

FINANCIAL SCARCITY AND FINANCIAL DECISION-MAKING

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People who are financially strapped make astonishingly bad financial decisions. Politicians and mainstream economic theorists assume that most people, including bankruptcy debtors, use a rational financial decision-making process that includes evaluating options and then choosing the option that provides the best long-term results. Under this view, people who buy things or services they cannot afford do so because they are unwilling to exercise self-control or because they are attempting to opportunistically game bankruptcy laws.

This Article argues that people who are in financial distress make bad financial decisions for reasons that have little to do with strategic or rational behavior. Relying on behavioral science that explores how people make decisions when they are facing scarcity, this Article argues that certain tendencies can cause people to make sub-optimal financial decisions. This Article presents a series of bad financial decisions financially distressed people make (or attempt to make) both before and after they file for bankruptcy and argues that financially distressed people often make stupid financial decisions precisely because they are financially distressed.

Bankruptcy policies cannot truly help financially distressed Americans as long as they continue to be based on a pure economic model of consumer behavior. This Article urges decision-makers to incorporate behavioral-science insights to help them understand why financial scarcity impairs the decision-making process and causes cash-starved Americans to make decisions that might appear to be bewildering to lawyers, judges, or politicians. This Article ends by suggesting things that bankruptcy laws, lawyers, and judges can do to help financially distressed Americans make better financial decisions before, during, and (hopefully) after their bankruptcy cases.

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INTRODUCTION

Most people who have filed for bankruptcy have made bad, often astonishingly bad, financial decisions. They probably do not realize just how flawed their decision-making process is because many attempt to make bad choices even when they are under the supervision of a bankruptcy judge. It is possible that debtors make bad financial decisions because they are unwilling to exercise self-control or because they are attempting to opportunistically game bankruptcy laws. It is more likely, though, that people who are in financial distress make bad financial decisions for reasons that have little to do with strategic or rational behavior.

On September 15, 2015, President Obama issued an executive order that acknowledges the role behavioral science can play in explaining how people make

decisions.¹ This Order directs executive departments and agencies to “identify policies, programs, and operations where applying behavioral-science insights may yield substantial improvements in public welfare, program outcomes, and program cost effectiveness.”² Ten years ago, during hearings and debates on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), no one seemed to think that behavioral science could help explain why people make bad financial decisions. Instead, Congress concluded that bankruptcy laws encouraged people to spend irresponsibly because the laws made it too easy for people to erase debts in bankruptcy.³

The members of Congress who voted in favor of BAPCPA did so without considering whether behavioral science might explain why debtors make such bad financial decisions. In fact, even though empirical data did not support the presumption that people made bad financial decisions because bankruptcy laws were lax, BAPCPA’s supporters concluded that debtors would make better financial decisions if bankruptcy laws were revised to stigmatize and penalize their bad financial decisions.⁴ To prevent abuse, punish debtors, and try to make bankruptcy a more stigmatizing process, Congress imposed additional burdens and restrictions on debtors and their lawyers. Discharging debts in bankruptcy is now harder, more complicated, and more expensive for financially stressed people. BAPCPA also makes it riskier for lawyers to file bankruptcy petitions for their clients because they potentially face personal liability if they erroneously certify that the information contained in the bankruptcy petition is accurate.⁵

To put it mildly, Jean Braucher was not a fan of BAPCPA. In critiquing BAPCPA, she noted the “breathtaking” number of inconsistencies, typographical errors, and other flaws in the legislation.⁶ She stressed that the “subtext of [BAPCPA] was the view that bankruptcy judges and consumer debtors’ lawyers needed to be reined in to keep them from facilitating abuse by consumer debtors.”⁷ As Jean noted, BAPCPA was—by design—punitive legislation; it is hostile towards

1. Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 15, 2015).

2. *Id.*

3. See A. Mechele Dickerson, *Regulating Bankruptcy: Public Choice, Ideology, & Beyond*, 84 WASH. U. L. REV. 1861 (2006) [hereinafter Dickerson, *Regulating Bankruptcy*] (discussing rhetoric during bankruptcy reform debates).

4. While it is difficult to conclusively prove that there is a stigma attached to filing for bankruptcy, data collected in a survey of married couples who filed for bankruptcy indicate that debtors feel stigmatized by bankruptcy and engage in a number of strategies to “mitigate the shame and social disapprobation they experienced as a result of their bankruptcies.” Deborah Thorne & Leon Anderson, *Managing the Stigma of Personal Bankruptcy*, 39 SOC. FOCUS 77, 78 (2006); see also Michelle Maroto, *The Scarring Effects of Bankruptcy: Cumulative Disadvantage Across Credit and Labor Markets*, 91 SOC. FORCES 99 (2012) (discussing the stigmatizing effect of bankruptcy on employment).

5. Stefania Albanesi & Jaromir Nosal, *Insolvency After the 2005 Bankruptcy Reform*, FED. RES. BANK OF N.Y. (2015).

6. Jean Braucher, *The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need Not Be Futile*, 2007 U. ILL. L. REV. 93, 97.

7. *Id.* at 94.

debtors and views their lawyers as little more than “slapdash con artists, genuine bad guys.”⁸

Despite BAPCPA’s significant flaws, it cannot be labeled a total failure. Since 2006, annual consumer bankruptcy filings have been lower than total annual filings before BAPCPA was enacted.⁹ However, consumer debt levels have remained high, and foreclosure rates have skyrocketed, especially during the recent recession.¹⁰ Since BAPCPA went into effect, Americans have remained buried in debts (e.g., student loans or home mortgages) that cannot be discharged in bankruptcy. So, while consumer bankruptcy filing rates have dropped since 2006, the financially distressed people who are no longer able to file for bankruptcy still need the relief a bankruptcy discharge could provide.¹¹

Even if BAPCPA is viewed as a success because of the effect it has had on the total number of bankruptcy filings, BAPCPA’s assumptions about why people are overindebted are based on the flawed presumption that financially distressed people make decisions using a rational economic model. In light of President Obama’s recent Executive Order, bankruptcy policies and practices should incorporate insights from behavioral science so that bankruptcy laws effectively provide relief to financially distressed Americans.

This Article explores the reasons financially distressed Americans predictably and regularly make dumb financial decisions and why those decisions often land them in bankruptcy. This Article, like many that Jean wrote, rejects the notion that bankruptcy laws should be based on a “simple economic model of consumer behavior.”¹² Even if a bankruptcy system that stigmatized and penalized people was appropriate in 1978 (when the current Bankruptcy Code was enacted) or in 2005 (when Congress enacted BAPCPA), existing bankruptcy laws no longer respond to the substantially changed and strained economic conditions America’s underclass now faces. Moreover, neither state nor federal bankruptcy laws can help people reduce their debt levels or make better financial decisions until they reflect the reasons people who are financially stressed make bad financial decisions.

This Article first discusses the processes people use to make financial decisions and why certain behavioral tendencies often cause people to make suboptimal decisions. Part II of this Article discusses research that shows how the stress of financial scarcity causes people to make bad financial decisions. Stated

8. *Id.* at 95.

9. AM. BANKR. INST., ANNUAL BUSINESS AND NON-BUSINESS FILINGS BY YEAR (1980–2013) (2015), http://abi-org.s3.amazonaws.com/Newsroom/Bankruptcy_Statistics/Total-Business-Consumer1980-2013.pdf.

10. RESEARCH & STATISTICS GRP., FED. RES. BANK OF N.Y., QUARTERLY REPORT ON HOUSEHOLD DEBT AND CREDIT 3 (2015), www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2015Q3.pdf; *see also* Albanesi & Nosal, *supra* note 5.

11. Albanesi & Nosal, *supra* note 5.

12. Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 508 (1993) [hereinafter Braucher, *Lawyers and Consumer Bankruptcy*].

differently, financially distressed people make stupid financial decisions precisely *because they are financially distressed*. This Article then discusses bad financial decisions financially distressed people often make, including playing the lottery and taking out payday loans, and explains why financial scarcity causes them to make those decisions. Part IV of this Article provides a series of flawed decisions consumer debtors attempted to make in actual bankruptcy cases. Although those financial decisions might appear wholly irrational to bankruptcy lawyers, judges, or members of Congress, Part IV suggests the debtors' decision-making processes are not irrational given the financial scarcity they face.

Part V of this Article argues that bankruptcy policies should shift from a pure economic model of consumer behavior to what Jean described as "a socio-economic paradigm of human behavior."¹³ This Article ends by suggesting ways bankruptcy laws, lawyers, and judges can help financially distressed Americans make better financial decisions before, during, and (hopefully) after their bankruptcy cases.

I. MAKING FINANCIAL DECISIONS

Whether the financial decision is big or small, everyone has a process they use to decide when, why, and how to purchase a good or service. Although the best way to make decisions is to use a careful, methodical, and rational process, insights from behavioral science explain why people who are financially stressed often make flawed financial decisions. They make spending mistakes because, as they focus on quenching an immediate financial fire, they often fail to focus on the potentially detrimental financial consequences those current spending choices could have in the future.

A. *The Process*

Everyone uses a decision-making process when purchasing something. Most individuals gather information from friends or family, the Internet, or visit a brick-and-mortar store to determine options and compare prices.¹⁴ After gathering and evaluating options, buyers typically narrow the range of items they will consider, using a set of criteria that involves cost and a limited number of product characteristics (e.g., color, size, quantity, or type).¹⁵ Because household savings rates remain low and most U.S. households do not have even one month of income in liquid savings,¹⁶ the decision-making process often continues even after the buyer

13. *Id.* at 503.

14. GREGORY ELLIEHAUSEN, FED. RES. BD. & GEO. WASH. UNIV., IMPLICATIONS OF BEHAVIORAL RESEARCH FOR THE USE AND REGULATION OF CONSUMER CREDIT PRODUCTS 6 (2010), <http://www.federalreserve.gov/pubs/feds/2010/201025/201025pap.pdf>.

15. *Id.*

16. PEW CHARITABLE TR., THE PRECARIOUS STATE OF FAMILY BALANCE SHEETS (2015), http://www.pewtrusts.org/~media/assets/2015/01/fsm_balance_sheet_report.pdf. While the personal savings rate rose to 11% in December 2012 because lenders tightened credit and made it harder for consumers to borrow after the recession, the rate dropped to 4.3% by December 2013 and has not been higher than 5.4% since 2013. *Personal Saving Rate*, ECON. RES.: FED. RES. BANK ST. LOUIS, <http://research.stlouisfed.org/fred2/series/PSAVERT> (last visited Jan. 23, 2016).

has made a decision about what to purchase. Many must then decide how to pay for their purchases.

People with disposable income (“cash-flush” individuals) probably give little thought to how to pay for small-dollar items because they typically have bank accounts and credit cards. With economic slack, they can pay for small-dollar items and routine expenses with cash, a check, or a credit card.¹⁷ While only the wealthiest people can make large purchases (e.g., a house) or pay for expected (e.g., college tuition) or unexpected (e.g., emergency medical care) expenses in cash, people with relatively predictable income generally do not have to consider how they will pay for larger recurring monthly expenses, such as rent, mortgage, or car-loan payments.

While cash-flush individuals do not need to take out loans to pay for small-dollar purchases, people who have little economic slack (“cash-starved” individuals) often do not have cash or access to credit cards to pay for their purchases—whether big- or small-dollar.¹⁸ Even after they decide what to purchase, cash-starved individuals must often engage in an additional decision-making process to borrow money (from friends or family) to pay for basic needs¹⁹ or find a financial services provider—e.g., credit card provider, payday lender, or title pawn lender—to help finance larger purchases.

