

Perhaps more importantly, the availability of consumer finance may promote consumption of basic goods and services by enabling consumers to smooth their consumption across periods of varying income. The availability of credit enables borrowers to consume goods and services based on their expected wealth or income rather than available income or assets. If an individual experiences a temporary drop in income or liquidity, he or she can borrow to maintain a level of consumption that is justified by expected income.[41] Furthermore, such smoothing can enable individuals and households to avoid financial collapse in the wake of an income or expense shock and to thus avoid incurring greater individual and social costs.[42]

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[39] *See infra* note 134 and accompanying text.

[40] For a discussion of the concept of development, see *supra* notes 32–34.

[41] *See, e.g.*, John H. Cochrane, *A Simple Test of Consumption*, 99 J. POL. ECON. 957, 973–74 (1991); Jonathan Morduch, *Between the Market and the State: Can Informal Insurance Patch the Safety Net?*, 14 WORLD BANK OBSERVER 187, 200, 202 (1999); Jonathan Morduch, *Income Smoothing and Consumption Smoothing*, 9 J. ECON. PERSP. 103, 104 (1995); Paul Gertler et al., Do Microfinance Programs Help Families Insure Consumption Against Illness? 3 (2003) (unpublished article, on file with University of California, Berkeley) (noting that "[m]ak[ing] savings more convenient and improv[ing] access to credit" are ways to enable families to self-insure against illness); *see also* Anjini Kochar, *Explaining Household Vulnerability to Idiosyncratic Income Shocks*, 85 AM. ECON. REV. 159, 163–64 (1995); Robert M. Townsend, *Consumption Insurance: An Evaluation of Risk-bearing Systems in Low-income Economies*, 9 J. ECON. PERSP. 83, 83–84 (1995); Robert M. Townsend, *Risk and Insurance in Village India*, 62 ECONOMETRICA 539, 540–41 (1994).

[42] If individuals are unable to avoid financial collapse, they may become more likely to draw upon social assistance, thereby imposing direct social costs. *See, e.g.*, Barr, *supra* note 35, at 273 & n.17 (2004).

Similarly, at least some household consumption may be more appropriately considered investment.[43] Consider purchases of durable goods. Such goods effectively become assets of the individual or household purchaser that may yield significant returns. Purchasing a vehicle, for example, may reduce overall transportation costs. As assets, durable goods may be used as collateral to acquire additional capital, which may in turn be put to productive use. Consumers may eventually use goods such as vehicles, computers, and other small appliances for both commercial and personal activities. Durable goods may also serve a consumption-smoothing function by providing assets that households can borrow against when it might otherwise be difficult for them to obtain credit. Furthermore, consumption of many non-durable goods and services—especially healthcare and education—are effectively investments in human capital. Such investment can increase the productive capacity of individuals and help them acquire skills that make them effective entrepreneurs and innovators.

Consumer credit may also be used to finance informal or nascent profit-making ventures. There is evidence that individuals in both developed and developing countries fund profit-seeking activities by borrowing in their capacity as consumers, perhaps because creditors would not extend credit against the potential success or failure of these profit-seeking activities.[44] While this is functionally a form of commercial finance, it is made possible by the expansion of consumer financial markets. Similarly, as noted above, some consumer goods can serve both personal and profit-making functions. Finally, under some circumstances, individual and household consumption may also expand final demand for domestic durable and non-durable goods and services. In that case, the availability of consumer finance may support a virtuous cycle of economic growth.[45]

[43] 1 HANDBOOK OF DEVELOPMENT ECONOMICS 387 (Hollis Chenery & T.N. Srinivasan eds., 1988).

[44] *See, e.g.*, Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J.L. & ECON. 543, 544–44 (2003) ("The fact that 20 percent of personal bankruptcy filings list business debts suggests how important personal bankruptcy procedures are for entrepreneurs."). Drawing an example from India, approximately twenty-five percent of debt incurred by urban households in that country and fifty-three percent of debt incurred by rural households is used for a business purpose. ALL INDIA DEBT AND INV. SURV., REP. NO. 501, 59TH ROUND, NSSO, HOUSEHOLD INDEBTEDNESS IN INDIA AS ON 30.06.2002, at 39 (2005).

[45] *See, e.g.*, Dean M. Maki, *The Growth of Consumer Credit and the Household Debt Service Burden*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 43 (Thomas A. Durkin & Michael E. Staten eds., 2002) ("Consumer spending accounts for over two-thirds of the U.S. gross domestic product, and has been a key driver of the strong economic growth of the country has experienced since the early 1990s . . . ."); FED. DEPOSIT INS. CORP., EVALUATING THE CONSUMER LENDING REVOLUTION (2003) [here-

The experience of the burgeoning global microfinance industry provides at least some evidence that expanding access to consumer finance can promote development.[46] Microfinance institutions generally lend very small amounts of money to individuals and groups to fund microenterprises.[47] Because this industry is still a relatively small part of any particular economy, it is questionable whether microfinance now significantly affects broad measures of financial deepening.[48] Furthermore, as one writer notes, "[t]here are few reliable estimates of the net impacts of [microfinance] programs."[49] There is some evidence, however, that expanding microfinance can benefit individuals and households along important categories of human development by increasing their consumption of basic goods and services.[50] It is important to note that evidence drawn from the experi-

inafter CONSUMER LENDING], *available at* http://www.fdic.gov/bank/analytical/fyi/2003/091703fyi.html (describing how consumption plays a significant role in promoting growth of the American economy); *see also* JONATHAN ABLETT ET AL., MCKINSEY GLOBAL INST., THE "BIRD OF GOLD": THE RISE OF INDIA'S CONSUMER MARKET 93–102 (2007) (proposing that consumption in India has the potential to spur growth in that country). Maki notes that there has been relatively little research on the role of consumer credit in the economy. Maki, *supra*, at 45. In fact, it appears that at least some developing countries have adopted policies in recent years to encourage consumer borrowing to support overall growth in their economies. *See infra* note 134 and accompanying text.

[46] Barr, *supra* note 35, at 273; Karlan & Zinman, *supra* note 13, at 2 ("Expanding access to credit is a key ingredient of development strategies worldwide."). The United Nations designated 2005 as the International Year of Microcredit. *Id.* Muhammad Yunus, founder of the Grameen Bank in Bangladesh was awarded the Nobel Peace Prize along with Grameen Bank in 2006. Press Release, The Norwegian Nobel Committee, Nobel Peace Prize 2006 (Oct. 13, 2006), *available at* http://nobelprize.org/nobel_prizes/peace/laureates/2006/press.html. For a compelling critique of the enthusiasm for Grameen Bank's lending model, see generally Rashmi Dyal-Chand, *Reflection in a Distant Mirror: Why the West Has Misperceived the Grameen Bank's Vision of Microcredit*, 41 STAN. J. INT'L L. 217 (2005).

[47] *See* Jonathan Morduch, *The Microfinance Promise*, 37 J. ECON. LIT. 1569, 1569–71 (1999); Karlan & Zinman, *supra* note 13, at 3 (2006). Thus, most studies of the effect of microborrowing focus on microentreprenurial borrowing, not consumption. *Id.*

[48] Morduch claims that expanding finance to the not-so-poor may "foster economic efficiency and perhaps economic growth." Morduch, *supra* note 47, at 1572; *see also* Valerie Bencivenga & Bruce D. Smith, *Financial Intermediation and Endogenous Growth*, 58 REV. ECON. STUDS. 195, 203–04 (1991).

[49] Morduch, *supra* note 47, at 1598.

[50] There is evidence, for example, that improving access to credit for low-income individuals and households appears to increase their consumption of basic goods and services. *See* Karlan & Zinman, *supra* note 13, at 2–4; Morduch, *supra* note 47, at 1593; *see also* SHAHIDUR KHANDKER, FIGHTING POVERTY WITH MICROCREDIT: EXPERIENCE IN BANGLADESH 145–46 (1998); Signe-Mary McKernan, *The Impact of Microcredit Programs on Self-Employment Profits: Do Non-Credit Program Aspects Matter?*, 84 REV. ECON. & STAT. 93 (2002); Mark Pitt & Shahidur Khandker, *The Impacts of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter?*, 106 J.

ence of microlending is only imperfectly probative of the effects of expanding access to conventional consumer financial markets. Microfinance is generally extended for the purpose of reducing poverty by helping poor individuals begin to earn income. It is arguably distinguishable from conventional, formal consumer credit.[51] It is not generally extended to individuals who already have appreciable disposable income, and it is not generally extended to finance purchases of relatively expensive goods or services like automobiles, healthcare, or education. Recently, however, Karlan and Zinman have shown that access to slightly larger amounts of conventional consumer credit can promote individual and household consumption of goods and services that are associated with human development.[52] In that study, a South African lender relaxed lending standards to extend loans to some borrowers who would not have received credit under normal measures of creditworthiness. The researchers found that those borrowers were more likely to remain employed, less likely to experience hunger, and less likely to become impoverished than similar applicants who were refused consumer loans.[53]

Finally, expanding the availability of consumer finance may also promote development more indirectly by helping to support important social and cultural institutions. A consumer who is drawn into formal financial markets may become more invested in the continued stability of his or her society, perhaps because his or her ability to satisfy debt obligations depends in part on the general success of the broader economy. Furthermore, as individuals and households are able to consume "discretionary" goods like healthcare and education, and are thereby able to develop their own capacities, they may become more affirmatively committed to broader institutional and economic development. In many developing countries, political support for development policies is essential yet contingent and often fleeting.[54] Individuals may be more likely to support such policies if they

POL. ECON. 958 (1998); Nidhiya Menon, Consumption Smoothing in Microcredit Programs 1 (Aug. 2003) (unpublished article, on file with Deptartment of Economics, University of Connecticut). Not all microfinance improves consumption, however. *See* Morduch, *supra* note 47, at 1594. It is interesting that there is evidence that wealthier families benefit more from microfinance than do poorer families. *See id.* at 1599–1601. This may provide additional support for the claim that consumer lending can support growth and development as per capita incomes rise in an economy.

