

Lessons from Product Safety Regulation for Reforming Consumer Credit Markets in Japan and Beyond

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Abstract

The Global Financial Crisis has prompted belated re-regulation of consumer credit markets in major economies worldwide, but much work remains in progress, and Japan had already re-regulated in 2006. This article first summarises our better understanding nowadays about the operation of these markets in various jurisdictions, including Japan, as a basis for better policy-making. Chicago School economics has been further discredited; information economics and especially behavioural economics provide more compelling explanations and recommendations. Cultural risk cognition studies and related political theory also provide important insights. However, these fields of study mainly provide empirically-informed normative perspectives justifying *why* we should re-regulate consumer credit services. Consequently, this article also takes a closer look at *how* to do so. In particular, it teases out analogies with contemporary regulation securing the safety of tangible consumer *products*, and calls for a new duty on lenders to notify regulators of abnormal problems arising from *services* they have supplied. This should make the ‘regulatory enforcement pyramid’ both more effective and legitimate, reducing the potential for further financial crises.

I Post-Crisis Financial Markets Re-regulation

‘*Ought*, it is said, implies *can*’.¹ So writes Dan Kahan of Yale Law School, co-director of its ‘Cultural Cognition Project’. The saying is commonly attributed to

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Immanuel Kant,² although that 18th-century German philosopher was hardly renowned for pithy aphorisms. He developed this principle as part of an elaborate moral theory, focused more on the individual. But we share Kahan's broader intuition that *normative* recommendations for public policy should be *empirically informed* — if not, necessarily, empirically determined.

The Global Financial Crisis ('GFC') in 2008, and ensuing economic recession, have called into question many conventional understandings about financial markets — in particular, that 'reputable firms do not place risky products on the markets, that innovation is stifled by regulation and that regulators are not as well placed as the market to judge the value of products'.³ Pre-GFC laissez-faire approaches, and 'light-handed' or 'principles-based' regulation, are being reassessed. This has been most evident at the 'wholesale' end of the market, namely in how financial institutions raise funds — by on-selling consumer loans through securitisation, for example. But attention has also turned to the inter-related 'retail' end — how firms lend to consumers in the first place.⁴

In the US, the Obama Administration committed to establishing what was to become in October 2010 the 'Consumer Financial Protection Bureau' ('CFPB'), belatedly bringing together and strengthening disparate regulatory powers over consumer lending.⁵ In the UK, the government announced in July 2010 the creation of a new 'Consumer Protection and Markets Authority' ('CPMA'). The CPMA is expected to 'take a tougher, more proactive and more focused approach to regulating conduct in financial services and markets than has the FSA' ['Financial Services Agency'], whose functions it will take over as the FSA is now seen as having been too lax in regulating the mortgage loan market.⁶ The Treasury (the UK's economics and finance ministry) also proposes bringing within the CPMA the powers of the Office of Fair Trading over other consumer credit (unsecured loans, credit card lending, and the provision of goods or services on

¹ Dan Kahan, 'The Cognitively Illiberal State' (2007) 60 *Stanford Law Review* 115, 154 (emphasis added). See generally <<http://research.yale.edu/culturalcognition>>.

² See, eg, Paul Guyer, *Kant, Immanuel* (2004) *Routledge Encyclopedia of Philosophy* (online) <<http://www.rep.routledge.com/article/DB047SECT11>>.

³ Iain Ramsay and Toni Williams, 'The Crash that Launched a Thousand Fixes: Regulation of Consumer Credit after the Lending Revolution and the Credit Crunch' in Kern Alexander and Niamh Moloney (eds), *Law Reform and Financial Markets* (Edward Elgar, 2011) 221, 222, citing Lord Turner, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (Financial Services Authority, 2009). See also United States, Financial Crisis Inquiry Commission, *Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (2011) ('*Financial Crisis Inquiry Report*'); and, more generally, John Farrar, 'The Global Financial Crisis and the Governance of Financial Institutions' (2010) 24 *Australian Journal of Corporate Law* 227.

⁴ For more on the (belatedly evident) inter-linkage between the two, see John Coffee, 'Financial Crises 101: What Can We Learn from Scandals and Meltdowns — from Enron to Subprime?' in R P Austin (ed), *The Credit Crunch and the Law* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2008) 36, 50.

⁵ Compare Adam Levitin, 'The Consumer Financial Protection Agency' (Georgetown Law and Economics Research Paper No 1447082, Georgetown Law Faculty, 2009) 144 with Consumer Financial Protection Bureau, *CFB — Consumer Financial Protection Bureau*, Consumer Financial Protection Bureau <<http://www.consumerfinance.gov>>.

⁶ HM Treasury, Department for Business Innovation & Skills, *A New Approach to Financial Regulation: Consultation on Reforming the Consumer Credit Regime* (December 2010) 7.

credit), which is currently outside the FSA's jurisdiction. This market segment had already been reformed in 2010 partly to implement a revised *Consumer Credit Directive* (2008/48/EC) from the European Union (EU).⁷ Even Australia, more sheltered from the GFC thanks largely to a mining boom and close economic links with more buoyant Asian markets, has enacted a more harmonised national consumer credit regime. It is centred on the *National Consumer Credit Protection Act 2009* (Cth) ('*NCCP Act*'), and is underpinned also by the *Australian Consumer Law* (schedule 2 of the *Australian Competition and Consumer Act* (Cth), as amended in 2010) which regulates unfair terms in consumer contracts generally.⁸

Especially in the US and the UK, however, these reforms have tended to focus on filling in gaps in coverage and on merging regulatory functions. Fewer attempts have been made to introduce new regulatory tools, or to engage in fundamental re-evaluations of the empirical and theoretical grounds for credit regulation. Japan, therefore, provides an interesting comparative reference point, as it comprehensively re-regulated unsecured consumer credit markets even before the GFC. Amendments to the previous legislation (Law No 32 of 1983) by Law No 115 of 2006, which renamed the principal statute as the *Moneylenders Law*, adding new disclosure and 'responsible lending' requirements. The amendments also brought down a statutory interest cap, to between 15 and 20 per cent (depending on the size of the loan). It is no longer possible to charge higher 'grey zone' interest under certain conditions, as had been provided in the 1983 legislation.⁹ Interest rate caps also remain common in other jurisdictions influenced by the 'civil law' tradition, but had been undermined in the US since the 1980s, and are still not harmonised across Australia. The UK abolished caps as long ago as 1854, and the government decided not to reintroduce them in 2005, but the issue is now again under review.¹⁰ Generally, interest rate controls have proven controversial because they put in stark relief a basic problem in consumer lending markets. How should policy makers reconcile private interests (including the availability of credit to tide over cashflow difficulties experienced temporarily by consumers) with public interests (a competitive and fair market)?¹¹

⁷ Ibid 9; see also David Kraft, 'Private Law Control of Consumer Credit in the United Kingdom' in Christian Twigg-Flessner et al (eds), *Yearbook of Consumer Law 2008* (Ashgate, 2007) 403.

⁸ Gail Pearson and Richard Batten, *Understanding Australian Consumer Credit Law: A Practical Guide to the National Consumer Credit Reforms* (CCH, 2010); Stephen Coronos, *The Australian Consumer Law* (Thomson Reuters, 2011).

⁹ Souchirou Kozuka and Luke Nottage, 'Re-regulating Unsecured Consumer Credit in Japan: Over-indebted Borrowers, the Supreme Court, and New Legislation' in Deborah Parry, et al (eds), *Yearbook of Consumer Law 2009* (Ashgate, 2008) 197.

¹⁰ Iain Ramsay, 'Regulation of Consumer Credit' in Geraint Howells, Iain Ramsay and Thomas Wilhelmsson (eds), *Handbook of International Consumer Law and Policy* (Edward Elgar, 2010) 366, 397–403 (discussing also the controversy over a commissioned empirical study influencing the 2005 decision); James White, 'The Usury *Trompe l'oeil*' (2000) 51 *South Carolina Law Review* 445; Jessica Wright, 'Screws Turned on Loan Sharks', *The Sun Herald* (Sydney), 28 August 2011, 3; Annette Sampson, 'Payday Lenders Set for Stoush on Reforms', *Weekend Money*, *Sydney Morning Herald* (Sydney), 10 September 2011.