B. The Psychology of Making Decisions

After deciding what to purchase and how to pay, people should theoretically reevaluate the decision-making process and confirm that the financial decision is sound.²⁰ Insights from behavioral science show why this reevaluation rarely happens.

1. Focusing on the Present

While everyone knows the importance of setting long-term goals, people routinely make short-term financial decisions that can derail their long-term plans.

17. FED. DEPOSIT INS. CORP., 2013 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS (2014), <http://www.fdic.gov/householdsurvey/2013report.pdf>. In addition to being banked, cash-flush people are more likely to pay their credit card balances in full each month. See BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2014, at 28 (2015), <http://www.federalreserve.gov/econresdata/2014-report-economic-well-being-us-households-201505.pdf> [hereinafter ECONOMIC WELL-BEING IN 2014] (finding that 55% of households who earn more than \$100,000 are convenience users who pay their bills in full each month).

18. People with economic slack typically have buffers like savings accounts or credit cards that they can use when they encounter an unexpected economic shock. Paige Marta Skiba, *Regulation of Payday Loans: Misguided?*, 69 WASH. & LEE L. REV. 1023, 1029 (2012).

19. See Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217, 1234 (2004); Laura M. Tach & Sara S. Greene, “*Robbing Peter to Pay Paul*”: *Economic and Cultural Explanations for How Lower-Income Families Manage Debt*, 61 SOC. PROBS. 1 (2014).

20. ELLIEHAUSEN, *supra* note 14, at 4.

One reason people may make financial decisions that harm them in the future is because people have a tendency to understate their current debts²¹ and underpredict their future expenses.²² Behavioral research shows that people often “view their distant selves as strangers” and “fail to consider their changing tastes over time.”²³ As a result, people “often act in ways that prioritize the present (e.g., overspend today) and leave negative consequences for the future (e.g., large debt burdens).”²⁴ Likewise, people often make spending decisions based on how the decision affects their *current* status quo—not how the decision may help or hurt them in the future.²⁵

Generally speaking, people who use cash to pay for a purchase understand the costs and benefits of the purchase because they understand—at the time of purchase—what they are giving up in the present (e.g., savings or buying other things).²⁶ Behavioral research shows, however, that people tend to overestimate the short-term benefits from a purchase or financial decision and underestimate the costs²⁷ when they make the purchase on credit.²⁸ That is, while buyers will need to sacrifice in the future to make monthly loan or credit card payments if they buy something on credit, the buyer only vaguely feels the “pain” of the future sacrifice at the time of the purchase.

Similarly, people have a tendency to place a higher value on things they have or *can* have immediately and discount the value of items they can acquire or enjoy in the future using savings.²⁹ Because people highly value things they can get and use immediately, they find it psychologically difficult to part with the things they have. As a result, they often (irrationally) refuse to part with those items, even if it is clear they can no longer afford to keep them.³⁰

21. Stephanie Moulton et al., *Borrowing Capacity and Financial Decisions of Low-to-Moderate Income First-Time Homebuyers*, 47 J. CONSUMER AFF. 375, 378 (2013).

22. Hal E. Hershfield et al., *Leveraging Psychological Insights to Encourage the Responsible Use of Consumer Debt*, 10 PERSP. ON PSYCHOL. SCI. 749, 749 (2015).

23. *Id.*

24. *Id.*

25. ELLIEHAUSEN, *supra* note 14, at 12–14. For example, research shows that homeowners often fail to refinance their higher interest rate mortgage loans when interest rates decline or to enroll in programs that would allow them to refinance those higher rate mortgage loans. Homeowners choose not to refinance because of the time and upfront costs associated with refinancing, their inability to understand the complexity of the financial transaction, and the benefits “are not immediate, but rather accrue over time.” Benjamin J. Keys et al., *Failure to Refinance 2* (Nat’l Bureau of Econ. Research, Working Paper No. 20,401, 2014).

26. *Id.*

27. Vldas Griskevicius et al., *When the Economy Falts, Do People Spend or Save? Responses to Resource Scarcity Depend on Childhood Environments*, 24 PSYCHOL. SCI. 197 (2013).

28. ELLIEHAUSEN, *supra* note 14, at 3.

29. STUART A. VYSE, *GOING BROKE* 68–70 (2008) (discussing the theory of hyperbolic discounting).

30. Sendhil Mullainathan & Eldar Shafir, *Savings Policy and Decisionmaking in Low-Income Households*, in INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT, AND BANKING AMONG LOW-INCOME HOUSEHOLDS 121, 124 (Rebecca M. Blank & Michael S. Barr eds., 2011) [hereinafter Mullainathan & Shafir, *Savings Policy*].

2. Willpower and Self-control

Individuals make better financial decisions, save more, and accumulate more household wealth when they exercise self-control and carefully consider their spending decisions.³¹ People who exercise self-control are more likely to set long-term goals (e.g., save for a down payment on a house) and then keep track of what they need to do to achieve those goals (e.g., set aside a fixed amount to save each month).³² While research shows that impulse buying is common among U.S. buyers,³³ people who set goals and create a plan to achieve them are more likely to make wise spending decisions and less likely to engage in impulse buying.³⁴

In order to exercise self-control, individuals must constantly focus on their future plans and avoid all impulses to spend in ways that derail their future plans.³⁵ In addition, people cannot exercise self-control if they do not have the capacity to commit to their set goals, such as sufficiently stable monthly earnings they can set aside for savings. Insights from behavioral science help explain why people fail to exercise self-control and why those who lack self-control splurge and routinely make bad financial decisions.

As noted in the last Section, because people value things they can consume in the present, it is harder for them to resist the temptation to spend rather than save, especially because people find it hard to predict their future expenses. In addition to a tendency to spend now and pay later, people facing a temptation to spend are more likely to “yield to the impulse if it does not perturb [their] plan too much.”³⁶ The problem, though, is that most people have a hard time accurately predicting what will derail their future plans “too much” because of the tendency people have to underestimate their future spending needs.³⁷

Even people who are disciplined and exercise self-control tend to discount how their short-term decisions—to eschew saving or make relatively inexpensive, one-time purchases—might affect their future financial security. For example, American households overall have inadequate retirement savings,³⁸ and one reason households fail to save is because they do not understand the power of compound interest.³⁹ Just as people do not understand the cumulative beneficial effect of saving

31. VYSE, *supra* note 29, at 84, 92–93; *see also* Nina Biljanovska & Spyros Palligkinis, *Control Thyself: Self-control Failure and Household Wealth* (Sustainable Architecture for Fin. in Eur., Working Paper No. 69, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2509080.

32. Biljanovska & Palligkinis, *supra* note 31.

33. James A. Roberts & Chris Manolis, *Cooking up a Recipe for Self-control: The Three Ingredients of Self-control and Its Impact on Impulse Buying*, 20 J. MARKETING THEORY & PRAC. 173 (2012).

34. Roy F. Baumeister, *Yielding to Temptation: Self-control Failure, Impulsive Purchasing, and Consumer Behavior*, 28 J. CONSUMER RES. 670 (2002).

35. ELLIEHAUSEN, *supra* note 14, at 23.

36. *Id.* at 21.

37. *See* Hershfield et al., *supra* note 22.

38. ECONOMIC WELL-BEING IN 2014, *supra* note 17, at 37.

39. *See* Annamarie Lusardi & Carlo de Bassa Scheresberg, *Financial Literacy and High-Cost Borrowing in the United States* (Nat'l Bureau of Econ. Research, Working Paper No. 18,969, 2013), <http://www.nber.org/papers/w18969>.

small amounts over time, they also fail to understand the cumulative harmful effect of spending small amounts over time. Most people likely understand that making a one-time, relatively small-dollar purchase (e.g., buying an expensive pair of jeans, the newest iPhone, or season tickets to an athletic event) will not cause them long-term harm in the same way that making a one-time purchase of an expensive home would. They often fail to realize, though, that these small-dollar financial decisions, over time, could prevent them from saving enough to make a down payment to buy a house in the future or saving enough retirement income.⁴⁰

Finally, recent research indicates that people who grow up in lower socioeconomic, resource-constrained households are more impulsive, take greater financial risks, and approach temptations more quickly than people raised in higher socioeconomic environments.⁴¹ Indeed, even for individuals who are no longer poor, the research indicates that growing up poor increases the likelihood that people will make impulsive and harmful financial decisions when they face a financial crisis because they often view their future as bleak and hopeless.

3. *Self-control When the Spending Is Easy*

As discussed above, people who use a deliberative decision-making process are more likely to avoid impulse buying and make better, more rational decisions. Because it has become easier for buyers to purchase items quickly, it has also become easier for them to make impulse purchases.⁴² Today, there is usually little delay between the time shoppers decide to buy something and the time they complete the sale and enjoy their purchase. Online shopping in particular makes it easy to spend because it eliminates the time it takes to get to a brick-and-mortar store and search shelves for a particular product.

With the Internet, potential buyers can quickly find and compare an almost unlimited supply of goods and services. Assuming the purchaser has a credit card and has not exceeded its limit, most purchases can be completed with a click (online), or a swipe and maybe a signature (in stores). New shopping innovations, such as Amazon 1-Click, let buyers choose an item and complete the online order with just one computer click.⁴³ Similarly, with the proliferation of smartphone applications, buyers can instantaneously complete purchases by scanning a barcode.

40. VYSE, *supra* note 29, at 63 (explaining “delay discounting,” which causes people to place higher value on immediate rewards rather than delayed rewards).

41. See Griskevicius et al., *supra* note 27.

42. Impulse buying is generally defined as purchases that occur because of the presence of an “immediate stimulus object” that causes feelings of “excitement, pleasure, and a powerful urge to buy that precludes any thoughtful or deliberate consideration of the implications and future outcomes resulting from the purchase.” Jeffrey S. Podoshen & Susan A. Andrzejewski, *An Examination of the Relationships Between Materialism, Conspicuous Consumption, Impulse Buying, and Brand Loyalty*, 20 J. MARKETING THEORY & PRAC. 319, 322 (2012).

43. See *About 1-Click Ordering*, AMAZON, http://www.amazon.com/gp/help/customer/display.html/ref=hp_left_cn?ie=UTF8&nodeId=468482 (last visited Jan. 23, 2016).

Given how quick and easy it is to make purchases, especially for small-dollar items, buyers can make spending decisions and complete purchases without stopping to consider whether their decisions are sound.⁴⁴ While online shopping and the ability to complete a purchase by quickly swiping a credit card (or scanning a cellphone) in a Starbucks or Wal-Mart is convenient, speed impairs the decision-making process because speed makes it harder for people to exercise self-control and increases the risk that the buyer will make an irrational spending decision.⁴⁵

II. THE EFFECT OF SCARCITY ON THE DECISION-MAKING PROCESS

Politicians and mainstream economic theorists assume most people, including bankruptcy debtors, use a rational financial decision-making process that includes evaluating options and then choosing the option that provides the best long-term results.⁴⁶ As this Part shows, virtually everybody—even cash-flush individuals—routinely and predictably make irrational and harmful financial decisions. Moreover, whether individuals carefully decide or act impulsively, making financial decisions almost always involves some form of scarcity—be it scarcity of time, financial resources, or mental capacity.