[51] Admittedly, the distinctions between these types of financial relationships are blurry. These distinctions are drawn here only to acknowledge that evidence of the effects of microfinance may not directly support the claims of this Article.

[52] *See generally* Karlan & Zinman, *supra* note 13.

[53] *Id.* at 5.

[54] *See infra* notes 110–15 and accompanying text.

experience direct benefits of broader growth and development. The capacity of credit to enable individuals to smooth consumption in the wake of economic distress or dislocation may have especially important political consequences.

C. *Costs of Consumer Lending*

If consumer credit can, in theory, help fuel economic growth or development, it can also generate significant costs and negative externalities. Some of these relate to macroeconomic effects of expanding consumption. Such consumption may lead to destructive inflation.[55] As noted above, it may also lead to erosion of the domestic savings rate.[56] Other potential risks and costs stem from consumers' financial distress or over-indebtedness.[57] Consumers may become over-indebted because they are overly optimistic, uninformed, or undisciplined; any of these qualities can cause an individual to borrow too much in relation to their actual and/or expected incomes. Available data from the United States suggest, however, that most consumers in this country are likely to become insolvent or experience financial distress because they experience unexpected exogenous shocks, such as involuntary unemployment or sickness.[58]

[55] An increasing demand for goods and services, for example, tends to create an upward pressure on prices, and high inflation can erode the benefits of rising incomes. In general, taming inflation is the job of central bankers who control monetary policy and have the ability to increase credit constraints to dampen inflationary effects.

[56] *See supra* note 37 and accompanying text.

[57] While over-indebtedness is difficult to define, it is a much broader category than formal insolvency. As the term is used here, it includes not only insolvency and financial distress, but a high ratio of debt-to-income (and debt-to-assets) as well. Readers will inevitably disagree about what debt-to-asset/income ratio, if any, constitutes "over-indebtedness" in any particular context. This Article does not aim to define the concept of over-indebtedness, but it does assume that over-indebtedness can occur well before an individual or household becomes insolvent.

[58] *See, e.g.*, TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLECLASS: AMERICANS IN DEBT (2000); Melissa B. Jacoby & Elizabeth Warren, *Beyond Hospital Misbehavior: An Alternate Account of Medical-Related Financial Distress*, 100 NW. U. L. REV. 535, 552–55 (2006); Melissa B. Jacoby, Teresa Sullivan & Elizabeth Warren, *Rethinking the Debates over Health Care Financing: Evidence From the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375(2001); David Himmelstein et al., *Illness and Injury as Contributors to Bankruptcy*, HEALTH AFF. (WEB EXCLUSIVE), Feb. 2, 2005, at W5-63, *available at* http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1.pdf; *see also* David Dranove & Michael L. Millenson, *Medical Bankruptcy: Myth Versus Fact*, HEALTH AFF., Feb. 28, 2006, at W74 (challenging some of the conclusions of Himmelstein et al.). It is certainly possible that many consumers and households become over-indebted for behavioral reasons and then suffer an external shock that pushes them over the edge into insolvency. We simply do not know as much about the determinants of over-indebtedness as we do about the determinants of bankruptcy or insolvency. In any event, the determi-

As indebted consumers have trouble repaying obligations, they inevitably incur additional costs in the form of late fees and penalties, or additional charges for renewals, rollovers, and forbearances.[59] These additional costs reduce the amount of money consumers have to spend on other goods and services, which may have negative effects on their own welfare and on broader economic growth.[60] This may result in a misallocation of financial resources. But over-indebtedness can create additional costs, especially when it deepens financial distress or hastens insolvency. Over-indebted individuals may become less productive, perhaps thereby creating negative externalities, if their indebtedness reduces their incentives to earn income. Because they must use a large portion of wage income to repay creditors, they may not get much personal benefit from their labors. Consumer over-indebtedness may impose additional costs on society if individuals' indebtedness causes them to seek publicly funded social assistance. Over-indebted individuals may also under-consume necessary goods (like food) or "discretionary" goods (like education or health care), which can impose longer-term costs on society. If individuals try to work their way out of insolvency or over-indebtedness, they may subject themselves to physical harms and degraded health—they may also stress basic social and cultural institutions, especially familial relationships.[61] Psychological dimensions of financial distress may increase these effects.[62] Finally, as recent prob-

nants of over-indebtedness likely vary across countries; it is possible that exogenous shocks are more or less of a determinant of financial distress in developing countries than they are in the United States or vice versa.

[59] Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1374, 1393 (2004); Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 384–92 (2007); Feibelman, *supra* note 16, at 166 (discussing the costs of financial collapse).

[60] *See, e.g.*, CONSUMER LENDING, *supra* note 45 ("The unusual pattern of consumer spending and borrowing during and after the recent recession has led some experts to worry that consumers are overburdened. Under some of the more pessimistic scenarios, future economic growth could be stifled as consumers are forced to curtail spending to service debt.").

[61] *See, e.g.*, Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?*, 44 SANTA CLARA L. REV. 1065, 1077–78 (2004) (noting the emotional and social costs of debtors with high debt burdens); Hallinan, *supra* note 16, at 130; Melissa B. Jacoby, *The Debtor-Patient: In Search of Non-Debt-Based Alternatives*, 69 BROOK. L. REV. 453, 476–77 (2004) (discussing the connection between financial distress, emotional stress, and health problems); *see also* John C. Akard, *The Human Side of Bankruptcy*, 18 AM. BANKR. INST. J. 28, 28 (1999).

[62] *See, e.g.*, F.H. Buckley & Margaret F. Brinig, *The Bankruptcy Puzzle*, 27 J. LEGAL STUD. 187, 194 (1998); Rafael Efrat, *Bankruptcy Stigma: Plausible Causes for Shifting Norms*, 22 EMORY BANKR. DEV. J. 481, 484 (2006); Teresa Sullivan, Elizabeth Warren & Jay L. Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Ex-*

lems stemming from the experience of subprime mortgage financing in the United States illustrate, widespread over-indebtedness can sometimes cause broader disruptions for financial firms and capital markets. Unfortunately, data on these various costs are very limited. It is increasingly important to have such information, however, as there is growing evidence of increasing levels of over-indebtedness in developing countries with nascent consumer financial markets.[63]

III. LAW AND CONSUMER FINANCE

A. *Law, Finance, and Development*

This Part examines whether legal reforms can promote the benefits and reduce the risks and costs of expanding consumer finance. A large and important body of research examines the role that legal rules, regimes, and institutions play in providing important conditions for financial deepening, growth, and development.[64] This body of research is part of a much larger body of literature on the role of law in promoting social and economic development.[65] This intellec-

traordinary Increase in Bankruptcy Filings, 59 STAN. L. REV. 213, 215 (2006); Scott Fay et al., *The Bankruptcy Decision: Does Stigma Matter?* 2 (University of Michigan Departmentt of Economics, Working Paper No. 98-01, 1998).

[63] Default rates appear to have been increasing in many of these countries. It also appears that consumers in these countries are increasingly seeking relief from their obligations or protection from their creditors. There are growing indications of frequent aggressive debt collection activities by creditors in these countries. *See infra* note 142.

[64] For good and recent discussions of much of this literature, see KENNETH W. DAM, THE LAW-GROWTH NEXUS: THE RULE OF LAW AND ECONOMIC DEVELOPMENT (2006) and Ohnesorge, *supra* note 12, at 243–52. Some of this work focuses on the quality of basic legal institutions, such as the ability of judicial systems to protect property rights or to enforce contractual obligations. *See, e.g.*, DEEPAK LAL, THE POVERTY OF DEVELOPMENT ECONOMICS (1983); DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE (1990); DOUGLASS C. NORTH & ROBERT PAUL THOMAS, THE RISE OF THE WESTERN WORLD: A NEW ECONOMIC HISTORY (1973); Douglass C. North & Barry Weingast, *Constitutions and Commitment: The Evolution of Institutions of Public Choice in Seventeenth Century England*, 49 J. ECON. HIST. 803, 824 (1989); Dani Rodrik, Institutions for High-Quality Growth: What They Are and How to Acquire Them (Oct. 1999) (unnumbered working paper), *available at* http://ksghome.harvard.edu/~drodrik/institutions.pdf.

[65] *See generally* BRIAN Z. TAMANAHA, ON THE RULE OF LAW: HISTORY POLITICS, THEORY (2004). This intellectual tradition includes the work of writers such as Max Weber, Friedrich Hayek, and John Locke, among countless others. *See* F.A. HAYEK, THE CONSTITUTION OF LIBERTY (1960); 1 F.A. HAYEK, LAW, LEGISLATION, AND LIBERTY: RULES AND ORDER (1973); 2 F.A. HAYEK, LAW, LEGISLATION, AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE (1976); 3 F.A. HAYEK, LAW, LEGISLATION, AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE (1979); MAX WEBER, LAW IN ECONOMY AND SOCIETY (1954); *see also* Rashmi Dyal-Chand, *Exporting the Ownership Society: A Case Study on the Economic Impact of Property Rights* 5 (University of New England School of Law, Work-

tual tradition is broadly associated with a series of law and development movements that have helped foster large- and small-scale development and reform projects across the globe since the 1950s.[66] Improving domestic legal systems continues to be a centerpiece of the World Bank's activities to promote development and to improve living conditions around the globe.[67]

Modern economic theories of development emphasize this connection between law reform and development, ascribing a crucial role to human institutions in general and to legal institutions in particular.[68] In this context, legal institutions most notably include courts and other administrative bodies, judges, lawyers, and legal rules and regimes. But they also include a broader spectrum of guides and constraints—formal and informal—that help structure human interaction.[69] According to this literature, the primary ways that legal institutions promote economic development is by securing and stabilizing property rights[70] and by providing for the enforce-

ing Paper No. 15-2007) (citing JOHN LOCKE, SECOND TREATISE OF GOVERNMENT § 124 (1690)).