¹¹ See also Nicola Howell, Therese Wilson and James Davidson, 'Interest Rate Caps: Protection or Paternalism' (Centre for Credit and Consumer Law Research Paper, Griffith University, December 2008).

Japan's experience is also useful for testing explanations — from various economic, cultural and political theory perspectives — for the growth and the re-regulation of consumer credit markets.¹² Developments in Japan are often comparable to those in other industrialised countries. For example, suppliers of cash loans (popular in Japan) have developed a 'sweat box' business model similar to that found in the US for credit card lending, aimed at ensuring customers never really pay off the loan principal.¹³ This article therefore examines Japan in comparative context to develop empirically-informed but more normative perspectives on why and how we might need to re-regulate consumer credit more comprehensively, in countries like Australia, in a post-GFC era. Part II A queries the empirical basis and normative implications of 'Chicago School' economics, which have been undermined more generally by the GFC. Part II B and part II C argue that 'information economics' and especially 'behavioural economics' provide a stronger empirical basis for policy-making innovation, in Japan and elsewhere.¹⁴ However, part III also highlights the empirical and normative challenges emerging from the 'cultural cognition of risk' studies of Kahan and his co-researchers. Thus, through outlining developments, especially in Japan, the first half of this article analyses a variety of realistic contemporary rationales for *why* we should now be more open to re-regulating consumer credit.

The second half of this article focuses more on *how* we might do so, setting Japan in broader comparative context. In particular, we take up the challenge of drawing analogies between regulating consumer credit *services* and regulating the safety of tangible consumer *products*. This notion has already helped to establish the CFPB recently in the US, inspired partly by the Consumer Product Safety Commission, which was created in 1972.¹⁵ Part IV A of this article suggests that — as with consumer goods safety — our assessments of the probability and extent of harm from consumer lending (including the nature of its target customers) should impact on whether we rely more on markets, private law redress through the court system, or direct regulation by public regulation. We argue that public regulation should often play a major role, yet part IV B identifies a major gap in the regulation of consumer credit services compared to consumer product safety regulation in Japan and major trading partners, including Australia. Just as the latter now requires suppliers of goods to notify regulators of serious product-related accidents, we suggest that consumer credit suppliers should disclose

¹² Souichirou Kozuka and Luke Nottage, 'The Myth of the Careful Consumer: Law, Culture, Economics and Politics in the Rise and Fall of Unsecured Lending in Japan' in Johanna Niemi-Kiesilainen, Iain Ramsay and William Whitford (eds), *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives* (Hart Publishing, 2009) 199.

¹³ See generally Ronald J Mann, 'Bankruptcy Reform and the "Sweat Box" of Credit Card Debt' (2007) *University of Illinois Law Review* 375.

¹⁴ See also Stephen P King and Rhonda L Smith, 'The Shaky Economic Foundations of Consumer Protection Policy and Law' (2010) 18 *Competition and Consumer Law Journal* 71.

¹⁵ Oren Bar-Gill and Elizabeth Warren, 'Making Credit Safer' (2008) 157 *University of Pennsylvania Law Review* 1; Elizabeth Warren, 'Unsafe at Any Rate' (2007) 5 *Democracy — A Journal of Ideas* <<http://www.democracyjournal.org/5/6528.php>>. For an insightful European precursor to the idea of extending consumer product safety regulation design and implementation to consumer credit regulation, see Nik Huls, Ugo Reifner and Thierry Bourgoinie, *Overindebtedness of Consumers in the EC Member States: Facts and Search for Solutions* (Centre de Droit de la Consommation, 1994).

abnormal problems arising with their borrowers (such as suicides by borrowers or personal insolvencies, known to lenders, which are occurring in unusually high numbers by industry standards). This type of information disclosure obligation is arguably a prerequisite to a more effective ‘regulatory enforcement pyramid’.¹⁶ It is also one that should have broad appeal to policy-makers and citizens adopting diverse economic, political or psychological perspectives on consumer credit problems.

Overall, therefore, this article draws on empirically-informed normative theories from multiple disciplines or fields of study, as well as experiences across several jurisdictions and neighbouring areas of law, to reassess rationales for consumer credit regulation and its many potential forms. This more holistic approach to financial markets regulation — open to insights from various product markets, international experiences and theories — offers more hope for avoiding future global economic crises.

II The Multiple Economics of Consumer Credit Markets

A A ‘Chicago School’ Fable

Let us begin by re-assessing the hitherto influential Chicago School of neoclassical economics in light of what we now know about financial markets, particularly since the GFC. This theory presumably would still try to explain developments in Japan, or indeed any other capitalist economy, in simple terms. The following account taken from Chicago School economics may seem like a caricature, yet we must be alert to ‘zombie economics’ — convenient but dangerous theories that keep coming back to haunt us.¹⁷ This is especially true as some commentators persist in purporting to explain more and more aspects of law-related behaviour in Japan by applying this sort of theoretical lens.¹⁸ These commentators’ research programs in fact hew closely to the Chicago School’s three basic tenets. First, the School’s fundamental premise is that markets always clear, so that observed outcomes are basically efficient. Second, this premise can only be proven by ‘objective facts’, rather than what people declare to be their motivations or understandings. Third, the Chicago School reveals a more or less

¹⁶ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

¹⁷ See generally John Quiggin, *Zombie Economics: How Dead Ideas Still Walk Among Us* (Princeton University Press, 2010).

¹⁸ See, eg, J Mark Ramseyer, Minoru Nakazato and Eric Rasmusen, ‘Public and Private Firm Compensation Compared: Evidence from Japanese Tax Returns’ (Harvard Law and Economics Discussion Paper No 628, 1 February 2009); J Mark Ramseyer, ‘The Effect of Universal Health Insurance on Malpractice Claims: The Japanese Experience’ (Harvard Law and Economics Discussion Paper No 648, 4 September 2009). (These studies probably should be better understood as indirectly aimed at influencing policy debates *in the US*, particularly after the GFC, where reform discussions have belatedly emerged about re-regulating executive remuneration as well as improving the public health service.) Compare also J Mark Ramseyer, ‘Law & Economics in Japan’ (Harvard Law and Economics Discussion Paper No 686, 1 December 2010) with J Mark Ramseyer and Minoru Nakazato, *Japanese Law: An Economic Approach* (University of Chicago Press, 1999).

overt normative preference for market mechanisms — even when professing to engage in descriptive (empirical) analysis.¹⁹

Predictably, therefore, Chicago School economists would first explain Japan's expansion in consumer credit as resulting from free market forces. They would argue that lax licensing of lenders meant that market entry was basically uncontrolled, with the growth in loans being simply a response to consumer demand — just as in other advanced industrialised economies. Second, on this view, Japan's legislative interest caps would have been set considerably higher than market rates or only haphazardly enforced. This would be necessary to avoid artificial and inefficient credit rationing, as well as potential for the government to direct the market by manipulating interest rates.²⁰ Third, on a Chicago School analysis, interest rates charged were presumably high simply because consumer lenders provided smaller loans to riskier customers, with higher debt collection costs further exacerbated by Japan's cartelised legal profession.²¹ Fourth, this view would emphasise that only a minority of borrowers ended up over-indebted, filing for bankruptcy or even committing suicide; and that they had only themselves to blame — for gambling badly, while spending other people's money. In sum, the market cleared and outcomes were efficient.