A. Time Scarcity

It is time-consuming to explore all possible purchasing and financing options. Given this, people rarely consider every option when confronted with too many choices.⁴⁷ Instead, they often rely on the advice of friends and family or consider only a few product characteristics rather than use a complex, multi-step decision-making process.⁴⁸ Rather than use a deliberative process that evaluates all possible choices, they often make quick or reflexive financial decisions.⁴⁹

Research shows that people typically use a more elaborate decision-making process only if they are buying an expensive item, an item they view as important, or an unfamiliar item.⁵⁰ People generally use a long and complicated decision-making process only if they conclude that the benefits of gathering additional information exceed the cost (in time) of doing so.⁵¹ To save time, most purchasers take shortcuts and consider only a few product characteristics (e.g., color, size, or cost).⁵² Given the ease of online shopping, buyers may focus on how quickly an item

44. For small-dollar purchases in stores, there is virtually no delay between the time the cashier rings up the purchase and the time the person pays because many stores let buyers charge items to a credit card without providing an electronic signature.

45. See RONALD T. WILCOX, *WHATEVER HAPPENED TO THRIFT?: WHY AMERICANS DON'T SAVE AND WHAT TO DO ABOUT IT* (2008).

46. See Braucher, *Lawyers and Consumer Bankruptcy*, *supra* note 12.

47. John R. Hauser et al., *Self-reflection and Articulated Consumer Preferences*, 31 *J. PRODUCT INNOVATION MGMT.* 17 (2014); see also WILCOX, *supra* note 45, at 60–61.

48. ELLIEHAUSEN, *supra* note 14, at 5–9.

49. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 141.

50. People who are replacing an item that has worked well for them in the past may use a truncated decision-making process that consists of little more than buying the same product again. ELLIEHAUSEN, *supra* note 14, at 9.

51. *Id.* at 5.

52. *Id.*

can be shipped, for example, rather than the total cost of the product or whether they could purchase the item cheaper in-store. Similarly, when deciding how to finance a purchase, buyers often focus on the amount of the monthly payment rather than the total cost of the product, including accrued interest.⁵³

With the luxury of disposable income, cash-flush individuals do not need to spend time thinking about which basic goods or services to purchase or how to pay for those basic necessities. Even when time is scarce, cash-flush people can quickly make decisions about basic necessities because they know they can pay for those items with cash, check, or a debit/credit card.⁵⁴ In addition, because they are not facing financial scarcity, cash-flush individuals who lack sufficient time to carefully consider their purchases face little risk of long-term consequences if they make a rash financial decision about a small-dollar purchase.

Moreover, even if they regularly succumb to the temptation to splurge, cash-flush individuals have financial slack, which helps them avoid catastrophic financial consequences that might otherwise result from irrational spending decisions. Indeed, one significant difference between the consequences of irrational spending for the cash-flush and the cash-starved is that cash-starved people have little economic slack and “[w]ith little slack, [they] have less room to fail.”⁵⁵ While the cash-starved are routinely castigated as irresponsible if they buy something that was not budgeted for, a cash-flush individual who makes a similarly unwise financial decision is viewed as buying an affordable luxury.⁵⁶

B. Financial Scarcity

As noted earlier, during legislative debates about BAPCPA, many members of Congress concluded that debtors engaged in opportunistic financial decision-making with help from bankruptcy laws. While all people have a tendency to make bad decisions if they are presented with too many options or if they have too many decisions to make, cash-starved people often make decisions that are inexplicable to cash-flush people (like members of Congress and judges). Their decisions appear bewildering, however, because people with disposable income generally are not aware that financial scarcity “creates its own mindset, changing how people look at problems and make decisions.”⁵⁷ Stated differently, there are cognitive consequences to not having financial slack and the stress of financial scarcity causes bad decision-making.

53. *Id.* at 9, 14; *see also* Austin, *supra* note 19, at 1249 (noting that poorer individuals “are more concerned with whether their periodic payments are manageable than with the actual interest rate charged”); Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 141.

54. Anuj K. Shah et al., *Some Consequences of Having Too Little*, 338 *SCI.* 682 (2012).

55. SENDHIL MULLAINATHAN & ELDAR SHAFIR, *SCARCITY: WHY HAVING TOO LITTLE MEANS SO MUCH* 83 (2013) [hereinafter MULLAINATHAN & SHAFIR, *SCARCITY*].

56. *Id.* at 84.

57. Shah et al., *supra* note 54, at 682.

1. Information Overload, Decision Fatigue, and the Bandwidth Tax

People rarely use an elaborate, multi-step process to make decisions, especially small-dollar decisions, because a complex decision-making process is both time consuming and mentally exhausting. Even people who only need to make a limited number of decisions will make some bad decisions if they are presented with too many choices. That is, people who have a seemingly unlimited supply of choices usually will not consider all of the options because of information overload.⁵⁸

While cash-flush individuals may act impulsively and irrationally or may suffer from information overload or decision fatigue,⁵⁹ financial scarcity increases the likelihood of an irrational decision.⁶⁰ Behavioral economists have observed that financial scarcity unconsciously “captures attention whether the mind’s owner wishes it or not and impedes the ability to focus on anything else.”⁶¹ They have also observed that financial scarcity imposes what has been called a “bandwidth tax.”⁶² The bandwidth tax occurs when people are forced to constantly focus on an immediate crisis, which causes them to ignore other decisions.

Given the stress involved in making decisions, cash-flush individuals should make better financial decisions than cash-starved individuals because they are not constantly forced to make decisions. As behavior scholars have noted: “When money is abundant, basic expenses . . . are handled easily as they arise. The expenses come and go, rarely requiring attention and hardly lingering on the mind.”⁶³ In contrast, when money is scarce people *constantly* think about money. They are forced to make numerous financial decisions and every spending decision, whether big- or small-dollar, seems pressing. The need to constantly make decisions compromises their bandwidth and makes it more likely that they will make bad financial decisions over time.⁶⁴

2. Tunneling

Cash-flush people are more likely to set goals and make financial decisions that lead to long-term benefits because money is not scarce. In contrast, cash-starved individuals often do not set long-term goals because they have so many short-term decisions to make.⁶⁵ Behavioral research shows how scarcity causes “tunneling,” or

58. See Claude Messner & Michaela Wänke, *Unconscious Information Processing Reduces Information Overload and Increases Product Satisfaction*, 21 J. CONSUMER PSYCHOL. 9 (2011).

59. ROY F. BAUMEISTER & JOHN TIERNEY, *WILLPOWER: REDISCOVERING THE GREATEST HUMAN STRENGTH* 90 (observing that “decision fatigue helps explain why ordinarily sensible people . . . splurge on clothes, buy junk food at the supermarket, and can’t resist the car dealer’s offer to rustproof their new sedan”).

60. Shah et al., *supra* note 54, at 685.

61. MULLAINATHAN & SHAFIR, *SCARCITY*, *supra* note 55, at 9.

62. *Id.* at 38, 158; see also BAUMEISTER & TIERNEY, *supra* note 59, at 69–70; Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 129.

63. Shah et al., *supra* note 54, at 682.

64. *Id.* at 684–85.

65. While it takes time and effort to thoroughly consider decisions, taking shortcuts inevitably causes people to make suboptimal decisions that solve an immediate

focusing on the most immediate and pressing financial need to the exclusion of others. When financial scarcity causes tunneling, people neglect long-term financial consequences because they are focused on finding ways to meet their pressing, short-term financial needs.⁶⁶

Tunneling causes cash-starved people to make bad short-term financial decisions out of sheer necessity.⁶⁷ Even though it is crucial for them to carefully consider their financial decisions, when cash-starved individuals are focused on one pressing need, such as getting money to reconnect utility service, they might forget to (or decide not to) take care of another short-term financial need, such as making a payment on a car loan or credit card, even though neglecting to pay a bill might have long-term negative financial consequences.⁶⁸ Tunneling also makes it harder for people facing financial scarcity to make and achieve long-term goals because they are constantly focusing on short-term financial crises and finding ways to pay for their current, basic needs.⁶⁹

When making a short-term decision to pay one bill but neglect others, cash-starved people often create bigger short- and long-term financial crises, increasing their short- and long-term costs. For example, a cash-starved person may rationally opt to pay for electricity rather than cellular phone service if someone in the household has a medical condition that could become life threatening without heat or air conditioning. But, an unintended consequence of foregoing cellular phone service may include loss of future earnings if the cash-starved person is unemployed and misses a call from a prospective employer.

Similarly, behavioral research shows that tunneling routinely prevents cash-starved homeowners from performing routine home maintenance, like repairing a roof or mending a broken fence. Instead, they focus on paying their mortgage debt and preventing a foreclosure sale. As sensible as this may be, bypassing routine maintenance ignores the long-term importance of properly maintaining the exterior appearance of a home and this short-term decision decreases the market value of the home and, ultimately, the homeowner's wealth.⁷⁰

C. Scarcity and Depleted Willpower

In addition to the stress caused by having too many options to consider, it takes an extraordinary amount of willpower to constantly and carefully evaluate every financial decision. Behavioral research indicates that constantly dwelling on ways to solve short-term financial crises deprives people of the mental resources they need to exercise self-control.⁷¹ It is especially hard for lower-income, cash-

problem but likely create a long-term problem. BAUMEISTER & TIERNEY, *supra* note 59, at 68–70.

66. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 29–30, 36.

67. BAUMEISTER & TIERNEY, *supra* note 59, at 68–70.

68. Research indicates that poor people may pay as much as 5% of their annual income on late fees and the costs to reconnect utilities and telephones. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 129–30.

69. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 7.

70. Shah et al., *supra* note 54, at 683.

71. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 158.

starved people to exercise self-control and avoid irrational or impulse spending because they are more likely to have easy access to their cash than cash-flush people.⁷²

Higher-income workers generally receive monthly wages that are directly deposited into an account at a traditional lending institution. In contrast, many lower-income workers are paid every week or every other week,⁷³ and lower-income workers (including migrant or immigrant families) who work in informal labor markets are often paid in cash.⁷⁴ People who receive their weekly earnings in cash will find it is harder to resist the urge to spend money, as people have a “greater tendency to spend cash in the wallet compared to funds deposited in the bank.”⁷⁵

In addition, cash-starved individuals frequently have their earnings with them because they are more likely to be unbanked—i.e., without checking or savings accounts.⁷⁶ Because their cash—even if meager—is readily available, they must exercise self-control every time they are paid in order to resist the temptation to spend (rather than save) money on items that, even if not luxurious, are not necessities.⁷⁷ Moreover, because of the tendency to spend rather than save quickly accessible cash, an unbanked person who has a long-term goal of saving to buy a high-dollar item (e.g., a house, car, or large appliance) must exercise extraordinary willpower to resist spending a large amount of accessible cash.⁷⁸

While exercising willpower to make informed decisions is intellectually and mentally taxing, it is important because people who fail to exercise willpower are more likely to succumb to an unwise or irrational spending temptation.⁷⁹ Just as financial scarcity makes the decision-making process stressful (because there are more decisions to make), financial scarcity makes it harder to exercise willpower because there are so many things to be resisted. Cash-starved people “can afford so little, so many more things need to be resisted, and [their] self-control ends up being

72. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 127.

73. *Id.* at 131.

74. JOHN P. CASKEY, BEYOND CASH-AND-CARRY: FINANCIAL SAVINGS, FINANCIAL SERVICES, AND LOW-INCOME HOUSEHOLDS IN TWO COMMUNITIES ii (1997), http://www.swarthmore.edu/Documents/academics/economics/beyond_cash_and_carry.pdf.

75. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 127–28, 135.

76. Jesse Bricker et al., *Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances*, FED. RES. BULL., June 2012, at 1, 26–33 (discussing how the poorer you are, the less likely you are to have a checking or savings account); *see also* Sherrie L.W. Rhine & William H. Greene, *Factors that Contribute to Becoming Unbanked*, 47 J. CONSUMER AFF. 27 (2013).