[66] *See supra* note 12 and accompanying text; *see also* DAVID M. TRUBECK & ALVARO SANTOS, THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL (2006); Daniel Berkowitz et al., *The Transplant Effect*, 51 AM. J. COMP. L. 163, 163–64 (2003); Bryant G. Garth, *Building Strong and Independent Judiciaries Through the New Law and Development: Behind the Paradox of Consensus Programs and Perpetually Disappointing Results*, 52 DEPAUL L. REV. 383, 385–89 (2002); David Trubek & Marc Galanter, *Scholars in Self-Estrangement: Some Reflection on the Crisis in Law and Development Studies in the U.S.*, 1974 WIS. L. REV. 1062, 1065–69; Dyal-Chand, *supra* note 65, at 4 n.19.

[67] *See supra* note 12 and accompanying text.

[68] Writers contributing to this body of work have explored various human institutions that affect development. *E.g.*, CULTURE MATTERS: HOW VALUES SHAPE HUMAN PROGRESS (Lawrence E. Harrison & Samuel P. Huntington eds., 2000); WEBER, *supra* note 65; MAX WEBER, THE PROTESTANT ETHIC AND THE SPIRIT OF CAPITALISM (1958); Robert D. Putnam, *Bowling Alone: America's Declining Social Capital*, 6 J. DEMOCRACY 65 (1995); *see also* Daron Acemoglu, Simon Johnson, & James Robinson, *Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution*, 117 Q.J. ECON 1231 (2002); Robert J. Barro, *Economic Growth in a Cross Section of Countries*, 106 Q.J. ECON. 407 (1991); Gerald W. Scully, *The Institutional Framework and Economic Development*, 96 J. POL. ECON. 652 (1988); Rodrik, *supra* note 64 (describing institutions that are important for growth, including social insurance regimes).

[69] *See, e.g.*, Douglass C. North, Prize Lecture, pt II (Dec. 9, 1993), *in* ECONOMIC SCIENCES: 1991–1995 (NOBEL LECTURES) 112 (Torsten Persson ed., 1997).

[70] *See, e.g.*, DAM, *supra* note 64, at 129–33; HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 182–88 (2000); RAJAN & ZINGALES, *supra* note 25, at 129–157 (discussing the importance of property rights in history); TAMANAHA, *supra* note 65, at 119–21 (2004); Gordon C. Rausser, *Lessons for Emerging Market Economies in Eastern Europe*, *in* THE EMERGENCE OF MARKET ECONOMIES IN EASTERN EUROPE 311, 311–332 (Christopher C. Clauge & Gordon C. Rausser eds., 1992); WORLD BANK, WORLD BANK DEVELOPMENT REPORT 1996: FROM PLAN TO MARKET 48–49 (1996); Cheryl W. Gray, *Legal Process and Economic*

ment of contractual obligations.[71] Because most financial relationships are contractual in nature, enforcement of contractual obligations is particularly important for the growth of financial markets.[72] While there is growing consensus that these basic legal institutions can promote financial deepening and economic development, it has been surprisingly hard to prove. A number of recent studies have shown that judicial quality is correlated with financial deepening,[73] and a smaller number of studies appear to show a causal effect of judicial enforcement on credit markets.[74]

An important and influential body of literature on law and finance looks beyond the basic legal institutions described above and also explores how particular legal protections for corporate investors

Development: A Case Study of Indonesia, 19 WORLD DEV. 763 (1991); Richard A. Posner, *Creating a Legal Framework for Economic Development,* 13 WORLD BANK RESEARCH OBSERVER 1 (1999); *see also* Dyal-Chand, *supra* note 65, (critiquing this tradition). The stability of property rights, it is argued, improves the ability of economic actors to control an asset and direct or retain returns on the asset. Rodrik, *supra* note 64, at 5. This in turn helps motivate actors to acquire economic assets in the first place, to develop those assets, and to improve the processes by which they develop such assets. *Id.* It also enables individuals to use their assets as capital—to allocate rights or interests in the asset in return for financing. *See* DE SOTO, *supra*, at 6; RAJAN & ZINGALES, *supra* note 25, at 32–33.

[71] *See, e.g.*, DAM, *supra* note 64, at 123–29; Posner, *supra* note 70, at 3–8; *see also* Mathieu Chemin, *Does Judicial Quality Shape Economic Activity? Evidence from a Judicial Reform in India* 6 (Centre Interuniversitaire sur le Risque, les Politiques Économiques et l'Emploi, Working Paper No. 07-25, 2007). For a classic description of the economic role of contract, see MARVIN A. CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 1–11 (4th ed. 2001).

[72] *See* RAJAN & ZINGALES, *supra* note 25, at 7–8, 27. In theory, if enforcement of obligations is uncertain or slow, then borrowers may act opportunistically and refuse to repay or to renegotiate with their creditors. This will presumably increase the cost of capital. *See, e.g.*, Daniel R. Fischel, *The Economics of Lender Liability,* 99 YALE L.J. 131, 133–37 (1989); *see also* Chemin, *supra* note 71, at 3–4, 23 (discussing the economic literature on this point).

[73] *See, e.g.*, Marcela Crisitini et al., *The Importance of an Effective Legal System for Credit Markets: The Case of Argentina, in* DEFUSING DEFAULT: INCENTIVES AND INSTITUTIONS 119, 155–56 (Marco Pagano ed., 2001); Armando Castelar Pinheiro & Celia Cabral, *Credit Markets in Brazil: The Role of Judicial Enforcement and Other Institutions*, in DEFUSING DEFAULT: INCENTIVES AND INSTITUTIONS, *supra*, at 157; Tullio Japelli et al., *Courts and Banks: Effects of Judicial Enforcement on Credit Markets*, 32 J. MONEY, CREDIT & BANKING 223 (2005). As is true with the correlation of financial deepening and growth, however, it is hard to establish that the existence of basic legal institutions causes financial deepening and that these factors are not endogenous. *See* Chemin, *supra* note 71, at 2–3.

[74] *See, e.g.*, Matthieu Chemin, *Decoding the Code of Civil Procedure: Do Judiciaries Matter for Growth?* 2, 28–35, 43–53 (Centre Interuniversitaire sur le Risque, les Politiques Économiques et l'Emploi, Working Paper No. 07-26, 2007); Chemin, *supra* note 71, at 5.

and lenders appear to promote economic growth.[75] Some of these protections are related to equity investments in firms, including shareholder rights, especially shareholder voting mechanisms.[76] Others relate to lending relationships, including creditors' rights against defaulting and insolvent firms,[77] especially corporate bankruptcy laws.[78] A number of studies in this literature indicate that corporate bankruptcy law is correlated with economic growth, and these find-

[75] *E.g.*, Raphael LaPorta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) [hereinafter LaPorta et al., *Law and Finance*]; Raphael LaPorta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) [hereinafter LaPorta et al., *Legal Determinants*]. For helpful discussions of this literature, see DAM, *supra* note 64, at 31–35, 204–08; Ohnesorge, *supra* note 12, at 252–55; Rajan & Zingales, *supra* note 25, at 576; James Q. Whitman, *Consumerism Versus Producerism: A Study in Comparative Law*, 117 YALE L.J. 340, 351 (2007); Thorsten Beck & Ross Levine, *Legal Institutions and Financial Development* 18 (World Bank Development Research Group, Working Paper No. 3136, 2003) (reviewing the law and finance literature). For recent works in the law and finance literature, see, for example, Stijn Claessens & Leora F. Klapper, *Bankruptcy Around the World: Explanations of its Relative Use*, 7 AM. L. ECON. REV. 253 (2005); Simeon Djankov et al., *Debt Enforcement Around the World* (European Corporate Governance Institute, Working Paper No. 147/2007, 2007).

[76] *E.g.*, LaPorta et al., *Legal Determinants*, *supra* note 75, at 1133–37.

[77] *Id.* In one study, LaPorta and his coauthors measure protection of creditors as a function of (1) whether secured lenders are subject to an automatic stay in bankruptcy proceedings; (2) whether secured lenders can get their collateral in the event of a reorganization of their debtor; (3) whether debtors can file for bankruptcy without creditors' consent; and (4) whether management of a debtor can retain control of the debtor during reorganization. LaPorta et al., *Law and Finance*, *supra* note 75, at 1135. The authors find that such protections are correlated to growth. *Id.* at 1135–40.