Adherents to this school of thought would also no doubt have a simple explanation for Japan's regulatory reforms in 2006: 'public choice' theory.²² This sees regulation (inefficiently) constraining business activity as resulting from the advantage it creates for some industry sectors or firms over their rivals.²³ The theory can be straightforwardly applied, presumably, for the purpose of understanding the recent re-regulation of consumer credit. On this view, Japan's regulators would be less important players than the banks. By 2006 banks had perhaps extracted significant new know-how from credit finance companies, notably by investing in the most efficient ones. Yet the banks could have felt increasingly threatened, and were finally recovering from more than a decade of sluggish performance arising from massive non-performing loans extended during the boom of the 1980s. Re-regulation therefore disproportionately harmed emerging rivals, opening up space for banks to take over non-bank lenders and to expand consumer lending through new products like credit cards.

From the Chicago School perspective, moreover, the lower interest rate caps imposed in 2006 are either irrelevant or misguided. If still higher than the market-clearing rate, they will make no difference and again no credit rationing

¹⁹ Craig Freedman and Luke Nottage, 'You Say Tomato, I Say Tomahito, Let's Call the Whole Thing Off: The Chicago School of Law and Economics Comes to Japan' (Research Paper No 2006-4, Centre for Japanese Economic Studies, August 2006).

²⁰ Cf, eg, Yoshiro Miwa and J Mark Ramseyer, 'Directed Credit? The Loan Market in High-Growth Japan' (2004) 13(1) *Journal of Economics and Management Strategy* 171.

²¹ See generally J Mark Ramseyer, 'Lawyers, Foreign Lawyers, and Lawyer Substitutes: The Market for Regulation in Japan' (1986) 27 *Harvard Journal of International Law* 499.

²² J Mark Ramseyer, 'Public Choice' (1995) 34 *Chicago Law School Law and Economics Working Paper* <http://www.law.uchicago.edu/Lawecon/WkngPprs_26-50/34.Ramseyer.pdf>.

²³ Yoshiro Miwa and J Mark Ramseyer, 'The Legislative Dynamic: Evidence from the Deregulation of Financial Services in Japan' in Daniel Foote (ed), *Law in Japan: A Turning Point* (University of Washington Press, 2007) 153.

will occur. If lower, then this will just create a shortage. Licensed suppliers will seek to reprice their products (for example, increasing fees and charges other than interest) or seek to enforce debts more vigorously. Illegal lenders and practices will mushroom to meet still pent-up demand, and the shortage will worsen as more lenders move out of the market.²⁴ Thus, for Chicago School economists, interest rates instead should be completely deregulated, thereby undercutting illegal lenders and practices. No costly duties should be imposed on lenders to inform or inquire about borrowers — the latter know their situation best, so they should fend for themselves. The government's role, if any, should be restricted to overcoming coordination problems among different industry sub-sectors so that 'positive credit information' can be fully shared. The legal profession should also be completely deregulated to reduce debt collection costs.

However, although a few economists did advance some of these points prior to Japan's recent reform discussions,²⁵ such normative implications are undermined by weak or non-existent evidence for the underlying empirical claims. Although admittedly less so in unsecured consumer loan markets, controlling the supply of credit was in fact a major policy objective for the Japanese government especially through to the 1970s.²⁶ More tellingly, there is considerable evidence that lenders increasingly steered consumers into excessive indebtedness, with little variance in the very high interest rates charged, and that they collected debts very aggressively. These features are hardly compatible with a competitive market with well-informed consumers exercising free choice. Nor are there any indications (for example, through records of governmental 'deliberation council' meetings) in support of the public choice theory that large banks drove the re-regulation in Japan in 2006. The reforms resulted instead from growing evidence of credit market failures. Evidence emerged both in aggregate data on consumer over-indebtedness, and in specific examples of over-reaching and other market failures revealed in the media, as well as numerous court decisions — culminating in a Supreme Court judgment of 13 January 2006.²⁷

Also missing from the reform debate was any detailed attempt to estimate the elasticity and other features of the supply and demand curves in Japan's

²⁴ See, eg, Christopher Demuth, 'The Case Against Credit Card Interest Rate Regulation' (1986) 3 *Yale Journal on Regulation* 201; Thomas Durkin, 'An Economic Perspective on Interest Rate Limitations' (1993) 9 *Georgia State University Law Review* 821.

²⁵ Kenichi Nakamura, 'Competition and the Efficiency in Japanese Consumer Credit Market' (Japanese Cabinet Office Economic and Social Research Institute Discussion Paper Series No 22, December 2002).

²⁶ Credit controls were linked to a broader post-War tradition of limiting participants in various markets in Japan. See, eg, Richard W Rabinowitz, *Japan's Foreign Investment Law of 1950: A Natural History*, vol 19 (Deutsch-Japanische Juristenvereinigung, 2003); and generally Frank Upham, 'Privatized Regulation: Japanese Regulatory Style in Comparative and International Perspective' (1996) 20 *Fordham International Law Journal* 396.

²⁷ That judgment declared extra 'grey zone' interest void, since not paid 'voluntarily' as required by 1983 legislation, if the consumer loan contained (as was customary) an acceleration clause triggered by the borrower's default. See the case report in 60(1) *Minshu* 1, translated at <<http://www.courts.go.jp/english/judgments/text/2006.01.13-2004.-Ju-.No..1518.html>>. See also generally Shinichiro Suda, *Karyugui — Shohisha Kinyu no Jittai [The Reality of the Consumer Finance Foodchain]* (Takuma Shinsho, 2006) and further references discussed in Kozuka and Nottage, above n 9 and n 12.

consumer credit market. If both are very inelastic, for example, then any excess demand created by an interest rate cap set below the market-clearing rate will be small anyway. Excess demand will also diminish if the supply curve is likely to expand or if the demand curve contracts. Supply can expand, for example, as more reputable bank lenders move into the field, driving out the most aggressive non-bank lenders. Demand can contract if re-regulation causes consumers to become more aware of their options when faced with financial stress, including filing for bankruptcy rather than taking out new or renewed loans and thereby remaining in the 'sweat box'.²⁸ To the extent they considered such basic insights from micro-economics, law reformers in Japan seem to have followed their gut instincts. But they should not attract too much blame, as Chicago School theorists tend to rely on their own instincts too — namely, instead, that excess demand problems created by interest rate caps will be unsurmountably large.

Luckily, the instincts of Japan's law reformers seem to have proven more correct. The number of registered lenders had dropped by two-thirds in September 2009 compared to March 2006. Yet reports of illegal lending have not grown, at least in official statistics: complaints were similar in 2008 compared to 2007 (and half the level recorded in 2003). This suggests that the capped interest rates have not resulted in high levels of excess demand, creating credit exclusion or forcing consumers into the black market to maintain their borrowing habits. More generally, the number of borrowers with more than five loans more than halved in 2009 compared to 2005, and they are being screened much more carefully. Total outstanding consumer debt has shrunk back from its peak in 2006 to its level around 1999. The government is also promoting alternative financing schemes and debt or budget counselling services, especially at the local level, to expand 'safer' forms of credit supply.²⁹

More targeted empirical work still deserves to be done on the key features of Japan's unsecured consumer credit markets and their recent transformations — despite the difficulties involved — especially regarding the market for illegal loans. Yet the evidence so far challenges the simple Chicago School account anticipated above. That account's weak empirical foundations, in Japan's case, raise reasonable doubts about its applicability in other countries — and the normative implications of this theory. Fortunately, we can turn next to two other schools of economics that add more believable assumptions about human behaviour to generate more realistic assessments of developments in consumer lending, and therefore more plausible policy recommendations.³⁰

²⁸ Mann, above n 13.

²⁹ For original sources and further statistics, including a preliminary discussion of consumer bankruptcy trends, see Souichirou Kozuka, 'Punishing the Lenders for Whose Sake? Impact of the New Case Law and Follow-Ups to the 2006 Reform of Consumer Credit Regulation in Japan' in Susan Block-Lieb and Johanna Niemi (eds), *Contemporary Issues in Consumer Insolvency* (Peter Lang, forthcoming 2012).

³⁰ Parts II B and II C are updated and revised versions of arguments first presented in Kozuka and Nottage, above n 12, 213–18 (containing further references).