77. *See* Austin, *supra* note 19, at 1253 (explaining that borrowers may “pay several times the cost of an item” at a rent-to-own store because this may be “their only opportunity to participate in consumer culture by obtaining access to products that nearly everyone else enjoys”). In addition, people who keep cash rather than deposit it in a bank are not paid interest on their money and exposed to a greater risk of losing it to theft. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 127.

78. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 131 (“[A]ccessible cash can be extremely tempting and thus easy to spend on things that are most valued at the moment of spending.”).

79. ELLIEHAUSEN, *supra* note 14, at 23.

run down.”⁸⁰ Additionally, they spend so much time focusing on ways to pay for their purchases (big and small dollar) that their willpower is depleted, and they often succumb to the temptation to splurge.

As noted above, cash-flush individuals have the financial slack to make a few bad spending mistakes, and they do not experience the same stress of making financial decisions because they have fewer financial decisions to make. There is no escape for the cash starved. Cash-starved individuals must constantly make financial decisions and do not have the luxury of “tak[ing] a vacation from poverty.”⁸¹ They *always* think about how to pay for things.

D. Scarcity and Long-Term Planning

While cash-starved people often appear to make irrational short-term financial decisions, financial scarcity causes them to alter their preferred spending choices, like saving for retirement, because they must respond to more pressing financial crises, like reconnecting their electricity or preventing a foreclosure sale. For example, cash-starved people who unexpectedly receive a lump sum in cash (e.g., lottery winnings or work bonuses) have a tendency to spend rather than save that cash because of their concern that they may not have another opportunity to make those purchases.⁸²

A significant cognitive consequence of not having economic slack is that cash-starved people have little time or mental capacity to focus on developing future financial goals. Thus, rather than save for a purchase, cash-starved people try to alleviate their short-term financial crises by attempting to transform “small amounts of cash, which are easier to come by, into larger lump sums, which can be hard to attain.”⁸³ Likewise, rather than take the time to search for a low-cost loan, cash-starved people often borrow at high interest rates, even though this “pushes [them] deeper into scarcity.”⁸⁴

Finally, people facing financial scarcity often pay what has been called a “ghetto tax.”⁸⁵ Economists have documented that the poor often pay more for basic goods, like toilet tissue, because they cannot afford to buy a package and, thus, pay a higher unit price for a single roll of toilet tissue. Likewise, they often buy inexpensive but lower-quality products (e.g., clothing or furniture) that they will need to replace sooner because they do not have enough money to pay for the higher-quality goods. Finally, because they buy smaller quantities and products they will

80. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 159.

81. *Id.* at 148.

82. Hershfield et al., *supra* note 22, at 750; *see also* Griskevicius et al., *supra* note 27.

83. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 130. As discussed in more detail below in Section III.A, playing the lottery is one way poor people try to transform a small amount of money into a larger sum.

84. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 115.

85. Erick Eckholm, *Study Documents ‘Ghetto Tax’ Being Paid by the Urban Poor*, N.Y. TIMES (July 19, 2006), http://www.nytimes.com/2006/07/19/us/19poor.html?_r=0 (noting as an example of a ‘ghetto tax,’ “families making less than \$30,000 a year, paid an average of two percentage points more for car loans than did middle-class buyers”).

need to replace sooner, they must shop more frequently, which is less efficient and increases their transportation costs.⁸⁶

E. Cash Scarcity and Decision-Making

Cash-starved individuals often make financial decisions that appear to be irrational because they live in an environment where cash is highly valued. For example, many unbanked individuals avoid traditional lending institutions because they live in essentially a cash-only economy where they receive few noncash payments and have few expenses that they cannot pay for with cash.⁸⁷ Many cash-starved people participate in financial activities and informal labor markets that often operate on a cash-only basis. Those activities include paying friends, neighbors, or acquaintances to perform tasks like babysitting, repairing a fence, shoveling snow, or shopping at garage sales or flea markets.⁸⁸ In addition to worrying that they will need cash to participate in the informal economy, lower-income Americans have always had significantly higher un- and under-employment rates than higher-paid workers, and this gives them good reason to wonder whether they will have enough cash in the future to pay for goods or services in their cash-only economy.⁸⁹

People who live in an environment where cash is king may rationally decide to hoard cash and, instead, pay for purchases by borrowing, even if using cash or charging on a credit card might save them money.⁹⁰ For example, some payday borrowers who have credit cards choose to take out payday loans that charge higher fees than the interest the borrower would pay on the credit card because the borrower prefers to preserve liquidity on the credit card.⁹¹ Similarly, cash-starved people with unstable employment may decide to pay only the monthly minimum on credit card bills (though they will incur late fees) even if they can afford to make a higher monthly payment.

While it may seem irrational for someone to pay interest on an outstanding credit card balance if they can afford not to, that decision is rational to cash-starved people who live in environments where cash is scarce and valuable. Cash-flush people, on the other hand, generally have no need to view cash as a rare or precious commodity because they can be reasonably certain that their future earnings will give them access to cash if they need to participate in a cash-only transaction.

86. See THE BROOKINGS INST., FROM POVERTY, OPPORTUNITY: PUTTING THE MARKET TO WORK FOR LOWER INCOME FAMILIES (2006), http://www.brookings.edu/~media/research/files/reports/2006/7/poverty-fellowes/20060718_povop.pdf.

87. JOHN P. CASKEY, THE BROOKINGS INST. & HARVARD UNIV., BRINGING UNBANKED HOUSEHOLDS INTO THE BANKING SYSTEM (2002), <http://www.brookings.edu/~media/research/files/articles/2002/1/01metropolitanpolicy-caskey/caskey.pdf>.

88. Tim Slack, *Work, Welfare, and the Informal Economy: Toward an Understanding of Household Livelihood Strategies*, 38 J. CMTY. DEV. SOC'Y 26, 34 (2007).

89. *Employment Projections*, BUREAU OF LABOR STATISTICS, http://www.bls.gov/emp/ep_chart_001.htm (last visited Jan. 23, 2016).

90. VYSE, *supra* note 29, at 93.

91. Lusardi & de Bassa Scheresberg, *supra* note 39, at 6 (discussing research).

Moreover, because cash-flush people spend less time in cash-only labor markets, they do not need to hoard cash because the businesses they patronize are more likely to accept checks and credit cards.

Finally, research shows that people who grew up in financially scarce households make decisions because of that scarcity. For example, if they receive an unexpected influx of cash (e.g., inheritance, income tax refund, or lottery winnings), they are more likely to increase their spending—often significantly.⁹² Individuals who grew up in cash-flush households are more likely to use the unexpected cash to reduce debts or purchase tangible goods, while individuals who grew up in cash-starved households are more likely to spend the windfall on nondurable (e.g., food or entertainment) or luxury items, even if they continue to have pressing, unmet financial needs.⁹³

III. FINANCIAL DECISIONS AND CASH-STARVED AMERICANS

Cash-starved Americans make financial decisions that often make their already precarious financial situation worse. Typical examples include poor people who “invest” in lottery tickets, people who pay above-market fees to engage in basic financial transactions (e.g., cashing a check), or the disproportionate number of cash-starved Americans who take out high interest rate payday loans or high-cost subprime mortgages.

While these financial decisions may seem irrational, cash-starved people routinely make them for sensible reasons that nonetheless may be incomprehensible to people who are cash-flush. As the next Sections show, cash-starved people sometimes enter into high-cost or risky financial contracts and transactions out of need, convenience, or a failure to understand the risks associated with these transactions because of low financial literacy skills. Behavioral insights also can help explain why cash-starved individuals enter into high-cost and high-risk financial transactions: many underestimate the risks involved with the transactions and are overconfident about their ability to afford the costs imposed by these transactions.⁹⁴

A. *Playing the Lottery*

Research consistently shows that a disproportionate percentage of people who buy lottery tickets are poor and that, on average, poor people spend a larger percentage of their income on lottery tickets than middle- or higher-income people.⁹⁵ Because the odds of winning the lottery are notoriously low,⁹⁶ economists generally

92. Hershfield et al., *supra* note 22, at 750.

93. Griskevicius et al., *supra* note 27, at 201.

94. See Moulton et al., *supra* note 21, at 393 (finding that people who are overconfident about their “ability to pay off their debt are significantly less likely” to accept an offer to receive financial coaching).

95. Jens Beckert & Mark Lutter, *Why the Poor Play the Lottery: Sociological Approaches to Explaining Class-Based Lottery Play*, 47 SOC. 1152, 1153 (2012); Melissa Kearney, *State Lotteries and Consumer Behavior*, 89 J. PUB. ECON. 2269, 2273 (2005).

96. Edward J. McCaffery, *Why People Play Lotteries and Why It Matters*, 1994 WIS. L. REV. 71, 97.

conclude that people who play the lottery disconnect rationality when they gamble and then become rational again after they finish gambling.⁹⁷ Cash-starved people may play the lottery for reasons that appear irrational to people who have savings or predictably stable income.

Research indicates that cash-starved people sometimes view buying lottery tickets as a form of saving. Many purchase low-cost scratch-off tickets that have a relatively small jackpot (\$200–\$500), rather than tickets with a multi-million dollar payoff,⁹⁸ in an attempt to transform small dollars (the price of the ticket) into bigger sums (the jackpot). Though irrational, given the odds of winning, people who cannot (or do not believe that they can) save \$200 to make a larger purchase may play the lottery because they believe it is their best chance to earn enough money to solve their immediate financial crises.⁹⁹ Thus, they may be willing to spend small amounts each week to buy lottery tickets (even though the money could be saved or used for more basic needs) because of the tendency people have to yield to the temptation to spend a little as long as it does not derail their long-term plans too much.¹⁰⁰ In another behavioral explanation, cash-starved people may buy lottery tickets because they fail to understand the cumulative long-term negative consequences of buying these small-dollar tickets.

B. For-Profit Colleges

Paying for college tuition to earn a college degree is rational, given changes in U.S. labor markets and the competitive advantage a college degree now provides. Unfortunately, cash-starved people are more likely to attend (but not graduate from) colleges that are likely to leave them burdened with student loan debt. Specifically, poor people attend high-cost, for-profit colleges at disproportionately higher rates than people from middle- or higher-income households.¹⁰¹ Tuition at two-year for-profit colleges generally is lower than tuition at four-year private and public universities. But, for-profit colleges (whether two- or four-year) have significantly higher tuition rates than public community colleges.¹⁰²

A recent U.S. Senate investigation found that approximately 95% of students who attend for-profit schools finance their education with student loans, while only 60% of students who attend private not-for-profit colleges, 50% who attend public colleges, and 13% who enroll at two-year community colleges borrow to attend college.¹⁰³ In addition, while students at for-profit schools make up only

97. Serge Se'vigny & Robert Ladoucer, *Gamblers' Irrational Thinking About Chance Events: The 'Double Switching' Concept*, 3 INT'L GAMBLING STUD. 149, 149 (2003).

98. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 131.

99. *Id.*

100. *Id.*

101. Stephanie Riegg Cellini & Latika Chaudhary, *The Labor Market Returns to a For-Profit College Education*, 43 ECON. EDUC. REV. 125, 128 (2014) (“[T]he average income of a for-profit student is roughly \$15,000–20,000 less than a community college student.”).

102. *Id.* (reporting that tuition and fees at for-profit two-year colleges exceeded public community college expenses by five-fold).