[78] *See generally* LaPorta et al., *Legal Determinants*, *supra* note 75. These authors have been criticized for this emphasis on bankruptcy law. *See, e.g.*, DAM, *supra* note 64. As discussed *infra* notes 94 through 97 and accompanying text, there is much variation in bankruptcy laws around the globe. There are some basic components of these regimes, however, that arguably define the category. Most fundamentally, bankruptcy regimes provide a mechanism by which an insolvent debtor, or one experiencing some form of financial distress, can stay the collection efforts of its creditors and seek an orderly resolution or restructuring of its obligations. In the context of corporate debtors, a primary function of bankruptcy law is to provide a procedural mechanism for choosing between liquidation and restructuring of insolvent corporate debtors. *See, e.g.*, Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1807–08 (1998). This can increase creditors' insolvency-state return by avoiding inefficient liquidation where a debtor has a relatively high going-concern value. In the absence of a bankruptcy mechanism, creditors could easily face a collective-action problem and race to collect from a struggling debtor, effectively liquidating it. *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7–19 (1986). Bankruptcy law can also provide a timely resolution of claims and disputes to reduce the erstwhile wasting of assets. Ideally, these factors provide an ex ante benefit to borrowers by reducing the cost of credit.

ings have helped establish a growing consensus that corporate bankruptcy law can help support a robust financial market.[79]

Some of the early and most notable work in the law and finance literature asserted that, as a general matter, a country's legal origins affected its level of investor and lender protections. In particular, this work found that legal systems derived from common law roots are more likely to have strong investor and lender protections, which are generally correlated with higher levels of economic growth.[80] This aspect of the law and finance literature has been very controversial.[81]

[79] Corporate bankruptcy law is now widely believed to be particularly important for countries making a transition away from a planned economy. *See, e.g.*, JAMSHED J. IRANI, EXPERT COMMITTEE ON COMPANY LAW, REPORT ON COMPANY LAW 67 (2005); Alexander Biryukov, *Ukrainian Bankruptcy Law in the Context of Regional and International Developments*, 13 ANN. SURV. INT'L & COMP. L. 13, 15 (2007); Charles Booth, *Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam*, 18 COLUM. J. ASIAN L. 93, 94 (2004). The International Monetary Fund and the World Bank's joint Financial Sector Assessment Program include corporate bankruptcy/insolvency law as an important component of an effective legal infrastructure for financial systems. *See* Assessing the Legal Infrastructure of Financial Systems, Financial Sector Assessment Handbook, 223–38 (2005), *available at* http://www.imf.org/external/pubs/ft/fsa/eng/pdf/ch09.pdf ("Effective creditor rights and insolvency systems play a vital role in helping to sustain financial soundness, and they promote commercial confidence by enabling market participants and stakeholders to more accurately price, manage, and resolve the risks of default and nonperformance."). The Uniform Commission on International Trade Law has also published a legislative guide on bankruptcy/insolvency law to assist countries in "the establishment of an efficient and effective legal framework to address the financial difficulty of debtors." *See* 2004—UNCITRAL Legislative Guide to Insolvency Law, http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html (last visited Dec. 28, 2008).

[80] *See generally*, LaPorta et al., *Legal Determinants*, *supra* note 75.

[81] Several authors have criticized the basic law and finance literature, especially the significance of legal origins. *See* DAM, *supra* note 64, at 213–14; Beth Ahlering & Simon Deakin, *Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complimentarity?*, 41 LAW & SOC'Y REV. 865 (2007) (criticizing the legal origins claim); Douglas W. Arner et al., *Property Rights, Collateral, Creditor Rights, and Insolvency in East Asia*, 42 TEX. INT'L L.J. 515, 521–22 (2007); Daniel Berkowitz et al., *supra* note 66, at 167 (criticizing the legal origins claim); Stephen J. Choi, *Law, Finance and Path Dependence: Developing Strong Securities Markets*, 80 TEX. L. REV. 1657, 1669–94 (2002); John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229 (2007); Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 STAN. L. REV. 633, 634 (2007) (suggesting that the law and finance account of the prevalence of controlling shareholders is incomplete); Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 464 (2006) (arguing that legal origins are an incomplete explanation for variations in financial regulation). As two scholars have recently noted, "the classification of legal origins is really no more than a proxy for underlying differences. In order to avoid the problems of classification, therefore, it would be better to seek to code these differences directly." John Armour & Priya Lele, *Law, Finance, and Politics: The Case of India* 5 (European Corporate Governance Institute, Working Paper No.

Less controversial, however, is the proposition that certain types of legal rules and regimes—protections for investors and lenders in particular—are related to economic growth.[82] Even this claim is still subject to debate. As many writers have noted, basic enforcement mechanisms may matter more than the substance of laws and regulations.[83] Furthermore, it is not clear what significance the law and finance literature may have for developing economies.[84] These countries cannot change their legal origins. And, as noted above, it may be difficult for countries to adopt and employ such laws and regulations if they do not already have them.[85]

B. Legal Institutions and Consumer Finance

To the extent that consumer finance can promote growth and development, expanding this market should be a concern of development policy. And if legal institutions generally promote financial deepening, it stands to reason that such institutions have the potential to help unleash the productive capacity of consumer financial markets. As an initial matter, many of the legal institutions that are believed to promote financial deepening and growth in general—especially stable property rights and predictable enforcement of contractual obligations—presumably support the expansion of consumer lending in particular. If a creditor is likely to be able to enforce an individual's promise to repay, the creditor should be more likely to extend credit in the first place and to charge less for doing so. As the price for credit drops, more consumers should be able to borrow.

107/2008, 2008). In their study of India, these writers emphasize the "link between economic and financial structure." *Id.* at 7.

[82] *E.g.*, DAM, *supra* note 64, at 159–60 (noting that even critics of the law and finance literature agree that legal institutions can promote financial deepening); Armour & Lele, *supra* note 81, at 1 (noting the two related claims of the law and finance literature—law matters and origins matter).

[83] *See* Howell Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 275 (2007) (arguing that enforcement matters more than the substance legal regulation); DAM, *supra* note 64, at 207 ("[E]nforcement may be more important than substantive law in protecting shareholders and creditors.").

[84] DAM, *supra* note 64, at 226. The law and finance literature "has few direct policy implications for developing countries." *Id.* at 225. Dam observes that, for developing economies, protections for creditors—especially basic enforcement of contracts including regulation of secured lending and bankruptcy law—are more important than investor protections. *Id.* at 230. Dam also notes that low-income countries often have strong investor and lender protections. *Id.* at 207–08.

[85] *See id.* at 215–16. "[T]he less developed an economy the more important in the improvement in secured transaction law, as opposed to bankruptcy law . . . ." *Id.* at 217.

This reinforces the conventional understanding that improving general administration of justice is one of the most important goals that developing countries can pursue.

Beyond improving these basic legal institutions, however, other legal institutions or regulations may also directly or indirectly promote consumer lending. For example, banking laws and regulations can be designed or reformed to increase the ability or motivation of banks to lend to consumers. Policymakers might eliminate or relax regulations that direct banks' lending policies away from consumer finance, expand branching opportunities for banks, reduce barriers to entering financial services industries, liberalize foreign access to domestic retail banking sectors, and/or re-examine rate regulations. They might also adopt or improve credit-reporting institutions and credit-scoring systems.[86] And, as discussed below, legal institutions may help expand consumer lending by increasing demand for credit and lessening social or cultural resistance to borrowing.

Even if policymakers in developing countries do not want to take affirmative steps to expand consumer financial markets, rates of consumer lending in many of these countries will likely continue to increase, perhaps dramatically. Thus, in any event, it will probably be important for them to take steps to reduce the potential costs of consumer finance. The potential consequences of regulatory inaction in this area may be significant. Over-indebtedness and other costs of consumer borrowing have the potential to be disruptive forces in an economy, especially in a vulnerable, developing economy. Developing countries that have not already addressed the potential costs of growing consumer indebtedness may be forced by circumstance to do so. To date, the development community, including the World Bank, has been slow to emphasize the importance of attending to the promises and perils of increasing consumer lending.[87]

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[86] *See, e.g.*, Fair Credit Report Act, 15 U.S.C. § 1681 (Supp. 2006). "The banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to the continued functioning of the banking system." *Id.* at § 1681(a)(1). "Consumer reporting agencies have assumed a vital role in assembling and evaluating consumer credit and other information on consumers." *Id.* at § 1681(a)(3). For a nice discussion of the value of credit reporting in consumer financial markets, see Daniel B. Klein, *Promise Keeping in the Great Society: A Model of Credit Information Sharing*, 4 ECON. & POL. 117 (1992).

[87] It appears that the World Bank has recently begun to focus more on issues related to regulation of consumer lending. Last year, for example, the Bank participated in "pilot assessments" of "consumer protection in financial services." *See* WorldBank.org, Private Sector Development—Consumer Protection and Financial Literacy, http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT

There are a variety of common policies, rules, and legal regimes that contemporary societies employ to moderate the risks and costs of consumer lending and, ideally, to reduce over-indebtedness. These include disclosure requirements,[88] financial education,[89] ex ante substantive regulation (especially rate regulation),[90] and ex-post debt re-

/EXTECAREGTOPPRVSECDEV/0,,contentMDK:21361393~pagePK:34004173~piPK:34003707~theSitePK:570955,00.html (last visited Dec. 29, 2008). This year, the Bank sponsored the Global Seminar on Financial Literacy and Consumer Protection. *Id.*

[88] In theory, disclosure of the terms of proposed credit transactions should also promote financial markets. *See, e.g.*, Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491, 513 (1981); Hynes & Posner, *supra* note 15, at 193–95; 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 (1979). Some writers argue that the market itself will often or usually require sufficient disclosure. *See generally* Schwartz & Wilde, *supra*. Nonetheless, mandatory disclosure is a ubiquitous regulatory approach to consumer commercial transactions. *E.g.*, Thomas A. Durkin & Gregory Elliehausen, *Disclosure as a Consumer Protection*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 109, 110 (Thomas A. Durkin & Michael E. Staten eds., 2001) ("[M]andatory disclosure has become the main financial consumer-protection approach in the United States at the federal government level."). There are reasons to be skeptical about the effectiveness of such requirements. Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socioeconomics and Quest for Truth in Lending*, 14 CORNELL J.L. PUB. POL'Y 199, 219–34 (2005) (discussing mandatory disclosure in general and the Truth in Lending Act in particular); Hynes & Posner, *supra* note 15, at 194–95 (discussing criticism of the Truth in Lending Act in particular); Kathleen E. Keest, *Whither Now? Truth in Lending in Transition—Again*, 49 CONSUMER. FIN. L. Q. REP. 360, 360 (1995); Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 814–15 (2003); Edward L. Rubin, *Legislative Methodology: Some Lessons from the Truth-In-Lending Act*, 80 GEO. L.J. 233, 234–35 (1991). It is worth noting that written disclosures face additional limitations where a significant number of potential consumers cannot read, a circumstance that obtains in many emerging economies.