B *Taking 'Information Economics' Seriously*

The arguments of Chicago School economics sketched above assume perfect information, but the market for credit typically reveals asymmetry of information between the lender and borrower. Traditional proponents of regulation tend to emphasise the borrower's lack of information about the loan terms. Yet the creditor also finds it costly and difficult to distinguish riskier from less risky borrowers. Accordingly, excess demand and credit rationing can occur even without an interest rate cap or other regulation. When the lender raises the interest rate, the less risky borrower leaves the market while the riskier borrower remains. This is typical of 'adverse selection' in a market with imperfect information.³¹ The lender may not end up with an interest rate high enough to maximise profits, allowing for the default risk. If this rate is lower than the market-clearing level, there will be excess demand for credit.³² Thus, the arguments of Chicago School economists are only half true: the problem of excess demand cannot necessarily be solved by just doing away with any interest rate cap.

Faced with this adverse selection problem, borrowers may signal to the lender that they present a lower risk and therefore deserve a lower interest rate. They may accept loan terms allowing collection day or night, or have loans personally guaranteed by close relatives. However, if the legislator considers such signalling undesirable for broader public policy reasons, capping the interest rate can become an attractive regulatory response.

The 'sweat box' business model can be viewed as another private arrangement to solve the problem of adverse selection. If the interest rate is set high enough, only risky borrowers will remain in the market. Credit companies, recognising this problem, no longer expect the principal to be repaid but rely on interest payments for profitability. This kind of business model also benefits the credit companies by saving costs in more fully evaluating the risks presented by borrowers. Again, however, credit companies employing the 'sweat box' model may more likely resort to harsh collection methods. If borrowers face further information asymmetry and do not accurately assess in advance how harsh debt collection will be, capping the interest rate again can correct for such borrower behaviour.³³

These justifications of interest rate caps from information economics echo traditional arguments that justify usury law as a tool to fend off unscrupulous or

³¹ See generally George Akerlof, "'The Market for 'Lemons': Quality Uncertainty and the Market Mechanism' (1970) 84 *The Quarterly Journal of Economics* 488.

³² Joseph Stiglitz and Bruce Greenwald, *Towards a New Paradigm in Monetary Economics* (Cambridge University Press, 2003) 27.

³³ Technically, the focus will be on the difference between demand curves assuming full or no information about collection methods: Y Tsutsui et al, 'Jogenkinri Kisei no Zehi: Kodo Keizaigakutei Approach [Pros and Cons of Regulating High Interest Rates: A Behavioural Economics Approach]' (2007) 22 *Gendai Finance* 25.

abusive lenders.³⁴ Their proponents, therefore, would have favoured the re-regulation of Japan's consumer credit markets in 2006, and indeed would urge similar reforms elsewhere. However, more empirical data on the types and practices of borrowers and creditors are again required, especially the extent of adverse selection problems and countervailing signalling mechanisms, as well as their changes over time. Such studies were not forthcoming during Japan's reform discussions and have not been attempted since. Nonetheless, the information economics approach already provides a more persuasive explanation for major features of the Japanese market compared to a Chicago School perspective.

C *Testing and Applying Insights from 'Behavioural Economics'*

Lessons from an even newer school of economics were even less evident in Japan's re-regulation process, but they help greatly to explain the growth of consumer credit in Japan and many other countries. 'Behavioural economics' draws on evidence from social psychology to challenge the simplistic notions of wealth-maximising behaviour underpinning mainstream neoclassical economics, and even information economics.³⁵ For example, one field experiment in unsecured consumer lending in South Africa did find some evidence of adverse selection, but it was quite weak.³⁶ Instead, the study found very strong effects from marketing tactics adopted by lenders that exploited behavioural or psychological weaknesses on the part of borrowers. Firms therefore seemed able to raise aggregate demand without suffering too much adverse selection, hence dulling incentives for price competition.³⁷

More generally, and importantly for behavioural economics applied to consumer credit problems, after decades of studies 'the optimism bias is considered one of the most robustly confirmed biases in cognitive studies and social psychology'.³⁸ This is because individuals significantly overestimate the chances of good things happening to themselves, while underestimating chances of bad things. This finding has helped explain why individuals persist in addictive behaviours, including, for example, excessive reliance on credit card lending.³⁹ In addition, cross-cultural experiments have found that the Japanese are significantly

³⁴ Lynn Drysdale and Kathleen Keest, 'The Two-tiered Consumer Financial Services Marketplace' (2000) 51 *South Carolina Law Review* 589; Ronald Mann and Jim Hawkins, 'Just Until Payday' (2007) 54(4) *UCLA Law Review* 855, 906.

³⁵ Cass Sunstein, 'Boundedly Rational Borrowing' (2006) 73 *University of Chicago Law Review* 249; Susan Block-Lieb and Edward J Janger, 'The Myth of the Rational Borrower: Rationality, Behaviouralism and the Misguided "Reform" of Bankruptcy Law' (2006) 84 *Texas Law Review* 1481; Productivity Commission, *Review of Australia's Consumer Policy Framework*, Productivity Commission Inquiry Report No 45 (2008), Appendix B.

³⁶ Dean Karlan and Jonathan Zinman, 'Observing Unobservables: Identifying Information Asymmetries with a Consumer Credit Field Experiment' (2009) 77(6) *Econometrica* 1993.

³⁷ Marianne Bertrand et al, 'What's Psychology Worth? A Field Experiment in the Consumer Credit Market' (Yale University Economic Growth Center Discussion Paper No 918, July 2005).

³⁸ Ron Harris and Einat Albin, 'Bankruptcy Policy in the Light of Manipulation in Credit Advertising' (2006) *Theoretical Enquiries in Law*, 431, 435.

³⁹ See, eg, Ronald Mann, *Charging Ahead: The Growth and Regulation of Payment Card Markets* (Cambridge University Press, 2006).

more likely to expect negative events to occur to others than to themselves.⁴⁰ Over-optimism, especially in this sense, encourages consumers to take on loans leaving too little margin for error. Borrowers therefore often find themselves over-committed when disaster strikes in the form of lost income or employment, family breakdowns or medical emergencies.

Another significant and often-observed bias is ‘the illusion of control’. Individuals behave as if (more or less) chance events are subject to control, and they do not distinguish events involving chance versus skill when undertaking activities involving some control — such as being offered choices.⁴¹ Advertising emphasising choice by borrowers — loan amounts, repayment options, different lenders — can take advantage of such an ‘illusion of control’.

A third common cognitive bias is ‘availability’: individuals overemphasise things that spring readily to mind. Conversely, borrowers find it harder to recall past expenditures, encouraging them to take on more debt.⁴² The publicity given to (near-) cap interest rates may also lead lenders and even borrowers to consider them ‘normal’, even if a particular customer objectively presents a lower risk and therefore deserves a lower rate. Such borrowing behaviour may also be reinforced by ‘social norm cascades’.⁴³ ‘Herd behaviour’ can emerge as consumers increasingly start spending and then borrowing at high interest rates.

Experimental and other empirical studies from social psychology also uncover many other biases or complications that enter into human decision-making processes, with major implications for consumer lending markets.⁴⁴ For example,

⁴⁰ Steven J Heine and Darrin R Lehman, ‘Cultural Variation in Unrealistic Optimism: Does the West Feel More Invulnerable than the East?’ (1995) 68 *Journal of Personality and Social Psychology* 595 did find that Canadians were significantly more likely to expect that positive events would occur to self than to others, compared to Japanese counterparts. But see Edward Chang, Kiyoshi Asakawa and Lawrence Sanna, ‘Cultural Variations on Optimistic and Pessimistic Bias: Do Easterners Really Expect the Worst and Westerners Really Expect the Best when Predicting Future Life Events?’ (2001) 81 *Journal of Personality and Social Psychology* 476. They found no such differences between Japanese and European Americans. See also Edward Chang and K Asakawa, ‘Cultural Variations on Optimistic and Pessimistic Bias for Self Versus a Sibling: Is There Evidence for Self-Enhancement in the West and for Self-Criticism in the East When the Referent Group Is Specified?’ (2003) 84 *Journal of Personality and Social Psychology* 569.