103. See STAFF OF S. COMM. ON HEALTH, EDUC., LABOR, AND PENSIONS, 112TH CONG., FOR PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS (2012); see also JOEL BEST & ERIC BEST, THE

11% of the students in college, they receive a disproportionate share (approximately 25%) of student loan disbursements.¹⁰⁴ Since virtually all students who attend for-profit colleges pay their college tuition and fees using federal student loans, private for-profit colleges receive virtually all of their revenue from federal student loans.¹⁰⁵

The vast majority of students who attend for-profit colleges drop out and do not graduate with a degree.¹⁰⁶ Students who borrow to attend college but fail to receive a diploma have a bleak financial future for a number of reasons. First, the employment prospects of students who drop out of for-profit colleges are essentially the same as students who attend no college after graduating from high school. Second, these students have the burden of student loan debt—in contrast to debt-free high school graduates with comparable incomes.¹⁰⁷

Because even students who receive degrees from a for-profit college generally earn less than students who graduate from public community colleges, many now question whether a degree from a two-year, for-profit college is worth it given the significantly higher costs of obtaining that degree relative to costs at a community college.¹⁰⁸ In addition to lower earnings, research shows that students who attend for-profit colleges have higher unemployment rates than students who attend community colleges.¹⁰⁹ The combination of lower earnings and higher unemployment rates explains why students who attend for-profit colleges consistently have higher loan default rates.¹¹⁰ Specifically, while for-profit students make up only 11% of the students who attend college,¹¹¹ they account for 44% of total student loan defaults.¹¹²

Poor students are disproportionately represented at for-profit colleges for a number of reasons. First, low-income students with weak academic records may not be accepted to a public or not-for-profit private university. Similarly, they may attend high schools whose guidance counselors do not give one-on-one college advice to students perceived to be at-risk.¹¹³ Students may also choose to attend for-profit colleges because those institutions spend disproportionately more on recruitment than public colleges do, and they aggressively market and advertise their

STUDENT LOAN MESS: HOW GOOD INTENTIONS CREATED A TRILLION-DOLLAR PROBLEM 109 (2014); Cellini & Chaudhary, *supra* note 101, at 138.

104. BEST & BEST, *supra* note 103, at 115.

105. David Deming et al., *For-Profit Colleges*, 23 *FUTURE CHILD*. 137, 138 (2013); Richard Pérez-Peña, *Federal Lawsuit Accuses For-Profit Schools of Fraud*, *N.Y. TIMES*, Feb. 19, 2014, at A1.

106. BEST & BEST, *supra* note 103, at 107 (noting that in 2009 “only 22 percent of for-profit students enrolled in bachelor’s degree programs graduated within six years”).

107. *Id.* at 110; Patrick Denice, *Does It Pay to Attend a For-Profit College? Vertical and Horizontal Stratification in Higher Education*, 52 *SOC. SCI. RES.* 161, 162 (2015).

108. Cellini & Chaudhary, *supra* note 101, at 126.

109. Deming et al., *supra* note 105, at 141–42.

110. BEST & BEST, *supra* note 103, at 115; Deming et al., *supra* note 105, at 140.

111. Cellini & Chaudhary, *supra* note 101, at 129.

112. BEST & BEST, *supra* note 103, at 58.

113. *Id.* at 114 (discussing why at-risk students may end up borrowing to attend high-cost for-profit colleges).

ability to get students well-paid jobs after graduation.¹¹⁴ If lower-income students lack access to guidance counselors or family and friends who attended college, then they may be unable to evaluate whether a public community college would be a better and lower-cost educational option for them when they are recruited to attend for-profit colleges.¹¹⁵

Finally, some students may have been fraudulently induced to attend for-profit colleges. A recent government investigation found that employees of for-profit schools engaged in deceptive recruiting practices and often misled students about likely tuition costs and job prospects after graduation.¹¹⁶ The investigation found that students who attend for-profit college routinely fail to acquire marketable skills, training, or employment benefits in exchange for their relatively high student loan debt levels.¹¹⁷

One behavioral insight may also help explain why low-income students choose to attend for-profit colleges. Given the relatively low financial literacy rates of lower-income Americans, low-income students may be financially unsophisticated, may be overly optimistic about the potential benefits of attending a for-profit college, and may underestimate the costs to attend the for-profit college.

114. Deming et al., *supra* note 105, at 138–39; *see also* Rajeev Darolia et al., *Do Employers Prefer Workers Who Attend For-Profit Colleges? Evidence from a Field Experiment 5* (Nat'l Ctr. For Analysis of Longitudinal Data in Educ. Research, Working Paper No. 116, 2014). A U.S. Government report noted that, in 2009, for-profit colleges spent on average 22.7% of their operating budget on marketing, advertising, recruiting, and admissions staffing but only 17.2% on educational instruction. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-10-048T, FOR-PROFIT COLLEGES: UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES (2010), <http://www.gao.gov/assets/130/125197.pdf>.

115. *See* Pérez-Peña, *supra* note 105.

116. Deming et al., *supra* note 105, at 148; *see also* *For-Profit Schools: The Student Recruitment Experience: Hearing Before the S. Comm. on Health, Educ., Labor & Pensions*, 111th Cong. 10–38 (2010) (statement of Gregory D. Kutz, Managing Director, Forensics Audits and Special Investigations, Government Accountability Office).

117. Indeed, one recent report suggests that some students receive federal student loan aid to study for jobs they can *never* hold. *See* Pérez-Peña, *supra* note 105. For example, a recent lawsuit against a for-profit college alleges that the school accepted one student into its pharmacy technician certificate program, even though the student was a felon who could not be hired as a pharmacy technician, and allowed a convicted sex offender to participate in its massage therapy program, even though that conviction would prevent the student from becoming a licensed massage therapist. *Id.*

The U.S. Department of Education recently promulgated rules that are designed to make sure for-profit colleges actually prepare students for “gainful employment” in an actual occupation. Press Release, U.S. Dep't of Educ., Obama Administration Announces Final Rules to Protect Students from Poor-Performing Career College Programs (Oct. 30, 2014), <http://www.ed.gov/news/press-releases/obama-administration-announces-final-rules-protect-students-poor-performing-career-college-programs>. While this should help students who attend for-profit colleges in the future, the recent controversy involving the now insolvent Corinthians Colleges and the students who attended those for-profit schools (but refused to repay their student loans) illustrates the problems that have plagued students who have attended for-profit institutions.

C. Subprime Mortgages

Cash-starved individuals bought homes during the housing boom with low (or no) down payments using high-cost subprime mortgages that had low monthly payments and often required the borrower only to make interest payments.¹¹⁸ While there was no single cause for the housing market collapse, once the interest rates on cash-starved borrowers' subprime mortgage loans reset and unemployment rates increased to record high levels, borrowers were unable to afford their now higher monthly mortgage payments, and they lost their homes.¹¹⁹

Although buying a home with an unaffordable mortgage loan is not rational, behavioral insights can help explain why cash-starved renters may have been willing to buy homes that they could not afford. As previously mentioned, people have a tendency to underestimate their future expenses. Given this, some cash-starved individuals may have agreed to accept these high-cost subprime loans because they did not understand the mortgage terms and failed to realize that their monthly payments would skyrocket once the interest rates on their adjustable rate mortgages reset.¹²⁰ Similarly, some cash-strapped renters, when presented with the opportunity to convert a small amount of money (low initial mortgage payments) into a larger item (their own home), may simply have ignored the long-term costs for their subprime mortgages.

Some cash-starved borrowers who dreamed of living in their "own" home now, rather than save for a down payment, may have succumbed to the temptation to buy now and pay later. Others, who may have realized that they would never be able to save for a down payment or have sufficient and predictable disposable income to make the monthly loan payments, may nonetheless have decided that the short-term pleasure they would receive from being a homeowner outweighed the long-term risks associated with the high-cost subprime loan, even though that risk included losing their home to a foreclosure.

D. Alternative Financial Services

The alternative financial services industry (which includes payday lending, pawn or auto title lending, tax refund anticipation loans, rent-to-own shops, and check-cashing services) has grown dramatically since the 1990s. While middle- and higher-income Americans increasingly use these services, cash-starved people are more likely to use high-cost borrowing than people with financial slack.¹²¹ Despite the high costs associated with services offered by nontraditional financial lenders, cash-starved borrowers are less likely to have deposit accounts or obtain loans from the low-cost financial institutions and services that middle- and higher-income

118. A. MECHELE DICKERSON, HOMEOWNERSHIP AND AMERICA'S FINANCIAL UNDERCLASS: FLAWED PREMISES, BROKEN PROMISES, NEW PRESCRIPTIONS 75–77 (2014) [hereinafter DICKERSON, HOMEOWNERSHIP].

119. *Id.* at 81–84.

120. *Id.* at 105–06.

121. Lusardi & de Bassa Scheresberg, *supra* note 39, at 32. Recent research finds that approximately 25% of all Americans now use these high-cost financial services, though lower-income Americans are disproportionately likely to use the services. *Id.*

families patronize.¹²² Cash-starved people report that they do not use the lower-cost services provided by traditional banks for a number of reasons.

First, cash-starved individuals who carry a low balance in their checking accounts avoid traditional banks because of the monthly service fees these institutions assess accounts that fall below a certain balance. Employed cash-starved workers who need to cash their checks often use higher-cost check-cashing services because the check cashing fee is still lower than the monthly service fee traditional banks charge for accounts that have low balances.¹²³ Another reason cash-starved Americans rely on higher-cost, nontraditional financial service providers is their relative ease.

There are disproportionately fewer bank branches in low-income neighborhoods, which makes it harder for cash-starved people living in those areas to bank with a traditional bank.¹²⁴ Cash-starved people would make better borrowing decisions if they had access to lower-cost banking services given research that indicates that borrowers who meet with a bank representative are more likely to open a bank account.¹²⁵ Some cash-starved people also appear to avoid traditional banking services—even if the institutions are located in their neighborhoods—because they distrust banks, believe banks are meant to be used only by higher-income people, and think banking officers will judge them.¹²⁶

Behavioral insights can also help explain why cash-starved Americans may choose to use high-cost financial services products. Because, as noted earlier, people place a higher value on immediate rewards than delayed rewards,¹²⁷ cash-starved people may decide to use high-cost financial products like payday loans rather than wait and save enough money to purchase an item in the future. Tunneling and a lack of economic slack may also explain why cash-starved people engage in high-cost borrowing and why they pay more for basic financial transactions. That is, cash-starved individuals are always facing a financial crisis and focusing on ways to solve their current financial crises. Given this, they may choose to solve their present crisis

122. *Id.* at 3.

123. CASKEY, *supra* note 87, at 3.

124. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 133.

125. *Id.* at 138–39.

126. *Id.* at 133–34; *see also* CASKEY, *supra* note 87. Traditional lenders actually have an economic incentive to discourage cash-starved people from saving and to encourage them to borrow. Banks compete for cash-flush customers and favor their savings-accounts, because their disposable income allows them to save more and deposit more in their bank accounts. Because they have disposable income and often have assets they can pledge as collateral for a loan, the loans they receive from traditional banks typically have lower interest rates and are less risky because cash-flush individuals generally repay their loans on time and have lower deficiency or default rates.

In contrast, banks do not compete for the relatively unprofitable accounts of cash-starved people because they have little available cash and, thus, smaller savings account balances. Banks do, however, profit from the loans they offer to cash-starved people because the loans typically have higher rates of interest. In addition, because cash-starved borrowers are often delinquent on their payments, banks can assess late fees which makes this type of debt particularly lucrative to banks. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 134.