[89] If successful, financial education can enable consumers to learn how to manage consumption through budgeting, accounting, and employing credit and other financial services, it can also help individuals appreciate the benefit of substantive legal protections, including debt relief, which may in turn reduce the stigmas associated with debt and financial distress. Many commentators are skeptical, however, of the likely success of financial education programs. *See, e.g.*, A. Mechele Dickerson, *Can Shame, Guilt, or Stigma Be Taught? Why Credit Focused Debtor Education May Not Work*, 32 LOY. L.A. L. REV. 945, 947–48 (1999); Karen Gross & Susan Block-Lieb, *Empty Mandate or Opportunity for Innovation? Pre-petition Credit Counseling and Post-petition Financial Management Education*, 13 AM. BANKR. INST. L. REV. 549, 549–53 (2005); Karen Gross, *Financial Literacy Education: Panacea, Palliative, or Something Worse?*, 24 ST. LOUIS U. PUB. L. REV. 307, 309 (2005).

[90] Rate regulation has the potential to reduce over-indebtedness by limiting the immediate cost of credit, though creditors can often find ways to effectively avoid rate regulation, especially by charging higher costs and fees that are not included in calculating rates. Even if rate regulation effectively limits the amount that creditors can charge for lending, it is a relatively blunt tool. If successful, it inevitably limits access to credit according to credit-worthiness, but imperfectly so. Such regulation can make it unprofitable to lend to borrowers who have a certain level of risk, even if

lief, including restructuring obligations, regulating debt-collectors, and exempting some assets from the reach of creditors.[91] While each of these policies certainly has its limitations, it is likely that some combination of them could help reduce the risks and costs of deepening consumer financial markets in developing economies. It is also worth noting that most of these, especially education and disclosure, may help expand efficient lending as well as reduce its attendant risks and costs. Thus, in theory, there is an optimal combination of such legal regimes or institutions that would best support a consumer financial market in a developed or developing economy. This Article does not aim to describe such an optimal framework. Rather, it explores one particular legal regime—consumer bankruptcy—to elaborate the broader point that legal institutions have the potential to contribute to growth and development by promoting efficient consumer lending.

IV. CONSUMER BANKRUPTCY

Given the growing consensus that corporate bankruptcy law can promote sustainable growth and development, it is at least puzzling that consumer bankruptcy is, at most, peripheral to debates over development policy.[92] This incongruity probably stems from the fact that, as argued above, the literature on law, finance, and development generally ignores both the promises and the perils of deepening consumer finance. That said, it should not be surprising that the determinants of corporate finance are more a matter of concern for domestic policymakers than the determinants of consumer lending. The performance of commercial enterprises is likely to be more important for economic development than the expansion of consumer

those individuals could easily borrow and repay. *See, e.g.*, Karlan & Zinman, *supra* note 13. It can effectively prohibit transactions that would otherwise benefit particular borrowers and creditors, lead to credit rationing, and, in some circumstances, push borrowers to illegal sources of credit. *See id.*

[91] *See infra* text accompanying notes 98–104.

[92] The law and finance literature focuses on aspects of bankruptcy law that relate to firms and corporate bankruptcy, such as the role of managers of insolvent firms or the effect of reorganizations on secured creditors. *See supra* note 78 and accompanying text. It does not attempt to address whether consumer bankruptcy law also affects economic growth or development. For example, survey responses to a hypothetical insolvency involving a corporate debtor. *See* Djankov et al., *supra* note 75. *See also* Ziad Raymond Azar, Bankruptcy Policy: An Empirical Investigation of 50 Jurisdictions Worldwide, (unnumbered working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1079724 (analyzing corporate bankruptcy regimes). Rajan and Zingales appear to be among the very few who have proposed that consumer bankruptcy law may be an important component of development policy. *See* RAJAN & ZINGALES, *supra* note 25, at 278–306.

finance. But this alone does not explain the general lack of interest in considering the potential role of consumer bankruptcy in development policy. This Part argues that, at least under some circumstances, consumer bankruptcy law can provide an especially useful tool for promoting productive consumer finance in developing economies while reducing the attendant risks and costs of over-indebtedness. It also examines possible reasons why policymakers in developing countries may be hesitant to adopt or to reform consumer bankruptcy regimes.

A. *The Case for Consumer Bankruptcy*

At the broadest level of generality, the functions of consumer bankruptcy law are similar to those of corporate bankruptcy. Both are designed to resolve legal and financial issues relating to insolvent or over-indebted debtors—especially to protect the interests of creditors as much as possible and to efficiently allocate risks and losses. In the corporate context, this largely involves deciding whether to reorganize or liquidate an insolvent corporate debtor.[93] But consumers obviously cannot be liquidated. Consumer bankruptcy is thus generally a forum for arranging orderly repayment of debtors' obligations and, under most regimes, for restructuring at least some of their obligations. Although particular institutional designs vary considerably, consumer bankruptcy almost universally serves first to stay collection of an individual debtor's obligations and then to provide for a scheme of repayment, to eventually discharge some obligations, and to distribute debtor's available non-exempt assets to creditors.

Consumer bankruptcy law in the United States is widely recognized as providing comparatively generous opportunities to discharge obligations, allowing for relatively speedy discharge in exchange for non-exempt assets.[94] England and some former British colonies (like

[93] *See supra* note 78 and accompanying text.

[94] *See generally* Rafael Efrat, *Global Trends in Personal Bankruptcy*, 76 AM. BANKR. L.J. 81, 82 (2002). Insolvent individuals in the United States can voluntarily file for bankruptcy under Chapter 7 or Chapter 13 of the Bankruptcy Code, a federal statute. Most individuals in the United States file under Chapter 7, which allows a debtor to discharge many unsecured obligations if the debtor gives non-exempt assets to his or her unsecured creditors. *Id.* at 87. Debtors can obtain a discharge of debts under Chapter 13 if they complete a plan under which they must give their disposable income to unsecured creditors over a period of three to five years. *Id.* at 88. Until recently, individuals could choose rather freely whether to file under Chapter 7 or Chapter 13. After recent reforms to the Bankruptcy Code, some debtors with relatively high-income are precluded from filing under Chapter 7. For a description of the recent reform see, e.g., Bruce M. Price & Terry Dalton, *From Downhill to Slalom:*

Canada, Australia, and New Zealand) similarly provide for automatic discharge of some consumer debts but not as quickly as in the United States and with less generous exemptions.[95] A competing model of consumer bankruptcy, notably associated with France, allows consumers to discharge obligations at the discretion of administrative agents.[96] A third model of consumer bankruptcy relief, recently adopted by Germany, allows for a discharge of obligations after a debtor pays a portion of his or her non-exempt income for a period of years.[97] As these different models reflect, it is possible to calibrate the extent of debt relief available under any particular consumer bankruptcy regime through a variety of institutional design choices.

A consumer bankruptcy regime that provides some meaningful degree of debt relief (as all of the aforementioned models potentially do) can be an effective tool for reducing the social costs of consumer finance. Staying enforcement of a debtor's obligations, for example, gives the debtor a tool to escape, at least momentarily,[98] from their creditor's collection efforts. Such a stay of enforcement and collection activities should reduce at least some of the strain of financial distress. This effect may be large if this strain grows more acute as collection activities loom larger on the horizon. The stay also supports other functions of bankruptcy by providing time and space for these functions to be implemented. Perhaps most important, staying a debtor's creditors can give the debtor time to negotiate with his or her creditors. This may enable the debtor to keep assets that may be more valuable to the debtor than to the creditors; doing so might increase creditors' collective recovery from their common debtor. It can also help reduce the chances that a debtor will experience financial distress or help reduce the costs of such distress.

An Empirical Analysis of the Effectiveness of BAPCPA (and Some Unintended Consequences), 26 YALE L. & POL'Y REV. 135, 136–37 & n.2 (2007).

[95] Efrat, *supra* note 94, at 88–90. Countries including Russia, Taiwan, and the Netherlands have adopted a similar approach. *Id.* at 89.

[96] *See, e.g.*, Jason J. Kilborn, Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice 8–10 (2008) (unnumbered working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1080252 (describing this as the "Romantic" model).

[97] *Id.* (describing this as the "Germanic" model). In Germany, the period of payments is now six years. This model is similar to relief under Chapter 13 in the United States. *See* Efrat, *supra* note 94, at 88.

[98] To be clear, however, a stay would presumably enable secured creditors to enforce their security without significant delay or have the right to compensation or protection for the delay. *See* 11 U.S.C. §§ 361, 362(d)(1) (2000 & Supp. 2006).

Allowing debtors to discharge at least some obligations effectively insures them from some of the effects of financial distress.[99] Borrowers presumably pay a premium for this insurance in the form of higher interest rates.[100] To the extent that the right to discharge is mandatory, it forces those who borrow to insure against default in this way, making bankruptcy protection a form of social insurance.[101] This social insurance function of consumer bankruptcy can, in theory, reduce a variety of the costs associated with indebtedness. It may, for example, eliminate at least some of the psychological harms and costs associated with insolvency and over-indebtedness by reducing a debtor's overall financial obligations. The potential availability of bankruptcy protection may eliminate or reduce some of these costs of indebtedness even for individuals who do not actually seek protection in bankruptcy. An individual who simply knows that he or she can seek protection in bankruptcy if necessary may experience less emotional strain as a result of their over-indebtedness.

Bankruptcy protection can stem other, more tangible financial costs associated with default and over-indebtedness. As noted above, individuals who are over-indebted are likely to continue to incur various costs of financial distress, including fees, penalties, and replacement costs.[102] If individuals are able to obtain debt relief in bankruptcy, they should be able to avoid incurring at least some, perhaps many, of these costs. Similarly, debt relief can help insolvent or over-indebted individuals return to productivity. This is due in part to the fact that individuals obtaining relief will have more motivation to earn income because less of that income will go to their creditors. Probably more important, however, is the fact that debtors who obtain debt relief will then be able to borrow again for productive purposes. And finally, debt relief in bankruptcy enables individuals to smooth consumption of non-discretionary goods and services as well

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[99] *See* Feibelman, *supra* note 16, at 142 & n.25; *see also* Efrat, *supra* note 94, at 88.