⁴¹ Harris and Albin, above n 38, 436–7.

⁴² This need not occur only in the context of credit cards: cf Joydeep Srivastava and Priya Raghurir, ‘Debiasing Using Decomposition: The Case of Memory-based Credit Card Expense Estimates’ (2002) 12 *Journal of Consumer Psychology* 253.

⁴³ See generally Cass Sunstein, *Risk and Reason: Safety, Law, and the Environment* (Cambridge University Press, 2002).

⁴⁴ These include tendencies towards very complex ‘hyperbolic discounting’, problems dealing with extensive choices or information, more concern about losses than gains (the ‘endowment effect’), susceptibility to ‘framing’ effects (Productivity Commission, above n 35, 380–1) and ‘social influence’ (R B Cialdini, *Influence: The Psychology of Persuasion*, Collins 2007). People also tend to sign off on deals due to perceived ‘sunk costs’ of negotiations, partly to preserve social esteem: see Shmuel Becher, ‘Behavioural Science and Consumer Standard Form Contracts’ (2007) 68 *Louisiana Law Review* 117. The ready availability of credit may even disrupt the brain’s evolved mechanism for weighing pleasure versus pain: see Colin Camerer, George Loewenstein and Drazen Prelec, ‘Neuroeconomics: How Neuroscience Can Inform Economics’ (2005) 43 *Journal of Economic Literature* 9. See further Kozuka and Nottage, above n 12.

the Productivity Commission's *Review of Consumer Policy Framework* highlighted 'present bias', a preference for short-term gains:

The concern that people will often underweight future costs and benefits may lead governments to force people to save (superannuation requirements) or *ban particularly harmful behaviour* (such as taking addictive and harmful substances or acquiring credit at *usurious interests rates*).⁴⁵

Many of these problems also seem to afflict Japanese individuals.⁴⁶

Generally, individual borrowers are less likely to know about such problems than lender firms. The latter therefore have greater capacity to take advantage of consumers' heuristics and biases through advertising, debt collection practices and loan contract terms. Thus, at a minimum, behavioural economics encourages scepticism about traditional rules mandating information disclosure by lenders to borrowers. Such rules may address some information asymmetry, but much evidence now suggests that this information is not being effectively processed.⁴⁷ Some commentators outside Japan have gone on to urge regulation of substantive terms in contracts,⁴⁸ which could also include interest rate caps at least for certain types of consumer loans.⁴⁹ Others influenced by behavioural economics, however, had proposed less extensive re-regulation for credit card or payday lending in the US — admittedly, prior to the GFC.⁵⁰ Similarly, a recent commentary by Thaler and Sunstein generally urges regulators to draw on behavioural studies to 'nudge' firms (and individuals) towards better socio-economic outcomes, rather than imposing substantive requirements on them.⁵¹

By contrast, a comprehensive and very influential analysis justifying more extensive re-regulation 'making credit safer' was published in 2008 by Bar-Gill and Warren.⁵² They first suggested that consumer credit markets often fail *in theory* because:

⁴⁵ Productivity Commission, above n 35, 385 (emphasis added). However Appendix E (455–6) urged caution about interest rate caps on more conventional economic grounds such as the potential impact on accessibility of credit.

⁴⁶ See, eg, the studies of Chang and others, above n 40. Indeed, a recent study invokes the 'over-optimism' and 'availability' biases to explain a puzzlingly high rate of shareholder derivative actions in Japan — suits that do not seem to provide significant financial net benefits either to shareholder plaintiffs or their lawyers. See Dan Puchniak and Masafumi Nakahigashi, 'Japan's Love for Derivative Actions: Irrational Behavior and Non-Economic Motives as Rational Explanations for Shareholder Litigation' (2012) 45(1) *Vanderbilt Journal of Transnational Law* 1.

⁴⁷ Ramsay, above n 10 at 385–9. See also more generally Productivity Commission, above n 35, ch 11.

⁴⁸ Arguing for an expansive interpretation of Australia's new regime for unfair terms in consumer contracts; see Jeannie Paterson, 'The Australian Unfair Contract Terms Law: The Rise of Substantive Unfairness as a Ground for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934.

⁴⁹ Alan M White, 'The Case for Banning Subprime Mortgages' (2008) 77 *University of Cincinnati Law Review* 617.

⁵⁰ Mann, above n 39; Mann and Hawkins, above n 34.

⁵¹ Richard H Thaler and Cass R Sunstein, *Nudge: Improving Decisions About Health, Wealth and Happiness* (Yale University Press, 2009).

⁵² Bar-Gill and Warren, above n 15; see also Kathleen Engel and Patricia McCoy, 'A Tale of Three Markets: The Law and Economics of Predatory Lending' (2002) 80 *Texas Law Review* 1255.

- numerous information and behavioural problems limit consumer learning;
- third parties (NGOs) cannot easily assess the ‘safety’ of services (since their features can be, and typically are, changed more often compared to the features of tangible goods);
- reputable suppliers also face collective action constraints to (re-) educate consumers;
- lenders discriminate to limit the impact for improvements resulting from any ‘informed minority’ (typically stressed by Chicago School economists); and
- lenders know more about credit usage than borrowers.

Bar-Gill and Warren then presented compelling *evidence* of market failures in the US, derived from surveys of what consumers (mis)understand, their behaviour (regarding credit cards, mortgage loans and payday loans), and the lender’s design of features found in each type of contract (such as introductory ‘teaser’ interest rates, fees, and readily-available loan rollovers). They concluded that this evidence also demonstrated clear *net economic costs* created by consumer lending markets. These costs arose mainly from direct harms to consumers (such as paying credit card interest while holding other low-return assets) and many negative externalities (from financial distress, market distortions from mistaken lending decisions), impacting disproportionately on the uneducated, the poor, women and ethnic minorities.

The GFC and consequent recession highlighted even more disastrous externalities linked to credit market failures. This led to the US government establishing the CFPB, an overarching new regulator as recommended by Bar-Gill and Warren. Indeed, Warren was appointed as the special advisor to the Secretary of the Treasury (responsible for this new Bureau).⁵³ The CFPB not only brings together formerly disparate regulatory powers; but it also moves away from a tendency of looser ‘principles-based’ regulation, evident from the 1990s, towards enforcing — and potentially creating further — specific rules controlling misleading and abusive conduct in consumer credit markets.⁵⁴

By contrast, specific insights from social psychology and related empirical studies along the lines of Bar-Gill, Warren and others were lacking in Japan’s earlier re-regulation process.⁵⁵ In order to justify further interventions, perhaps law reformers again went with their gut instinct that lenders were exploiting various

⁵³ There was also talk of her becoming the Bureau’s first Director; but President Obama now contends with a Congress dominated by Republicans, and there are also fears that it may already starve the CFPB of funds. See Joe Klein, ‘Who’s Afraid of Reforming Wall Street? Well, Pretty Much Everyone in Washington, Except Elizabeth Warren’, *Time Magazine*, 14 March 2011, 15. Warren had previously headed, over 2008–09, the Congressional Oversight Panel created to investigate the US banking bailout (the ‘Troubled Assets Relief Program’).

⁵⁴ Vincent DiLorenzo, ‘The Federal Financial Consumer Protection Agency: A New Era of Protection of More of the Same?’ (Research Paper No 10-0182, St John’s University School of Law, 8 September 2010).