127. VYSE, *supra* note 29, at 63.

with the closest available financial products, even when the long-term costs of those products outweigh the present benefits of solving the immediate financial crisis¹²⁸

Given their structure and marketing, payday loans may be especially appealing to cash-starved people who need to access their future income to help resolve pressing cash-flow problems. Generally speaking, payday lenders give borrowers a cash advance on their next paycheck¹²⁹ if the borrower either agrees to give the lender access to his checking account or gives the lender what is essentially a post-dated check for the full balance of the loan.¹³⁰ Payday loans typically are for less than \$500 and are due in full on the borrower's next payday.¹³¹ Lenders charge a fee that usually ranges from \$10 to \$30 for every \$100 the person borrows.¹³²

While check-cashing fees are disproportionately higher than traditional bank fees, cash-starved households often cannot afford to pay the checking fees traditional banks charge their customers. That is, while banks do not charge their customers to cash checks, they will impose monthly fees on customer accounts that fail to maintain a minimum balance. Cash-starved people, who often are paid weekly or bimonthly, understandably choose to avoid opening accounts at traditional banks if they suspect they will not have sufficient funds in their accounts each month to avoid the monthly checking-account fee.¹³³ Thus, despite the high-costs associated with using a check-cashing service, employed cash-starved people who need to cash their payroll checks may rationally choose to use these services. In addition, cash-starved people may avoid using traditional banking services because of lender practices that place holds on deposited checks. This delay may be unappealing for cash-starved households who live paycheck-to-paycheck and need cash immediately to pay for a purchase or service.

Because people who grew up in financially distressed households are not optimistic about their future, it is not surprising that so many lower-income Americans enter into high-cost lending agreements. If the cash-starved conclude they have little to lose in the future, they might ignore the long-term costs associated with high-cost lending because of their pressing, immediate financial needs. In

128. Shah et al., *supra* note 54, at 683.

129. The Consumer Financial Protection Bureau describes payday loans in detail on its website. *What Is a Payday Loan?*, CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/askcfpb/1567/what-payday-loan.html> (last visited Jan. 23, 2016) [hereinafter *What Is a Payday Loan?*].

130. *Payday Loans*, FED. TRADE COMM'N (2008), <http://www.consumer.ftc.gov/articles/0097-payday-loans>.

131. *What Is a Payday Loan?*, *supra* note 129; PEW CHARITABLE TR., FRAUD AND ABUSE ONLINE: HARMFUL PRACTICES OF INTERNET PAYDAY LENDING (2014), http://www.pewtrusts.org/~media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf.

132. *What Is a Payday Loan?*, *supra* note 129; Lusardi & de Bassa Scheresberg, *supra* note 39, at 6. Even a relatively small fee of \$15 for a \$100 loan equates to almost 400% in annual interest, and some payday loans often have interest rates that exceed 1,000%.

133. Michael S. Barr, *Financial Services, Saving, and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey*, in INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT, AND BANKING AMONG LOW-INCOME HOUSEHOLDS 66, 75 (Rebecca M. Blank & Michael S. Barr eds., 2009).

addition, while payday loans and check-cashing services are high-cost, payday loans and check-cashing services are not economically irrational for a borrower who needs to repair the car he drives to work or who needs to cash her paycheck.

Payday loans are particularly appealing because they give borrowers immediate access to their next paycheck for what appears to be a modest charge.¹³⁴ Because cash-starved people typically focus on small-dollar figures and seek ways to convert small amounts into large amounts, they may view payday loans as a quick solution to a looming financial crisis—e.g., preventing a cellular phone or utilities from being disconnected. While payday borrowers may conclude that the benefits of having cash to prevent a crisis outweigh the costs associated with this form of lending, payday loans are particularly risky because of the tendency people have to underestimate their current debts and underpredict their future spending needs.¹³⁵

Because borrowers underestimate their ability to gather enough money to repay the initial loan, most payday borrowers cannot repay the loan in a lump sum. Instead, they pay only the fee/interest when the loan is due, renewing or rolling over the first loan into another payday loan.¹³⁶ Studies show that rollover payday loans exacerbate borrowers' existing financial situation by making it harder to pay other ongoing bills—e.g., rent, mortgage, or utilities.¹³⁷ Similarly, research indicates that payday borrowers have higher filing rates for chapter 13 bankruptcies.¹³⁸

E. Other Nontraditional "Borrowing"

While using a credit card to pay for goods and services over time has risks, credit cards are more highly regulated and generally not as high-cost as payday loans. Studies have found that some cash-starved people (especially those who have low levels of debt literacy) use payday lending—even though they could make the purchase at a lower cost using their credit cards—if they live in an environment where *cash is king*.¹³⁹

134. Skiba, *supra* note 18, at 1027. For a discussion of the typical payday-loan borrower, see Edward C. Lawrence & Gregory Elliehausen, *A Comparative Analysis of Payday Loan Customers*, 26 CONTEMP. ECON. POL'Y 299 (2008).

135. Shah et al., *supra* note 54, at 683. "Scarcity, of any kind, will create a tendency to borrow, with insufficient attention to whether the benefits outweigh the costs." *Id.* A recent study by Pew indicates that many payday borrowers use their federal tax refunds to repay payday loans. PEW CHARITABLE TR., PAYDAY LENDING IN AMERICA: REPORT 2, HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 37 (2013), [http://www.pewtrusts.org/~media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-\(1\).pdf](http://www.pewtrusts.org/~media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf). While it may be irrational to give the IRS an interest-free loan, this may be the way they are able to save money.

136. Skiba, *supra* note 18, at 1028, 1031.

137. Lusardi & de Bassa Scheresberg, *supra* note 39, at 7.

138. See Skiba, *supra* note 18, at 1040.

139. Lusardi & de Bassa Scheresberg, *supra* note 39, at 6 (discussing research); Hershfield et al., *supra* note 22, at 751. Behavioral research also indicates that some people buy goods on credit even though they could pay for the item with cash because they were worried that they would need the cash in the future and would not "have the discipline to replenish the liquid assets if they depleted them." ELLIEHAUSEN, *supra* note 14, at 6.

In addition, cash-starved people sometimes “borrow” money by deciding to pay bills late, or they “borrow” future earnings by reducing the amount of taxes that are withheld from their paychecks.¹⁴⁰ While deciding to engage in these forms of borrowing may help quench an immediate financial fire, the decision may create a bigger crisis if the person is forced to pay interest on the late fees, or if the worker has not saved enough money to pay taxes when they are due on April 15.

IV. THE FINANCIAL DECISIONS DEBTORS MAKE IN BANKRUPTCY

The Federal Judicial Center (“FJC”) conducts workshops annually that provide education and training for federal judges. I was asked to facilitate two recent workshops that considered the financial decision-making process cash-starved Americans use before and during bankruptcy cases.¹⁴¹ To frame the discussions, I asked bankruptcy judges to provide anonymous examples of what they perceived to be ridiculous financial decisions debtors made (or attempted to make) in cases assigned to them.

Most of the decisions involved a debtor’s attempt to agree to be legally bound to repay a debt—i.e., to reaffirm the debt—even though they could discharge the debt in their bankruptcy case.¹⁴² The decisions, listed below, display many of the irrational behavioral tendencies that cash-starved Americans exhibit outside of bankruptcy.

- A single parent of three young children sought to reaffirm a debt and keep a full-length fur coat even though paying for the coat would leave her no discretionary income.
- A debtor sought to reaffirm a debt for a Harley motorcycle because it had low gas mileage even though he could not afford the additional insurance that was required for the vehicle and he lived in an area of the country that frequently had ice and snow.
- Debtors sought to reaffirm loans for a speedboat and jet skis.
- A debtor who did not have enough income to repay a car loan sought to reaffirm the loan and pay for the car using money she would save by canceling her health insurance.
- A pregnant, unemployed debtor sought to reaffirm a loan for a car her boyfriend drove and pay for the car using money she would soon receive when her welfare payments increased after her baby was born.

140. Shah et al., *supra* note 54, at 682.

141. I facilitated the two workshops with the Hon. Shelley C. Chapman. My thanks to the bankruptcy judges who were members of the FJC’s bankruptcy best practices forum for providing these examples and to Denise Neary at the Federal Judicial Center for gathering these debtor vignettes.

142. See 11 U.S.C. § 524 (2012).

- A debtor sought to reaffirm a \$100/month rent-to-own debt for a 50" big screen TV rather than wait and save money to buy a new TV from a department store.
- A debtor sought to reaffirm a debt (\$50/month for 24 months) on a three-year-old computer rather than buy a new one because the debtor knew how to operate the older computer model.
- A debtor wanted to continue to make mortgage loan payments for a home she could no longer afford because the home had been in her family for three generations.
- A debtor wanted to continue making mortgage loan payments for a dilapidated and moldy home she could no longer afford because she wanted her child to grow up in that home.

These irrational decisions ostensibly support the views expressed by members of Congress during the BAPCPA hearings that consumer bankruptcy rates were soaring in the 1990s and early 2000s because debtors refused to exercise self-control.¹⁴³ But, as is true outside of bankruptcy, the dumb decisions these financially distressed debtors attempted to make likely had little to do with rational, opportunistic behavior. In fact, given how bizarre some of the decisions are, it is hard to imagine that the debtors were capable of behaving opportunistically. Behavioral insights can, however, help explain their decision-making process.

Many of the irrational decisions debtors attempted to make involved their attempt to keep their homes. This is not surprising given the role that homeownership plays in the lives of most Americans.¹⁴⁴ Jean observed years ago in a study on local legal culture that debtors often choose the more expensive chapter 13 over the quicker and cheaper chapter 7 because they want to try to keep homes and cars, even if they are in arrears on their mortgage or car loans and cannot afford to keep those items.¹⁴⁵ Given this, it is not surprising that so many debtors wanted to continue making payments on mortgages that were larger than the value of their homes. In addition, the behavioral insight about the emotional attachment people tend to have for the things they own can help explain why debtors would rather remain in a moldy and unaffordable house than lose the home even though the mortgage loan is unaffordable.

Other behavioral insights also help explain debtors' decisions. As noted earlier, making financial decisions is stressful (especially when finances are scarce), and cash-starved people tend to focus on small costs, often ignoring the larger consequences that might result from their small-dollar decisions. Given these insights, it is not surprising that a debtor might want to keep paying for an old computer that she understood how to use even though buying a newer one was much more rational. Likewise, the debtor who wanted to keep his Harley probably focused

143. See generally Dickerson, *Regulating Bankruptcy*, *supra* note 3.

144. See generally DICKERSON, *HOMEOWNERSHIP*, *supra* note 118.

145. Braucher, *Lawyers and Consumer Bankruptcy*, *supra* note 12, at 508–09.

only on the small costs associated with owning the item (gasoline) and disregarded the risk that having a motorcycle as the only source of transportation in a cold climate is not rational and might lead to bad and more costly consequences.

Finally, as noted earlier, people place an inordinately high value on the things they have and tend to focus on present consumption while underestimating future expenses. Given this, it is not surprising that a debtor would rather pay for something she can use now (the car) rather than pay for something (health insurance premiums) that might be useful for future expenses. Likewise, it is not surprising that debtors attempted to reaffirm debts for luxury items they could use in the present (e.g., the fur coat or the Harley) even though reaffirming future costs one cannot afford on an unnecessary item is not a rational financial decision.¹⁴⁶ Similarly, because the pain of losing something outweighs the pleasure people think they will receive from a similar replacement item, it is not surprising that a debtor would attempt to reaffirm a debt for a big-screen television or old computer, even though the sound financial decision would be to save money and buy a cheaper and better replacement item in the future.