[100] The increased cost of credit and potential rationing may also push some high-risk borrowers to illegal sources or to costly secured lending (or equivalents, like pawnbrokers). As discussed below in more detail, it may also have some offsetting beneficial effects in limiting the indebtedness of high-risk borrowers or forcing private parties or public institutions to make investments in information gathering and evaluation. *See supra* note 97 and accompanying text.

[101] *See* Feibelman, *supra* note 16, at 142. This requirement is desirable if purchasing such insurance is generally efficient but would not otherwise take place. This circumstance might occur, for example, if market failures undermine the market for such insurance. *See id.* at 137 n.25 (noting that markets for potential substitutes for debt relief in consumer bankruptcy, such as wage insurance, divorce insurance, and credit insurance, are either unavailable or very thin).

[102] *See supra* Part III.B.

as "discretionary" goods and services like health care and education. This should not only reduce the likelihood that individual debtors will require social assistance but it should help enable them to develop their basic productive capabilities as well.

If bankruptcy law can provide private and public benefits ex post, there are good reasons to believe that it can also help promote nascent consumer financial markets ex ante. While bankruptcy law may appear to be primarily designed to protect insolvent consumers, it can provide considerable potential benefits to creditors and credit markets. In fact, consumer bankruptcy and insolvency regimes were historically a tool for creditors of insolvent consumer debtors.[103] As noted above, a well-functioning bankruptcy regime can, in theory, improve the ability of creditors to enforce obligations and to collect debt from insolvent debtors.[104] In the consumer context, bankruptcy does this primarily by enforcing security interests and distributing non-exempt unsecured assets to unsecured creditors pro rata. Many regimes also require that a debtor repay a portion or all of their disposable income before they can discharge or restructure their obligations.

As in the corporate setting, these functions can help solve a collective action problem for creditors.[105] Without the coordinating regime, creditors might rush to attach available assets, perhaps forcing a debtor into insolvency or reducing the debtor's ability to earn income. If they do, they might end up recovering less as a group than they would if they hesitated in pursuing their common debtor. A bankruptcy regime can also protect creditors' interests by enforcing other inter-creditor obligations through provisions that unwind preferential or fraudulent transfers.[106] If a consumer bankruptcy regime can increase the insolvency-state return of creditors, it should in turn help expand the availability or reduce the cost of credit to consumers.

Even if such relief reduces creditors' insolvency-state returns from debtors who experience financial distress, however, it might improve their credit-granting decisions ex ante, reducing defaults and over-indebtedness in the first place. Exposing creditors to the

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[103] *See generally* BRUCE H. MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2002); DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

[104] *See* JACKSON, *supra* note 78.

[105] *See id.*

[106] *See generally* 11 U.S.C. § 547 (2000 & Supp. 2006) (preferential transfers); 11 U.S.C. § 548 (2000 & Supp. 2006) (fraudulent transfers).

possibility of discharge of obligations owed to them may give creditors additional incentives to gather reliable aggregate and borrower-specific information bearing on the probability of default. Lower-risk borrowers would in turn have incentives to provide information indicating that their actual risk profile justifies credit. Higher-risk borrowers would, of course, have to pay higher rates for credit; but this theoretically should reduce the amount of credit that these individuals can borrow. This might reduce the chances that these higher-risk individuals would become over-indebted, though some of them would presumably seek financing from informal lenders. Over time, such borrowers could establish a credit history that would reveal themselves to be less risky and would help them qualify for lower rates. If these circumstances obtain, then the increased exposure to debt relief may effectively force creditors to allocate credit more efficiently. This likely would hurt most those lenders who do not have access to good information. But formal lenders would have incentives to invest in sophisticated credit scoring and in the evaluation of information, which would further help promote the expansion of consumer credit markets. As discussed below, it is important to acknowledge that expanding debt relief might not have these beneficial effects and, if not, it might significantly harm nascent consumer financial markets.

Consumer bankruptcy also may promote the expansion of consumer financial markets by making individuals more willing to borrow in the first place. This is an ex ante effect of the insurance function of debt relief, which effectively removes or lessens at least some of the risk of borrowing. If consumers are aware of the protections afforded under bankruptcy law, and assuming that they are at least somewhat risk-averse, this should make borrowing somewhat more appealing or less forbidding. Assuming that at least some consumers would not choose to obtain credit—or as much credit—in the absence of bankruptcy protection, the availability of such protection should make consumers more willing to obtain and to use credit to become productive economic actors, to invest in durable goods, to invest in their own human capital, to use credit to smooth consumption in the wake of income or expense shocks, and, perhaps, to become more invested in their society's growth and development. As with almost all insurance, such protection can give rise to moral hazard, increasing consumers' incentives to borrow recklessly.[107] It is

[107] *See, e.g.*, Charles G. Hallinan, *supra* note 16, at 100–03; Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 ILL. L. REV. 301, 329–31 (2004); Feibelman, *supra* note 16, at 166–70.

therefore important that a consumer bankruptcy regime be designed to ensure that borrowers bear a significant portion of the risk of their own default.[108]

Finally, as Rajan and Zingales have argued,[109] the availability of consumer bankruptcy law may help strengthen political support for development policies in indirect ways. There is often significant political opposition to such policies, especially because these policies often involve serious social and financial risks. For example, privatization of resources, including financial resources may disrupt existing financial relationships, create labor dislocations, lead to the dismantling of subsidies, and expose individuals and households to unfamiliar forms of risks and losses. Individuals who experience such circumstances can easily become disenchanted with the policies responsible for their dislocation and losses.[110] Social insurance, social assistance, and other types of safety net policies can help minimize these effects and perhaps reduce political opposition to development policies.[111] Developing countries tend to have weak and informal safety nets to deal with these (hopefully) transitional dislocations and losses.[112] To the extent that consumer bankruptcy strengthens a country's safety net, it may soften the blow of economic expansion[113] and defuse the political obstacles to reforms that promote development.[114]

B. Objections and Concerns

If consumer bankruptcy with meaningful debt relief can have a beneficial effect in promoting economic growth and development, one might reasonably expect to see a global convergence toward this policy. In particular, one might expect that consumer bankruptcy would be a common component of development policy in emerging economies with nascent consumer financial markets. In fact, the recent trends of consumer bankruptcy adoption and reform do not

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[108] *See, e.g.*, Feibelman, *supra* note 16, at 167–69 (noting that filing fees, limits on dischargeability, and limits on refiling are formal aspects of U.S. bankruptcy law that may reduce the moral hazard of debt relief in bankruptcy).

[109] *See, e.g.*, RAJAN & ZINGALES, *supra* note 25.

[110] *See, e.g.*, Amy L. Chua, *Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development*, 108 YALE L.J. 1, 37, 63, 78, 107 (1998).

[111] *See* RAJAN & ZINGALES, *supra* note 25, at 300–06; Rodrik, *supra* note 64, at 9–12.

[112] *See* RAJAN & ZINGALES, *supra* note 25, at 20 ("[N]ewly developed or developing countries are still reliant on informal safety nets that have frayed long ago under the onslaught of markets.").

[113] *See id.* at 301 (proposing that consumer bankruptcy law can serve an important role in supporting development policy).

[114] *See id.* at 278 (describing a primarily political role for bankruptcy's fresh start).

quite bear this out. On the one hand, there has been a marked trend toward liberalizing debt relief and bankruptcy law across the globe.[115] The list of countries that have recently adopted or liberalized consumer debt relief includes Australia,[116] Norway,[117] Finland,[118] the United Kingdom,[119] the Netherlands,[120] France,[121] Germany,[122] Russia,[123] Hong Kong,[124] Israel,[125] Portugal,[126] South Korea,[127] and Sweden.[128] It is noteworthy that most of these countries enjoy rising per capita incomes and that most of them have adopted relatively modest measures of debt relief compared to the American fresh start approach.[129] Perhaps more interesting, it appears that most of the countries that have recently adopted or reformed their bankruptcy regimes have done so in the wake of signs of increasing consumer over-indebtedness.[130] Admittedly, it is extremely difficult and potentially misleading to draw general, theoretical conclusions about the

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[115] *See* JOHANNA NIEMI-KIELSILAINEN & ANN-SOFIE HENRIKSON, BUREAU OF THE EUROPEAN COMMITTEE ON LEGAL COOPERATION REPORT ON LEGAL SOLUTIONS TO DEBT PROBLEMS IN CREDIT SOCIETIES 41–42 (2005) (making recommendations supporting liberalized approach); Efrat, *supra* note 94, at 92–95; *see also,* Kilborn, *supra* note 96, at 7–8.

[116] *See generally* Rosalind Mason & John Duns, *Developments in Consumer Bankruptcy in Australia*, in CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 227.

[117] *See* Efrat, *supra* note 94, at 93.

[118] *See id.*

[119] *See id.*

[120] *See id.*; Kilborn, *supra* note 96, at 8, 11, 16, 17.

[121] *See* Efrat, *supra* note 94, at 93–94; Kilborn, *supra* note 96, at 8.

[122] *See* Efrat, *supra* note 94, at 85 & n.15; *see also* Christopher G. Paulus, *The New German Insolvency Code*, 33 TEX. INT'L L.J. 141 (1998).

[123] *See* Efrat, *supra* note 94, at 91, 94 & n.47 (noting that Russia adopted a federal insolvency law allowing for discharge of some obligations).

[124] *See generally* Charles D. Booth, *Current Trends in Consumer Insolvency in Hong Kong*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 187.