⁵⁵ Fumihiko Hiruma, ‘*Kashikingyoho Kaisei Mondai ni kansuru Shogiron no Saikento: Kaketa Shiten wa nanika?* [Revisiting the Debates on Amending the Moneylenders Law: A Missing Viewpoint?]’ (2007) 38 *Credit Kenkyu* 6.

psychological advantages over consumers. New ‘social norm cascades’ may have evolved as media attention focused on a string of incidents and partial reforms over the years. In addition, bringing down the interest cap might also have seemed ‘fairer’ due to a seemingly widespread human propensity to collaborate, established by experimental psychology as in the ‘Ultimatum Game’.⁵⁶ Experiments indicate that people seem to have an innate sense of fairness, which might clash with perceptions of exploitative profiteering by lender firms. However, that does not explain or justify why Japanese policy-makers and citizens decided on a new interest rate cap of 20 per cent, rather than say 15 or 25 per cent. Perhaps the decision was influenced by the ‘availability’ heuristic, especially in light of the Supreme Court’s judgment of 13 January 2006 and its run-up — reminding the public that 20 per cent was the norm, with the higher ‘grey zone’ rates being the exception.⁵⁷

Overall, it also seems risky for policy-makers to base decisions on *how* to regulate simply according to unarticulated intuitions such as these. It is more convincing to examine empirically how consumer decision-making may be tainted or even exploited by various biases, and then the related socio-economic net costs. Such detailed studies are also very important when determining *why* to regulate, as shown so convincingly by Bar-Gill and Warren in the case of consumer credit markets in the US.⁵⁸

III Cultural Psychology and Political Justifications for Re-Regulation

So far, this article has outlined how two more recent schools within economics, especially behavioural economics drawing on studies in social psychology, can provide a stronger empirical foundation for analyses of consumer credit markets — and more compelling normative implications — compared to Chicago School economics. However, extensive recent empirical research into ‘cultural risk cognition’ conducted by Kahan and various colleagues, within the US, now presents a challenge to some of the ‘heuristics and biases’ literature and therefore its application by ‘behavioural law and economics’ scholars such as Bar-Gill and Warren.

⁵⁶ The rules of this game involve player X proposing a division of \$100 between himself and player Y, which the latter can accept or reject. If accepted, both players keep the portions proposed; if rejected, both get nothing. Conventional economic accounts of rational wealth-maximising would predict that X would propose to keep \$99 and Y would accept \$1. Yet in actual experiments, replicated in both developing and developed countries all around the world, X offers much more. Compare, for example, Joseph Henrich et al, ‘In Search of Homo Economicus: Behavioural Experiments in 15 Small-Scale Societies’ (2001) 91(2) *The American Economic Review* 73; and S-H Chuah et al, ‘Do Cultures Clash? Evidence from Cross-National Ultimatum Game Experiments’ (2007) 64 *Journal of Economic Behaviour and Organisation* 35. A variant is the ‘dictator game’ where participants even know that their partners cannot refuse offers, Gerd Gigerenzer, *Gut Feelings: The Intelligence of the Unconscious* (Viking, 2007) at 68–9 reports that even in this game, university students in Japan, Europe and the US typically give 20 per cent.

⁵⁷ See the case report in 60(1) *Minshu* 1, translated at <<http://www.courts.go.jp/english/judgments/text/2006.01.13-2004.-Ju.-No..1518.html>>.

⁵⁸ See also generally Productivity Commission, above n 35 at 43–5.

In fact, Kahan's main target so far has been the normative inclination of Sunstein to restore decision-making to neutral 'experts', as a means of overcoming or lessening such biases. Kahan instead argues that large-scale survey and other evidence shows that individuals adopt stances that express values defining their identities. That is, they assess risky activities by evaluating their social meanings, rather than weighing risks rationally (as assumed by neo-classical economics) or irrationally (as determined by behavioural theory that emphasises specific biases or heuristics).⁵⁹ This argument provides a better explanation for some evidence from psychological studies conducted by Kahan and others. These show that if *more* information is provided about possible risks from goods produced using nanotechnology, for example, *more* polarisation of views emerges among groups with various orientations. Sunstein and other behavioural economists would predict *less* polarisation — contrary to the results from these studies.⁶⁰

Further, Kahan's research finds that groups holding worldviews which are 'egalitarian' (opposed to 'hierarchists' who favour distributing entitlements based on fixed and largely immutable characteristics) or communitarian (or 'solidarist': prioritising the interests of the collective) are particularly 'sensitive to environmental and technological risks, the reduction of which justifies regulating commercial activities that produce social inequality and legitimise unconstrained self-interest'.⁶¹ By contrast, 'individualists' (with the opposite worldview to 'solidarists') are 'disposed to react very dismissively to claims of environmental and technological risk because they recognise (again, subconsciously) that the crediting of those claims would lead to restrictions on commerce and industry, forms of behaviour they like'. 'Hierarchists' are so disposed as well, because 'they interpret concern with environmental risks as an explicit indictment of the competence and authority of societal elites'.⁶²

Kahan's studies therefore provide contemporary empirical validation for a similar view on risk cognition developed by the renowned social anthropologist Mary Douglas. Moreover, both suggest that resultant disputes about risk cognition generate normative implications regarding the ideal form for one's society.⁶³ However, Kahan's studies show how polarisation of risk assessments held by groups with different worldviews can be demonstrably diminished. An example comes from controversy over mandatory vaccination against the human papilloma virus (HPV), associated with the development of cervical cancer and other conditions. Differences in groups' risk assessments regarding vaccinations decrease if each group (such as individualists, generally opposed to state intervention) receives arguments about risks that it was culturally disposed to reject

⁵⁹ Dan M Kahan, 'Cultural Cognition as a Conception of the Cultural Theory of Risk' (Public Law Working Paper No 222, Yale Law School, 2008).

⁶⁰ Dan M Kahan et al, 'The Second National Risk and Culture Study: Making Sense of — and Making Progress in — the American Culture War of Fact' (Public Law Working Paper No 154, Yale Law School, 2007), 6–10.

⁶¹ Dan M Kahan et al, 'Culture and Identity-Protective Cognition: Explaining the White Male Effect in Risk Perception' (2007) 4 *Journal of Empirical Legal Studies* 465, 469.

⁶² Kahan et al, above n 60.

⁶³ Kahan, above n 59, 3, discussing Mary Douglas and Aaron B Wildavsky, *Risk and Culture: An Essay on the Selection of Technical and Environmental Dangers* (University of California Press, 1982).

from an ‘expert’ easily identifiable as otherwise sharing the same general worldview. Polarisation even diminishes if a ‘pluralistic advocacy’ situation is created in which experts of recognisably different worldviews are not uniformly pitted against advocates of a directly opposed cultural worldview. Similarly, reports about catastrophic risks from global warming can be made more credible for individualists if discussed in the context of removing restrictions on nuclear power (thus affirming their identity or worldview) rather than of instituting stronger anti-pollution controls (threatening individualists’ identity).⁶⁴

Kahan’s empirical studies so far have not tested for individuals’ reactions towards *consumer credit* risks, but we would expect them to split along similar lines — with individualists perceiving the risks as significantly less important than would communitarians, for example. His studies have also not yet been replicated in Japan. If they were, from other lines of research we would expect Japan to reveal a larger proportion of people still holding a ‘communitarian’ worldview. For example, experimental research from the University of Michigan’s Institute for Social Research (Cognition and Culture Program) has established an arguably related finding: individuals of Asian background tend to adopt more holistic perceptions than Western counterparts.⁶⁵ Also, and specifically with regard to Japan, a leading legal sociologist has recently re-emphasised a variety of distinctly more communitarian dimensions to law and society compared to the US in particular, despite some important shifts over recent decades.⁶⁶ This work by Tanase can also be seen as part of a broader ‘cultural turn’ in the study of Japanese law carried out in Western languages. It provides an important counterbalance to a tendency since the late 1980s to downplay cultural factors as significant explanatory variables.⁶⁷

We should not now revert to over-generalisations about the importance of culture in Japanese law and society — characteristic of much literature over the 1960s and 1970s. Nor should we be afraid to reassess and compare its exact contemporary role. In the field of consumer credit, for example, one reason for rapid growth in Japan over the 1980s and 1990s seems to have been a remarkable

⁶⁴ Ibid 17–19.