V. HELPING CASH-STARVED PEOPLE MAKE BETTER FINANCIAL DECISIONS

A. Bankruptcy

Traditional economic models assume people are rational actors who consciously choose to engage in wealth-maximizing acts based on their belief that they will benefit from the behavior. But, as Jean observed, debtors and other cash-starved individuals are not “rational actors strutting across an economic stage.”¹⁴⁷ As Jean’s work on local legal culture demonstrated, the “administrative practices of judges and trustees, and prevailing professional attitudes” can substantially affect choices that debtors make in consumer bankruptcy.¹⁴⁸

Jean’s earlier work revealed that bankruptcy lawyers let their clients choose chapter 13 (which requires debtors to spend five years repaying pre-filing debts) rather than chapter 7 (which allows debtors to avoid repaying most of their pre-filing debts) even when a chapter 7 filing would have been a better financial choice for the debtor.¹⁴⁹ Her more recent work returned to the issue of chapter choice and revealed the disturbing fact that bankruptcy lawyers appeared to steer black clients to chapter 13, but discouraged white clients from repaying their debts in a five-year chapter 13 plan.¹⁵⁰ Bankruptcy professionals, including judges and attorneys, should consider behavioral-science insights when they are confronted with seemingly irrational decisions that debtors have made (or seek to make) and they should, if possible, prevent debtors from making irrational financial decisions.

146. See ELLIEHAUSEN, *supra* note 14, at 10–12.

147. Braucher, *Lawyers and Consumer Bankruptcy*, *supra* note 12; see also VYSE, *supra* note 29, at 64.

148. Braucher, *Lawyers and Consumer Bankruptcy*, *supra* note 12, at 503.

149. *Id.* at 509.

150. See Jean Braucher et al., *Race Disparity in Bankruptcy Chapter Choice and the Role of Debtors’ Attorneys*, 20 AM. BANKR. INST. L. REV. 611 (2012).

The BAPCPA-mandated financial education courses¹⁵¹ require consumer debtors to take courses only from approved nonprofit budget and credit counseling agencies.¹⁵² While bankruptcy lawyers are not allowed to provide the statutorily mandated financial education, Jean strongly believed that bankruptcy lawyers should help their clients make better financial decisions. In addition to counseling clients about the need to budget and prepare for major financial events, like retirement or paying for their children's college, Jean believed that lawyers have a duty to help their clients understand the difference between what they may perceive as a moral obligation to repay their debts, and the fact that they have no legal obligation to repay debts that can be discharged in bankruptcy.¹⁵³

Jean also urged lawyers to help their clients learn from their past mistakes by exploring their clients' "place in the social institution of consumer credit and their social situation more generally."¹⁵⁴ As Jean noted in one of her articles on chapter choice:

Bankruptcy can be presented as an opportunity to rethink how a person should try to live in a culture both socially insecure and materialistic. A lawyer need not turn client counseling into a seminar on the work of Max Weber to raise some of these themes in a down-to-earth way. Rather than focusing on getting new credit in the future, lawyers will better serve debtor clients if they stress saving as crucial to future financial health and stability.¹⁵⁵

Lawyers might choose not to discourage their clients from repaying their debts over a five-year period in chapter 13 if the lawyer assumes that the debtor wants to do whatever it takes to keep a car or home. Or lawyers might be willing to go along with their client's choice to repay their debts in chapter 13 because that decision might fulfill what the client thinks is a moral obligation to repay debts. As the examples from the FJC workshop show, however, debtors often erroneously believe that they will be able to afford monthly payments on things (e.g., homes, jet skis, or fur coats) they have and want to keep. Rather than allow debtors to make bad financial decisions in bankruptcy, both courts and lawyers should discourage debtors who are eligible for a chapter 7 discharge from filing for chapter 13 and should discourage them from reaffirming otherwise dischargeable debts. Judges and lawyers should recommend that debtors discharge the debts and, if they choose, voluntarily repay those debts without being legally bound to do so.¹⁵⁶

151. See 11 U.S.C. §§ 109(h)(1), 727(a)(11), 1328(g)(1) (2012).

152. *Id.* § 111(a).

153. Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices—a Question of Professional Responsibility*, 5 AM. BANKR. INST. L. REV. 165, 191–93 (1997).

154. *Id.* at 192.

155. *Id.* at 193.

156. See *id.* Given the reasons cash-starved people predictably make bad financial decisions, bankruptcy lawyers must remain diligent in counseling their clients and steering them to the bankruptcy chapter that will give the client the best financial relief. And, lawyers

Future bankruptcy reform efforts should incorporate behavioral insights and reflect why cash-starved people often make bad financial decisions. Notwithstanding BAPCPA's attempt to make debtors behave more responsibly, consumer debt levels have remained high, and cash-starved Americans continue to struggle financially. If the goal of bankruptcy reform is to help debtors make better spending choices, the bankruptcy process should include techniques that respond to debtors' behavioral tendencies.

For example, as noted earlier, cash-starved people focus on the present and most Americans have difficulty predicting economic expenses that are too far in the future. In addition, behavioral research indicates that even when cash-starved people save, they often save for a specific purpose (e.g., to buy birthday presents or replace tires on their cars) rather than saving for the sake of saving.¹⁵⁷ Rather than continue to find ways to make bankruptcy more stigmatizing, Congress should find ways to provide immediate positive rewards for debtors who make rational financial decisions (e.g., choosing not to reaffirm consumer debts, avoiding payday loans, or completing a long-term financial education course). The reward could consist of a shorter chapter 13 repayment plan or the ability to discharge or restructure an otherwise dischargeable debt (e.g., student loans or mortgage debt). Structuring bankruptcy laws to give debtors periodic rewards if they make rational decisions during their bankruptcy cases would help them see the benefits of exercising self-control and avoid overspending because there would be a relatively short period between good behavior and receiving the reward.¹⁵⁸

B. Non-Bankruptcy Solutions

1. Expanding Lending Opportunities

Research shows that being banked and having a checking account increases the likelihood that a person will avoid extravagant spending, follow a budget, and pay credit card debts in full each month.¹⁵⁹ Likewise, people who have access to traditional banks and loan officers are more likely to be able to qualify for low-cost consumer loans, including mortgage loans.¹⁶⁰ Cash-starved people, especially if they are black or Latino, are significantly less likely to live in neighborhoods that have traditional bank branches. As noted earlier, because they are less likely to be banked, they are more likely to rely on higher-cost financial services providers (e.g., payday

who steer clients to the longer and more expensive chapter 13 process based on the race of the clients must guard against providing this (and any other) race-biased advice.

157. Shah et al., *supra* note 54, at 684.

158. Cf. Bruce J. Winick, *Harnessing the Power of the Bet: Wagering with the Government as a Mechanism for Social Change and Individual Change*, in *ESSAYS IN THERAPEUTIC JURISPRUDENCE* 219, 235–37 (David B. Wexler & Bruce J. Winick eds., 1991).

159. EVERFI & HIGHER ONE, *MONEY MATTERS ON CAMPUS: HOW EARLY ATTITUDES AND BEHAVIORS AFFECT THE FINANCIAL DECISIONS OF FIRST-YEAR COLLEGE STUDENTS* 12 (2013), <http://moneymattersoncampus.org/wp-content/uploads/2013/02/Money-Matters-on-Campus-Final-Report.pdf>.

160. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 138–39.

lenders or check-cashing services) even though those providers charge fees that are significantly higher than the fees banks charge for checking and savings accounts.¹⁶¹

Cash-flush people have easy access to traditional banks because those institutions are conveniently located for people who live in or near high-income neighborhoods.¹⁶² Similarly, because cash-flush people often have savings or assets (e.g., homes, businesses, or investments) that they can pledge as collateral, their borrowing costs are lower. Thus, even if they face an emergency or need credit to finance a larger purchase, they are more likely to have access to low-cost credit, and this lending option makes it easier for them to make better financial decisions.

Unless cash-starved people have more convenient and less expensive financial services options, they will continue to borrow from payday lenders, cash their payroll checks with check-cashing services, and buy consumer goods on credit from rent-to-own companies. Traditional banks maintain that it is not profitable for them to operate branches in lower-income neighborhoods because customers in those areas maintain low account balances and take out fewer (and smaller) loans.¹⁶³ One way to incentivize traditional banks would be to allow them to open what one scholar has described as bank “outlets.”¹⁶⁴

In addition to providing traditional banking services, bank outlets should offer low-cost check-cashing services. Though their fees should be lower than those charged by check-cashing stores, the additional revenue should help the bank outlet’s profitability. In addition, the outlet should offer savings accounts that allow cash-starved people to save small amounts. Banks should also offer deposit-secured, small-dollar loans to customers who maintain savings in the bank outlets, which could decrease cash-starved Americans’ reliance on high-cost payday loans.

Another way to make bank outlets more profitable would be to mandate that all paychecks be automatically deposited into an account at a highly regulated traditional bank. In addition to increasing the amount of deposits for bank outlets and helping cash-starved workers avoid check-cashing businesses, requiring all employers to deposit their workers’ wages into a bank account would prevent the workers from keeping their earnings in cash, which should help them save more.¹⁶⁵ Finally, to help their customers learn how to make better financial decisions, the bank outlet could partner with community groups to offer financial literacy

161. For example, while most check-cashing services process checks that have very little risk of nonpayment—e.g., employer-issued payroll checks or government checks—they charge fees that can be upwards of 3% of the check’s face value. Michael S. Barr & Rebecca M. Blank, *Savings, Assets, Credit, and Banking Among Low-Income Households: Introduction and Overview*, in INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT, AND BANKING AMONG LOW-INCOME HOUSEHOLDS 1, 3 (Rebecca M. Blank & Michael S. Barr eds., 2009).

162. *Id.*

163. CASKEY, *supra* note 87, at 5.

164. *Id.* at 4–8.

165. One limitation of this proposal is that many cash-starved workers are employed by businesses that do not offer direct deposit because of the cost and time it takes for the businesses to set up the procedure or because there is high employee turnover. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 128.

education that incorporates behavior insights about how scarcity affects the decision-making process.¹⁶⁶

2. Commitment Strategies

One way to make it easier for people to make better financial decisions would be to remove some of their choices. But because Americans revere the freedom of choice, reducing choices simply is not a feasible option. However, encouraging cash-starved individuals to voluntarily commit to do things that protect them from bad future consequences (i.e., “commitment” strategies) can reduce options without placing barriers between the buyer and her purchases.¹⁶⁷

Research (and common sense) shows that people are more likely to exercise self-control if they pre-commit to an activity or course of conduct that makes it harder for them to engage in a harmful activity.¹⁶⁸ Common nonfinancial examples include alcoholics who avoid cocktail parties; dieters who will not keep desserts, potato chips, or other high-calorie foods in their homes; and ex-smokers who avoid places where smoking is allowed and do not let people bring cigarettes into their homes. Commitment strategies also could work well to help cash-starved people avoid tempting financial transactions that could harm them in the future.

To help people save more and make better financial choices, it needs to be harder for them to access their money. As noted earlier, people prefer to spend in order to have and use things in the present rather than save and wait to have more beneficial things in the future. In addition, buyers are also more likely to engage in impulse spending when it is easy to spend. Given this, techniques that make it harder for people to have cash on them should slow their spending and give them more time to think about their spending choices.

Existing financial options that make it harder for people to access their money are both quaint and recently created. Quaint examples include participating in a Christmas club account that forces a person to save small amounts each month to ensure there is enough money at the end of the year to buy presents. Another example, which is becoming fashionable again, is layaway accounts. An increased use of layaway buying has particularly strong benefits because layaway allows the cash-starved to transform small amounts of cash into a larger sum that they can use to buy a big-ticket item.