[125] *See generally* Rafael Efrat, *The Political Economy of Personal Bankruptcy in Israel*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 167.

[126] *See* Efrat, *supra* note 94, at 86 & n.17; *see also* Maria Manuel Leitão Marques & Catarina Frade, *Searching for an Over-Indebtedness Regulatory System for Portugal and the European Union*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 121.

[127] *See generally* Soogeun Oh, *Personal Bankruptcy in Korea: Challenges and Responses*, 7 THEORETICAL INQ. L. 597 (2006) [hereinafter Oh, *Personal Bankruptcy*]; Oh, *supra* note 9.

[128] Kilborn, *supra* note 96, at 8.

[129] *See generally* Efrat, *supra* note 94.

[130] A number of writers have noted the fact that countries tend to adopt or reform consumer bankruptcy regimes in the wake of rising levels of consumer indebtedness. *See, e.g.*, Efrat, *supra* note 94, at 92–95; Jason J Kilborn, *Comparative Cause and Effect: Consumer Insolvency and the Eroding Social Safety Net*, 14 COLUM. J. EUROP. L. (forthcoming 2009); Kilborn, *supra* note 96, at 2–3.

benefits of consumer bankruptcy from these observations. At the very least, however, these data may suggest that policymakers in those countries that have recently adopted or reformed consumer bankruptcy laws have concluded that consumer bankruptcy can serve beneficial functions ex post, i.e., after significant numbers of consumers and households have become over-indebted.

On the other hand, a number of countries do not provide consumers with any bankruptcy protection, including some of the largest developing countries: China, Vietnam, Brazil, Turkey, Mexico, Argentina, Chile, and Venezuela.[131] Brazil and China are particularly interesting cases in this regard. Rates of consumer lending have increased dramatically in both countries in recent years.[132] As noted above, it appears that this increase in consumer borrowing is at least partly a product of domestic policies designed to increase consumption of domestic goods and services.[133] Not surprisingly, there is increasing evidence of consumer over-indebtedness in both countries.[134] Nonetheless, while both countries have bankruptcy regimes for commercial entities, neither has adopted a regime available for consumer debtors.[135] Brazil does have a civil insolvency process available to consumer debtors, but it appears to be primarily, or perhaps exclusively, a creditors' remedy and does not provide meaningful debt relief.[136] China recently adopted its corporate bankruptcy regime, but policy-

[131] *See* Efrat, *supra* note 94, at 82–84.

[132] Consumer lending has been growing dramatically in Brazil since the 1970s, especially in recent years. *See, e.g.*, de Lima Lopes, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 86–89; Marques & Benjamin, *supra* note 9, at 1. Consumer lending has been increasing dramatically in China in recent years, but it is still a nascent market—consumer credit accounted for approximately one percent of bank loans at the turn of the century. *See, e.g.*, Zhang, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 109 ("Despite impressive growth in recent years, the consumer credit market [in China] is still in its infancy stages.").

[133] Under Deng Xiaoping, "the basis of the national development [in China] has slowly shifted from production to consumerism." Zhang, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 106. The government in China has tried to encourage consumer borrowing, but there is weakness in both supply of and demand for credit. *See id.* at 109. Acquisition of durables in Brazil has been "generally stimulated by public polic[y]." de Lima Lopes, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 98.

[134] *See* Zhang, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 112 (discussing over-indebtedness in China); Marques & Benjamin, *supra* note 9, at 6 (discussing over-indebtedness in Brazil).

[135] Bankruptcy law in Brazil applies only to for-profit corporations and sole-proprietors. *See* de Lima Lopes, *supra* note 9, at 91; Marques & Benjamin, *supra* note 9, at 1.

[136] *See* de Lima Lopes, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 93. "[T]his procedure is seldom used." *Id.* at 93.

makers specifically decided not to extend the regime to consumer debtors.[137]

Like China and Brazil, India has experienced dramatic expansion of consumer lending in recent decades.[138] And although India has extended bankruptcy protection to consumers since its colonial era, it has not meaningfully reformed or modernized this regime since it was put in place. There is strong evidence that this system, like India's judicial system in general, is extremely slow and rather unpredictable.[139] The country has recently adopted reforms to its corporate insolvency laws to address these and other problems, but it has not adopted reforms to its colonial-era insolvency laws that apply to individuals.[140] As in Brazil and China, there is evidence of increasing over-indebtedness among Indian households.[141] In 2005, the Reserve Bank of India instituted a settlement program for small non-performing loans.[142] That same year, the Indian Law Commission created a committee to explore whether to reform the country's consumer insolvency regime.[143] That committee disbanded without making any formal recommendations.

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137 *See* Zhang, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 9, at 115. There have been some calls by scholars and advocates within the country for a consumer bankruptcy regime. *See id.* at 112–19. But these have apparently not generated much official support. *Id.*

138 *See generally* Adam Feibelman, *Consumer Finance, Development Policy, and the Case of India* (unpublished manuscript, on file with author).

139 *See, e.g.*, Armour & Lele, *supra* note 81, at 3.

140 *See id.* at 24–25.

141 It appears, for example, that default rates in the country are rising. *See* Y. VENUGOPAL REDDY, RESERVE BANK OF INDIA, ANNUAL POLICY STATEMENT FOR THE YEAR 2007–08, at 26 (2007). It also appears that growing over-indebtedness is increasingly becoming a matter of concern for legal and regulatory actors in India, especially the Reserve Bank of India. *See generally* Feibelman, *supra* note 138, at 52–53. There is also anecdotal evidence of growing over-indebtedness in the form of high-profile legal disputes of consumer debt collection. *See, e.g.*, Parinda.com *ICICI Personal Loan Customer Commits Suicide after Alleged Harassment by Recovery Agents*, http://www.parinda.com/news/crime/20070918/2025/icici-personal-loan-customer-commits-suicide-after-alleged-harassment-recov (last visited Dec. 28, 2008). In a recent case, *ICICI Bank v. Kaur,* Justice Lakshmanan of the Supreme Court of India refers to "the enormous amount of litigation pending and being filed against the banks" arising from the action of their collection agents. (2007) 2 M.L.J. 854 (S.C.).

142 *See* Letter from G. Srinivasan, Chief General Manager-in-Charge, Reserve Bank of India, to All Regional Rural Banks (Dec. 10, 2008), *available at* http://http://www.rbi.org.in/commonman/Upload/English/Notification/PDFs/88920.pdf; *see also* Letter from G. Srinivasan, Chief General Manager-in-Charge, Reserve Bank of India, to All Scheduled Commercial Banks (Dec. 27, 2005), available at http://www.rbi.org.in/commonman/Upload/English/Notification/PDFs/67937.pdf.

143 *See* INSOLINDIA, http://www.insolindia.com/activities.htm#4 (last visited Jan. 1, 2008).

Assuming that countries like Brazil, China, and India are experiencing increasing consumer over-indebtedness, it is not clear what lessons to draw from the fact that policymakers in these countries appear to have considered embracing consumer bankruptcy law or modernizing existing regimes yet decided not to do so. Again, it is important to be cautious in deriving theoretical insights from a handful of historically contingent circumstances. That said, the experience of these countries may suggest that their policymakers believe—rightly or wrongly—that such a regime would not provide net ex post or ex ante benefits. They may have determined, for example, that the potential ex post benefits discussed above are slight or that the threshold costs of necessary legal reforms are too high. Alternatively, it is possible that consumer over-indebtedness in these countries has not yet reached a point to justify the cost of adopting or reforming consumer bankruptcy.

In any event, it is worth emphasizing that the experiences in Brazil, China, and India reflect a consistent aspect of consumer bankruptcy policy across the globe: relatively few countries adopt or significantly reform consumer bankruptcy regimes while their consumer financial markets are nascent or before they experience widespread consumer over-indebtedness. Admittedly, this may be strong evidence against the claim, asserted above, that consumer bankruptcy can promote the expansion of consumer financial markets in developing economies. It may reflect that there is, in fact, no ex ante benefit to bankruptcy law with meaningful debt relief. This could be true, for example, if bankruptcy regimes do not solve collective action problems among consumer lenders—if, for example, creditors would not likely recover more from their debtors under bankruptcy law than they would in the absence of a bankruptcy regime. It is also possible that expanded bankruptcy protection might not make consumers more willing to borrow in the first place. It could be the case that social and cultural factors affect consumers' willingness to borrow more than the availability of debt relief.[144]

The experience of these countries may also reflect concerns that a consumer bankruptcy regime with meaningful debt relief would harm nascent credit markets more than help them. Such a regime could impose actual harm on an economy if it ends up disrupting vulnerable new consumer credit markets. Like most substantive regulation of credit, debt relief imposes some cost on creditors,[145] which

[144] *See infra* notes 148–50 and accompanying text.
[145] *See supra* note 16 and accompanying text.

creditors will pass on to debtors by raising the cost of credit or by limiting the availability of credit. Creditors in developing economies may not be able to evaluate the costs of an automatic stay or the risk of discharge of their obligations under bankruptcy law. And, as noted above, debtors might respond to the availability of debt relief by acting more opportunistically or by becoming less disciplined in borrowing.[146] Any of these effects could cause creditors to increase significantly the cost of credit. This could seriously limit the expansion of consumer lending, which would foreclose any potential benefits of deepening consumer financial markets described in Part I.

It is just as likely, however, that the developing world's relative lack of enthusiasm for consumer bankruptcy law may reflect that policymakers in these countries are simply skeptical about its potential benefits. This is not at all unreasonable given that there is surprisingly little data about the effects of bankruptcy on consumer behavior and on the pricing of credit. Policymakers may be willing to adopt or to reform bankruptcy law in their country yet refuse to do so in the absence of strong evidence of beneficial effects. Countries with emerging economies that are highly vulnerable to the consequences of policy mistakes may be especially hesitant to adopt or to modernize consumer bankruptcy regimes without strong evidence of such benefits.