⁶⁵ ‘To the Asian, the world is a complex place, composed of continuous substances, understandable in terms of the whole rather than in terms of the parts, and subject more to collective than to personal control’: Richard E Nisbett, *The Geography of Thought: How Asians and Westerners Think Differently — and Why* (Free Press, 2003), 100. One consequence was less evidence of the ‘illusion of control’ among Chinese compared to US respondents. Other significant differences from these empirical studies included increased tendency among Asians (from various countries) towards broader causal attributions; less tendency to categorise knowledge; and more willingness to set aside logic in favour of typicality and plausibility of their conclusions or their desirability, as well as compromise solutions and holistic arguments.

⁶⁶ Takao Tanase (trans: Luke Nottage and Leon Wolff), *Community and the Law: A Critical Assessment of American Liberalism and Japanese Modernity* (Edward Elgar, 2010). The earthquake, tsunami and nuclear power plant emergency that have hit Japan hard since 11 March 2011 evidence a still deep-rooted communitarian ethos in Japanese society. Examples include cooperative behaviour in evacuation camps and voluntary efforts to save power even in distant metropolitan areas.

⁶⁷ See especially J Mark Ramseyer, ‘Reluctant Litigant Revisited: Rationality and Disputes in Japan’ (1988) 14 *Journal of Japanese Studies* 111; cf, now, Luke Nottage, ‘The Cultural (Re)Turn in Japanese Law Studies’ (2009) 39 *Victoria University of Wellington Law Review* 755.

preparedness by borrowers to meet their contractual promises to lenders — even in quite unconscionable circumstances.⁶⁸ This is consistent with other empirical studies from the 1990s indicating that the Japanese do generally try to *uphold* contractual obligations, even when economic circumstances change considerably.⁶⁹

If Kahan's research therefore could be replicated in Japan to establish that the country does still have a high proportion of communitarians, for example, this could help explain why consumer credit risks came to be seen again as a major social problem well before the GFC. It could even help explain why additional interest rate restrictions remained an important part of the 2006 reforms addressing the risks associated with consumer lending. After all, government-imposed caps are arguably less threatening to the identity of communitarians than to the identity of individualists.

Normatively, however, this would still leave us with a problem. Future studies are likely to find that Japan includes a significant — even if smaller — group of citizens who are more individualist than communitarian, and/or perhaps hierarchist rather than egalitarian. After all, Kahan's studies within the US were also able to identify considerable proportions of Americans more or less influenced by all four major worldviews. Yet individualists or hierarchists are probably less likely to be concerned about the risks associated with consumer credit. Accordingly, if Japan purports to be a liberal rights-based democracy — as does the US — then policy-makers cannot straightforwardly impose the risk cognition preferences of one (larger) group over all others; that would amount to no more than a tyranny of the majority.

Given the evidence of divergent worldviews affecting risk assessments, Kahan therefore decries the 'cognitive illiberalism' implicit in the approach of Sunstein and others. He also argues against a Rawlsian principle of 'public reason' framing debates towards an 'overlapping consensus' — comprising values found to be common to all (reasonably held) 'comprehensive views'.⁷⁰ Instead, Kahan considers that genuine and empirically-grounded liberalism demands 'a new discourse norm, *expressive overdeterminism*, that seeks to contain cognitive illiberalism not by stripping it of partisan social meanings but by infusing it with so

⁶⁸ Kozuka and Nottage, above n 12.

⁶⁹ This contradicts a perception common in the 1970s among Western commentators, namely that the Japanese were comparatively prone to *renegotiate* contracts if circumstances changed significantly. See, Luke Nottage, 'Planning and Renegotiating Long-Term Contracts in New Zealand and Japan: An Interim Report on an Empirical Research Project' [1997] *New Zealand Law Review* 482.

⁷⁰ Kahan, above n 1, 129, citing John Rawls, *Political liberalism*, John Dewey essays in philosophy; no 4 (Columbia University Press, 1993); cf also George J Wallace, 'The Uses of Usury: Low Rate Ceilings Reexamined' (1976) 56 *Boston University Law Review* 451, for an adaptation of earlier Rawlsian political theory (as well as utilitarianism) to justify credit regulation — even interest rate caps. See also Eric A Posner, 'Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom of Contract' (1995) 24 *Journal of Legal Studies* 283, arguing generally that usury and unconscionability laws emerge as societies commit to a minimum 'welfare safety net'. Politicians have also been professing more commitment to improving the safety net in Japan, over recent years, which might provide a further explanation for the re-regulation of consumer credit observed particularly since 2006.

many that every cultural group can find affirmation of its worldviews within it'.⁷¹ He provides several examples, mostly in the US but also in France, of how 'expressive overdeterminism' has already helped to generate more effective and legitimate political outcomes. For example, tradable emissions laws simultaneously affirmed egalitarians' commitment to environmental protection and individualists' commitments to markets for attaining social ends. In addition, American social welfare laws initially appealed to egalitarians as a means to redistribute wealth, but also to hierarchists by relieving economic pressure on mothers who would otherwise be forced to work outside the home.⁷²

Thus, from Kahan's empirically-informed normative viewpoint, the package of consumer credit reforms introduced in Japan in 2006 may be justifiable quite apart from the rationales sketched above (parts II B and II C) from information and behavioural economics. Although a major feature was the reduced interest rate cap (arguably more appealing to egalitarians or communitarians), groups in Japanese society with different worldviews and risk cognition patterns may have found other features within the reforms that could affirm their own respective identities. For example, individualists would have appreciated the provisions supporting better credit information sharing and industry cooperation (strengthening the business capacity of lenders), and perhaps even some stricter requirements concerning debt collection and disclosures to borrowers (supporting these consumers' free choice and autonomy). Conversely, hierarchists in Japan may have appreciated the new prohibitions on lenders becoming beneficiaries under life insurance contracts taken out by their borrowers — reducing opportunities for borrowers to take out insurance and then commit suicide, thereby drastically disrupting family units.

However, these outcomes may simply reflect the fact that the reform package was a comprehensive one — or, put more uncharitably, one where policy-makers threw everything at longstanding and escalating problems in the hope that something would stick. The records of Japan's law reform committee deliberations certainly do not indicate much concern about acknowledging the different risk assessments and worldviews held by market individualists, for example. More broadly, Kahan's political theory remains quite minimalist, and open to the criticism that it gives too much credence to the values that happen to be held by various groups within a society.⁷³ Even accepting empirical realities, such as the cultural cognition of risk, political theory may seek to create more opportunities to uncover better society-wide outcomes — the aim usually of economic theory too — even if this implies more radical challenges to the self-identities or value systems held by particular groups and individuals.

⁷¹ Kahan, above n 1, 131 (emphasis added).

⁷² Consensus seemingly only broke down after new egalitarian elites insisted that the laws were or should be primarily aimed at liberating single mothers from dependence on male wage earners; *ibid* 133.

⁷³ Susan Bandes, 'Emotions, Values, and the Construction of Risk' (2008) 156 *Pennsylvania Law Review* PENNumbra 421.