With a typical layaway plan, a buyer deposits a relatively small amount of money (\$10 or 10% of the total purchase) to purchase an item (or group of items) from a store. The buyer then makes a series of regular payments and eventually purchases the items at some point in the future. The money buyers deposit in their layaway “accounts” does not accumulate interest in the way that money deposited in a bank does. But, once buyers give the store the deposit, those funds become illiquid and—in most instances—at least part of the deposited funds become nonrefundable, even if the buyer does not save enough money to purchase the

166. These, and other suggestions, are discussed in more detail in CASKEY, *supra* note 87.

167. VYSE, *supra* note 29, at 79–82.

168. ELLIEHAUSEN, *supra* note 14, at 22 (discussing empirical evidence).

desired durable good.¹⁶⁹ Given the difficulties the cash-starved face when trying to save money, whether because of lack of self-control or the inaccessibility and expense of traditional financial institutions, layaway accounts are a promising way to help the cash-starved make better financial decisions.

The United States already deposits most federal funds (e.g., military pensions and social security payments) directly into bank accounts. To help curb the tendency people have to spend a windfall like a tax refund, the IRS should be required to deliver the refund in smaller sums and in a form that makes it harder for the person to spend the entire lump sum at one time, such as a low-cost prepaid card.¹⁷⁰

In addition, the government should encourage employers to deposit wages directly into workers' bank accounts, especially if traditional banks are willing to open outlets that provide relatively low-cost financial services for cash-starved Americans. Direct deposits make it harder for the recipient of the cash to get access to their money because they must either go to a bank or find an ATM to withdraw money from their account. This additional step places time between the receipt of and access to the cash benefit, and the additional time gives people the opportunity to reflect on their decision to spend (or save) the money.

Requiring all employers to automatically deduct money from workers' paychecks and deposit it in retirement savings accounts would also help workers spend less and save more. President Obama's 2015 Executive Order on behavioral science notes that "automatic enrollment and automatic escalation in retirement savings plans have made it easier to save for the future, and have helped Americans accumulate billions of dollars in additional retirement savings."¹⁷¹ Other research similarly confirms the assumption that automatic enrollment options help increase retirement savings,¹⁷² especially for low-income and black and Latino employees.¹⁷³

One challenge with requiring automatic enrollment in retirement savings plans is that lower-income workers are less likely to work for a company that offers a retirement plan that makes automatic deposits into a 401(k) or other tax-deferred retirement account. Last year, the federal government created *my* Retirement Account ("*myRA*") to respond to that challenge.¹⁷⁴ As long as the worker's employer offers direct deposit and can direct part of the paycheck to the *myRA*, lower- and middle-income workers can deposit money in a *myRA*. The account does not charge the worker an opening fee or maintenance fees, and the worker is not required to make a minimum contribution. Because the worker owns the account, even if she moves to a new job, she can continue to contribute retirement savings in the account.

169. For a typical example of a layaway plan, see *Layaway*, WALMART, <http://www.walmart.com/cp/Layaway/1088466> (last visited Jan. 24, 2016).

170. Hershfield et al., *supra* note 22, at 750 (discussing ways to encourage people to save rather than spend a sudden influx of money).

171. Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 15, 2015).

172. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 124.

173. Barr & Blank, *supra* note 161, at 5.

174. *About myRA*, U.S. DEP'T OF THE TREASURY, MYRA, <http://myra.gov/about/> (last visited Jan. 24, 2016).

Creating opportunities for people to make better financial decisions that will help them avoid unnecessary spending and save for the future does not come without cost. For example, because many smaller employers do not offer direct deposit for their employees due to the costs associated with setting up the program, the government may need to give these employers some type of financial assistance, perhaps in the form of tax incentives, to make it more administratively and financially feasible for them to offer direct deposit. Nonetheless, the financial commitment strategies discussed are simple examples of non-bankruptcy solutions that can help cash-starved Americans avoid the behavioral tendencies that cause them to make unwise financial decisions.

3. Financial Literacy Education

Research shows that Americans “are ill-informed about the basic concepts related to debt and debt management” and that people routinely fail to take advantage of beneficial financial opportunities because they do not understand the complexities of the financial transaction.¹⁷⁵ For example, homeowners often fail to refinance high-interest mortgage loans even when it is profitable to do so,¹⁷⁶ and Truth in Lending Act (TILA) disclosures are still largely impenetrable to most buyers even though those forms have been repeatedly simplified.¹⁷⁷

Lower- and middle-income Americans, in particular, have lower levels of financial literacy and have a difficult time calculating how much it will cost them to buy an item on credit (including interest and, potentially, late fees).¹⁷⁸ Research consistently shows that people with lower levels of financial literacy are more likely to have high debt levels, lower household wealth,¹⁷⁹ and lower savings.¹⁸⁰ Moreover, there is a high positive correlation between people with low levels of financial literacy and people who use high-cost, less-regulated, alternative financial services providers (e.g., check cashers, rent-to-own companies, payday lenders, auto title lenders, and pawn shops).¹⁸¹

175. Lusardi & de Bassa Scheresberg, *supra* note 39, at 4.

176. Keys et al., *supra* note 25.

177. ELLIEHAUSEN, *supra* note 14, at 32.

178. *Id.*; see also Anders Anderson et al., *Optimism, Financial Literacy and Participation* (Nat’l Bureau of Econ. Research, Working Paper No. 21,356, 2015). Research shows that the people who are most likely to rely on high-cost borrowing are middle-to lower-income, not white, and are divorced or separated. However, even middle-income Americans (those earning between \$50,000 and \$75,000) are now purchasing basic goods and paying for routine services using high-cost loans because they do not have rainy day savings. Lusardi & de Bassa Scheresberg, *supra* note 39, at 14.

179. Anderson et al., *supra* note 178; see also Declan French & Donal G. McKillop, *Financial Literacy and Over-indebtedness in Low-Income Households* (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2505084.

180. Annamarie Lusardi & Peter Tufano, *Debt Literacy, Financial Experiences, and Overindebtedness* (Nat’l Bureau of Econ. Research, Working Paper No. 14,808, 2009), <http://www.nber.org/papers/w14808>.

181. See KENNETH TEMKIN & NOAH SAWYER, THE URBAN INST. METRO. HOUS. & CMTYS. POLICY CTR., ANALYSIS OF ALTERNATIVE FINANCIAL SERVICE PROVIDERS (2004), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/410935-Analysis-of->

Research also indicates that people who are not financially literate may make a bad financial decision because they focus on the bottom line: what they must pay each month. People often focus on a monthly (rather than total) payment because they are incapable of determining the total payment over time and are not comfortable focusing on larger numbers.¹⁸² Because they are more comfortable focusing on a smaller figure (e.g., the monthly minimum credit card payment), the cash-starved often make financial decisions that are affordable in the short-term even though other options may be less expensive in the long-term.¹⁸³

Recent survey results reveal, however, that most people who are woefully illiterate about basic concepts related to debt are overconfident about their ability to make good financial decisions about debt.¹⁸⁴ Indeed, most people have biased beliefs and perceptions about their own abilities and suffer from a form of the “Lake Wobegon” syndrome in thinking that they are more financially literate than they actually are.¹⁸⁵ The survey showed that people who did not understand fairly basic financial concepts nonetheless felt that their debt literacy was above average. People who have an unwarranted self-confidence are more likely to make bad financial decisions; this may explain why debtors who could discharge their debts in chapter 7 might attempt to repay those debts based on their erroneous assumption that they actually can afford to keep their homes, cars, or other possessions.

Many states now mandate that students display a basic level of financial literacy before they graduate from high school, though it is unclear whether these courses incorporate behavioral insights about why people make bad financial decisions.¹⁸⁶ In addition, BAPCPA now requires debtors to complete a financial education course before they can file for bankruptcy and then must complete another financial education course before they receive a discharge of their debts.¹⁸⁷ These courses, even if useful,¹⁸⁸ are unlikely to help cash-strapped debtors make better financial decisions unless the courses apply behavioral-science insights.

Financial education courses must do more than just tell people why they should pay their bills or why they should construct and adhere to a budget.¹⁸⁹ An effective financial literacy course must take into account behavioral insights that help the cash-starved understand how much money they have, what they realistically

Alternative-Financial-Service-Providers.PDF; *see also* Lusardi & de Bassa Scheresberg, *supra* note 39, at 15–18.

182. ELLIEHAUSEN, *supra* note 14, at 14.

183. Mullainathan & Shafir, *Savings Policy*, *supra* note 30, at 141.

184. Anderson et al., *supra* note 178, at 3.

185. *Id.*; *see also* Moulton et al., *supra* note 21, at 393.

186. Carly Urban et al., *State Financial Education Mandates: It's All in the Implementation*, FINRA INV. EDUC. FOUND., Jan. 2015, <http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p602380.pdf>.

187. 11 U.S.C. § 524 (2012).

188. Empirical research indicates that these mandatory debtor education courses are ineffective. Michael D. Sousa, *Just Punch My Bankruptcy Ticket: A Qualitative Study of Mandatory Debtor Financial Education*, 97 MARQ. L. REV. 391 (2013).

189. Moulton et al., *supra* note 21, at 379–80 (discussing mixed successes of homeownership education programs).

will need to spend in the future, why they spend, and why they do not save. While a budget can *tell* people what they cannot afford, even the most meticulously drafted budget cannot *prevent* people from buying things they cannot afford. Likewise, showing the cash-starved how to build a better budget will not help them change their attitude toward saving and spending.

Whether the program is administered by high schools, employers, or universities, a well-designed financial education also should reflect that financial scarcity impairs financially distressed people's bandwidth and that tunneling makes it harder for them to make good financial decisions.¹⁹⁰ A more behavioral approach to financial education would help cash-starved individuals understand that they may make bad financial decisions (e.g., using high-cost, nontraditional financial services) because they are focusing on their immediate financial fire and may have assumed that traditional banks or other forms of low-cost lending are not suitable for their needs.

Rather than telling the cash-starved how to build a better budget, a financial literacy program would teach participants the importance of understanding and resisting the behavioral tendency to focus on the present. Likewise, a behaviorally inspired financial literacy program would show students why they tend to spend and not save money from unexpected income windfalls and why they tend to underestimate both their current debts and future needs. Similarly, the program should help students understand the tendency to focus on small figures (e.g., a monthly minimum credit card payment or the cost of a lottery ticket) and explain the cumulative long-term negative consequences of doing so.

To help students create a budget that recognizes their tendency to buy things "now," even when that decision harms them in the future, the financial literacy program would teach students how to set a small number of financial goals. Those goals could include practical long-term ones (e.g., saving for retirement) and shorter-term "fun" goals (e.g., saving money to buy Christmas presents) that are easily attainable and provide benefits the person can enjoy relatively soon. The budget should allocate future funds (including unexpected windfalls) to those pre-determined goals, with the bulk of the funds being allocated to the more serious financial goals.

Designing and providing a financial education that incorporates behavioral insights will not alone make financially stressed people make better decisions. But a financial literacy course that clearly explains the cash-starved person's current financial situation should help them avoid the tendency to underestimate their current debts and their future expenses. Likewise, a financial literacy course that reveals the cognitive consequences of financial scarcity and proposes ways people can avoid those consequences should help the cash starved understand the importance of self-control and saving, and should help them avoid at least some unaffordable financial transactions.

190. MULLAINATHAN & SHAFIR, SCARCITY, *supra* note 55, at 162.

CONCLUSION

While some cash-starved Americans may fit the model of a rational economic actor, others make bad financial decisions for reasons that have little to do with rational thinking. Rather than assume that the financial decisions cash-starved individuals make are opportunistic and designed to take advantage of creditors, judges and policymakers should view their unwise spending choices with a “cognitive lens, informed by scarcity considerations.”¹⁹¹ While many aspects of the Bankruptcy Code are premised on the view that debtors intentionally run up their debts and then file for bankruptcy to avoid paying them, the recent research on how people behave when they face financial scarcity shows why bankruptcy laws will never succeed in helping financially distressed Americans make better choices as long as the laws ignore the cognitive consequences of financial scarcity.

191. *Id.*