Even if policymakers in a developing country are confident that a modern consumer bankruptcy regime would be beneficial in their context, there may still be political factors or a general lack of domestic receptivity that cause them to resist legal reforms. It is entirely possible, for example, that countries will avoid providing or improving consumer bankruptcy protections due to intractable political opposition. Powerful actors may oppose even ex ante efficient rules if their interests are short-term and the benefits of reform are long-term. Some creditors may be confident, for example, that they can recover their obligations more consistently than other creditors under the prevailing regime. Some may be concerned that an expanding market for consumer finance would invite new entrants to the market and may want to reduce the threat of such competition. If there is such political opposition to consumer bankruptcy law, there is unlikely to be an equally powerful constituency clamoring in favor of such reforms. Even if consumers or their advocates are an organized and powerful domestic political force, they are not likely to be focused on the potential ex ante benefits of consumer bankruptcy.

[146] *See supra* notes 107–08 and accompanying text.

Because the academic community has not examined the potential development role of consumer bankruptcy and international financial institutions do not advise developing countries to consider it, it is unlikely that domestic policymakers will experience much, if any, external pressure to do so.

Setting aside such political obstacles, institutional and/or cultural factors within a country may undermine the theoretical benefits of a consumer bankruptcy regime. As the history of law and development movements illustrate, a legal institution that is theoretically beneficial in general or in some contexts will often not be effective in other settings. There is a robust and growing literature on the challenges of transplanting legal regimes from one society to others.[147] As a general matter, this literature emphasizes that a society must be receptive to legal reforms for them to be effective. It must have the institutional capacity to support the legal regime in question, and there must be domestic demand for the reform. Policymakers in developing economies may be justifiably concerned that their societies will not be receptive to adopting or to reforming consumer bankruptcy law in either sense.

Developing economies should not invest time and resources in adopting or reforming a consumer bankruptcy regime if it is not capable of providing an administrative structure for the regime. Almost all of the benefits of bankruptcy law described above depend on the regime being at least minimally effective—relatively timely, if not speedy, and generally predictable. If a consumer bankruptcy regime is not effective in these ways, it is unlikely to provide any of its potential benefits. Consumers may not, for example, believe that they will derive any benefit from the regime. This likely would undermine the potential for a bankruptcy regime to encourage consumers to borrow in the first place, and it likely would do little to help them avoid emotional and physical costs of financial distress. It also would not do much to assuage their concerns about broader dislocations caused by their country's development policies. Similarly, an ineffective regime would not be likely to increase creditors' insolvency-state returns or make their returns more predictable. If a consumer bankruptcy regime fails in these respects, it will be unlikely to support the deepen-

[147] *See, e.g.*, ALAN WATSON, LEGAL TRANSPLANTS (1974); Berkowitz et al., *supra* note 66; Pierre Legrand, *The Impossibility of Legal Transplants*, 4 MAASTRICHT J. EUR. & COMP. L. 111 (1997); Ugo Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economics*, 14 INT'L REV. L. & ECON. 3, 7 (1994); Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 WM. MARY L. REV. 1055 (2004).

ing of consumer financial markets. In fact, an ineffective regime could have a dramatically negative effect on creditors if it provides for generous but unpredictable debt relief. In that case, creditors might charge a price for credit that significantly over-estimates their actual exposure to debt-relief, or they might simply decide not to participate in the market.

Policymakers in developing countries may also determine that there is not adequate domestic demand for such reforms. Expansion of consumer bankruptcy is often fraught with social, cultural, and ideological implications.[148] In particular, financial distress and discharge of obligations are stigmatized in most societies to some extent. In societies where such stigma is very strongly felt, debt relief under bankruptcy law or other laws may have little effect. Individuals in these societies may not be willing to employ the legal rules at their disposal. This phenomenon is arguably observable to some extent in the United States, where many individuals who would benefit from filing for bankruptcy do not do so.[149] As Martin explores in detail, the example of Japan is striking in this regard.[150] Although that country has adopted relatively generous consumer bankruptcy protection modeled largely on the U.S. system, the regime is rarely used.[151] This is apparently due, in large part, to social stigmas attaching to debt relief in that country.[152]

It is important to note that it is possible for policymakers to address or reduce many of the objections or obstacles to adopting consumer bankruptcy law in a developing country discussed above. It is possible to reduce the effects of debt relief in bankruptcy on the price of credit, for example, by circumscribing the availability of such relief. Limiting the scope of available discharge or increasing the preconditions for debt relief should reduce creditors' exposure to bankruptcy law by reducing the ability and incentives of consumers to act opportunistically. Policymakers may also address these risks by improving the quality of domestic credit reporting and credit scoring.

[148] *See generally* Efrat, *supra* note 62; Nathalie Martin, *The Role of History and Culture in developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT'L & COMP. L. REV. 1 (2005); Zhang, *supra* note 9, *in* CONSUMER BANKRUPTCY IN GOLBAL PERSPECTIVE, *supra* note 9, at 118–19 (discussing cultural aversion to debt in China); Oh, *Personal Bankruptcy*, *supra* note 127, at 32–33 (discussing consumers' reluctance to utilize bankruptcy relief due to social stigma).

[149] *See, e.g.*, Michelle White, *Why Don't More Households File for Bankruptcy?*, 14 J.L. ECON. & ORG. 205, 206 (1998).

[150] *See* Martin, *supra* note 148, at 59–60.

[151] *See id.* at 60.

[152] *See id.*

This should increase the cost to consumers of filing for bankruptcy and thereby reduce their incentives to act opportunistically. It is also likely that informal forces such as stigma or reputation will limit the extent to which borrowers behave opportunistically, especially in societies where the stigma associated with financial distress and debt relief are robust.

Similarly, it may be possible for policymakers to influence cultural or social factors within their country to increase the social demand for or reduce the social resistance to consumer bankruptcy law.[153] They may be able to do so by identifying familiar forms of debt relief and building a bankruptcy regime upon those indigenous institutions. They might also invest in financial education that casts a sympathetic light on debt relief. This may be easier to do in countries that already have some, albeit poorly-functioning, form of insolvency or bankruptcy law on their books, such as Brazil and India. It is doubtful that policymakers could eliminate or radically alter stigmas associated with debt relief in societies that have strong norms disfavoring debt or debt relief, but they might be able to reduce resistance enough to make it possible to adopt or expand bankruptcy protection for consumers. Finally, social demand for debt relief and consumer bankruptcy protection may be fluid—as levels of over-indebtedness rise, for example, this will likely influence citizens' and policymakers' receptiveness to the institution. This may help explain why recent reforms and adoptions have tended to occur in countries that have experienced such problems.

It may be harder, yet possible, to reduce the administrative and/or institutional obstacles to implementing a modern bankruptcy regime. Even if a country's judicial system is weak or flawed, however, it might be possible and desirable to design a consumer bankruptcy system that is somewhat insulated from judicial functions. Policymakers could, for example, adopt relatively formalistic bankruptcy rules that require only limited judicial discretion or attention.[154] If speed, predictability, and accessibility are primary concerns, it may be

[153] In recent years, a number of writers have proposed that promoting social and cultural change is an essential component of development policy. For an extensive discussion and critique of this body of work, see Amy J. Cohen, *Thinking with Culture in Law and Development*, BUFF. L. REV. (forthcoming 2009). Any attempt to influence or change social or cultural aspects of a society will inevitably be fraught with practical challenges and deep normative concerns. With these challenges and concerns in mind, this Article only tentatively suggests that policy-makers may be in a position to influence social and cultural factors within their own societies and that they are more likely to be successful in such efforts if they are attentive to social and cultural dimensions of existing domestic institutions.

[154] *See, e.g.*, Posner, *supra* note 70, at 3.

possible to create a distinct bankruptcy forum that is more administrative and less judicial in nature. Building institutional capacity and increasing social receptivity might be interrelated projects. The enactment of a consumer bankruptcy regime may, in itself, influence social demand or receptiveness to the institution, even if it is underutlilized for a while. And increasing demand for consumer bankruptcy may help build political support for making broader improvements in domestic legal and judicial institutions.

In sum, there are good reasons to believe that a consumer bankruptcy regime can support the beneficial expansion of consumer finance and reduce the overall risks and costs of consumer borrowing. Unfortunately, there is little empirical evidence bearing on these claims. The reluctance of many developing countries to adopt such regimes, except in the wake of widespread over-indebtedness or financial crises, may suggest that these claims are incorrect. Alternatively, it may indicate that policymakers may misperceive the benefits of such reforms or that they face practical obstacles to introducing or expanding bankruptcy protections for consumers. If policymakers are limited by practical obstacles, these need not be determinative; it may be possible to increase a country's institutional and social receptiveness to consumer bankruptcy.

V. CONCLUSION

Existing scholarship on law, finance, and development generally ignores the role that consumer finance and the regulation thereof might play in promoting economic development. In fact, there are good reasons to believe that deepening of consumer finance promotes growth and/or development in emerging economies. Regulation of consumer lending may support these effects by helping to expand the availability of consumer finance and by addressing the potential costs of over-indebtedness. Consumer bankruptcy law that includes meaningful debt relief has the potential to be an effective form of such regulation. It can help promote deepening of consumer financial markets by increasing the expected insolvency returns of creditors, by making such returns more predictable, and by encouraging risk-averse consumers to obtain finance. It can also limit the amount and the costs of consumer over-indebtedness. Thus, consumer bankruptcy law should be understood as a potentially key component of development policy, and not only in the wake of widespread over-indebtedness or financial crisis. Unless it appears that a society cannot effectively administer such a regime or that social or cultural factors would keep consumers from utilizing it, emerging economies should consider adopting a consumer bankruptcy system or modernizing their existing regimes.