IV Why and How to Re-regulate Consumer Credit: Analogies from Consumer Product Safety Regimes

So far, this article has examined and compared empirical evidence actually or potentially related to consumer credit markets, drawing on various schools within economics as well as cultural psychology and political theory, in order to establish a firmer foundation for normative justifications for the re-regulation of consumer lending. Although some variants are now challenged by Kahan's cultural risk cognition studies, behavioural economics emerges as a powerful tool for understanding credit market developments in developed economies, and justifications for various interventions. Particularly impressive is the study published in 2008 by Bar-Gill and Warren, yet its main normative recommendations are quite narrow and US-specific: the establishment of a new regulatory agency. Their study does urge generally a return to 'reliance on *ex ante* regulation rather than *ex post* litigation', to address pervasive market failures; but it ends with an invitation 'to those more deeply schooled in administrative law and other disciplines to help fill the picture of how such a regulator can optimally be structured'.⁷⁴

In 2007, in an influential publication entitled 'Unsafe at Any Rate' and aimed at a general audience, Warren had further queried why consumer products (such as toasters) are regulated to ensure minimum levels of safety (so they should not burn down homes) whereas consumer credit services were not (even though they can also lead to people losing their homes). After broadly identifying informational and decision-making problems afflicting consumer borrowers, Warren went on to propose a 'Financial Product Safety Commission' similar to the US agency established in the 1970s to monitor comprehensively and maintain the safety of tangible consumer goods. She suggested that this new regulator:

could develop nuanced regulatory responses; some terms might be banned altogether, while others might be permitted only with clearer disclosure. A Commission might promote uniform disclosures that make it easier to compare products from one issuer to another, and to discern conflicts of interest on the part of a mortgage broker or seller of a currently loosely regulated financial product.⁷⁵

However, although this publication helped push the US government to establish the CFPB in 2010, Warren did not develop detailed analogies with the different forms of consumer product safety regulation. Nor did she set out specifically how those forms might compare or interact with other mechanisms for promoting product safety.

The rest of this article therefore delves more deeply into these issues, arguing that useful guidance on both why and how to re-regulate consumer credit

⁷⁴ Bar-Gill and Warren, above n 15, 201.

⁷⁵ Warren, above n 15. The title harks back to a famous work about (lack of) safety in automobiles, which eventually resulted in major regulatory improvements for consumer product safety in the US: Ralph Nader, *Unsafe at Any Speed: The Designed-In Dangers of the American Automobile* (Grossman, 1965).

services can indeed come from comparing consumer product safety law and policy. Overall, we suggest that re-regulation should depend on estimates about market efficiencies (and inefficiencies), community or cultural values, and the political values behind current lending practices compared to the costs and benefits of various types of interventions.⁷⁶ More specifically, we draw insights for consumer credit from how public law, private law and markets can each provide incentives to supply safe goods (Part IVA). We also engage in a closer comparison of the specific regulatory tools now widely available to consumer product regulators in major developed countries — including Japan, the US, Europe and Australia (Part IVB).

A *Three Incentive Mechanisms for Safe Products – and Safe Credit?*

The starting point is to extend to *credit services* a matrix developed to correlate types of *product* risks with three major forces theoretically capable of providing greater incentives for consumer safety: markets, the judicial system (especially private law) and the political system (especially direct regulation by public authorities).⁷⁷

Table 1: Risk Types vs Safety Incentive Mechanisms

Risks: Probability / Severity of Harm		⇐ Severity of Harm ⇒		
			Judicial system (private law): Type I	
↑ Probability ↓	Markets: Types I and also III	Type III High/Low (eg 3b)	Type I High/High (eg 1, 2a)	<i>Political system</i> (public regulation): Type I
		Type IV Low/Low	Type II Low/High (eg 2b, 3a)	

⁷⁶ Cf Productivity Commission, above n 35, especially 44: a flowchart for ‘identifying and evaluating policy instruments’. The Commission argues that identifying the ‘problem facing consumers’ should involve considering ‘community expectations’ (including ‘fairness’ and ‘ethical treatment’) — in effect, political values — as well as market characteristics, information failures, and consumer characteristics (including ‘behavioural attributes’). Identifying the appropriate policy response should compare effectiveness and net benefits of competition policy, redress mechanisms (such as courts or ombudsman schemes), the provision of information, and (further) regulation of supplier behaviour or product quality. The flowchart also urges ‘periodic review’ if policy is implemented; we believe a good consumer policy-making process should equally include such a feedback loop if new policy is *not* implemented, as the problems, possible measures and net benefits may equally change over time.

⁷⁷ Luke Nottage, ‘Product Safety’ in Geraint Howells, Iain Ramsay and Thomas Wilhelmsson (eds), *Handbook of International Consumer Law and Policy* (Edward Elgar, 2010) 256, 260; adapted from Hiroshi Sarumida, ‘Comparative Institutional Analysis of Product Safety Systems in the United States and Japan: Alternative Approaches to Create Incentives for Product Safety’ (1996) 29 *Cornell International Law Journal* 79, 88. Cf also, A Mitchell Polinsky and Steven Shavell, ‘The Uneasy Case for Product Liability’ (2010) 123 *Harvard Law Review* 1437.

Thus, despite its often higher (direct and indirect) costs to society, public regulation tends to be invoked to address ‘Type I’ products — with a high probability of harm and grave consequences. Examples would include most pharmaceuticals (example number 1 in Table 1 above) or products used every day in or around the home that might contain quite toxic chemicals, such as certain types of wood coatings (example number 2a). Likewise, in consumer lending markets, public regulation may be more appropriate for payday or cash loan services generally. It also tends to be feasible for ‘Type III’ products where adverse consequences are less severe but risks of them materialising are high, such as cigarette lighters generally (number 3b). This is partly because repeated incidents typically generate media coverage or at least more scope for political attention. Certain types of ‘low-doc’ mortgages in the US, without all or many of the features associated with high levels of defaults (such as teaser interest rates), would be a good analogy from the field of consumer lending services.

Market forces can also play a role in encouraging suppliers to make both Type I and Type III products or services safer, as reputation can otherwise suffer. But this will often not be enough — for example, if all or most of the industry becomes entrenched in the ways it effects those supplies. Indeed, such entrenchment can readily occur when it is less costly to follow competitors’ strategies than to devise a more reputable product, as often tends to be the case in consumer credit markets.⁷⁸

Even more problematic are ‘Type II’ risks, where the probability of harm is low — thus limiting the scope for reputational effects on firms or impact on the political system — even if the consequences are drastic for particular victims. Cigarette lighters that fall into the hands of children are one example (number 3a). Another might be low-doc mortgages (even without teaser rates) targeted at particularly vulnerable groups such as the elderly poor. Another Type II product risk could be treated-wood building products professionally installed even in private homes (number 2b), with limited chances of owners coming into regular direct contact with them — albeit possibly still with devastating subsequent effects, such as cancers. An analogy in consumer lending would be payday or cash loans to well-educated higher-income earners, where default risks are generally significantly lower, but do occasionally materialise with disastrous consequences. For all these Type II risks, however, private law remedies can often be sufficient to motivate suppliers to take greater precautions. This is because potentially large damages claims can be more credibly asserted by consumers, despite barriers in access to justice through the court system.

Thus, public and private law as well as market mechanisms may each be more or less appropriate to incentivise suppliers towards optimal levels of consumer safety, depending on the likelihood of risks eventuating and their consequences. Also relevant in this schematic are the innate characteristics of likely consumers, and the situations in which the goods or services are likely to be consumed. Policy-makers should attempt these sorts of risk assessments across various types of consumer credit, following the lead of those interested in the

⁷⁸ See, eg, Bar-Gill and Warren, above n 15.

safety of tangible goods, although they may well find that some factors affecting riskiness are more specific to the services field.

Admittedly, the schematic itself is still quite stylised. For example, *public regulation* can comprise administrative law and sanctions, but also criminal law. The latter can provide specific criminal sanctions as part of a targeted regime, incorporated for instance within consumer law providing particular product safety requirements, or criminal law can have a more general impact through broader prohibitions found generally in a Criminal Code. An example from Japan is the offence of ‘professional negligence causing death’ (*Criminal Code*, Law 45 of 1907, art 211). This remains a comparatively important incentive mechanism encouraging professionals to take due care in supplying general consumer goods as well as medical services.⁷⁹ Administrative regulation and criminal sanctions may also be combined, as has occurred in Japan to constrain the most outrageously exploitative lenders.

Within the *private law* sphere, a traditionally important mechanism has been contract law — imposing duties on sellers to supply ‘merchantable’ and therefore safe goods. Since the 1970s, product liability law (typically characterised as tort law) has emerged to allow strict liability claims for ‘defective’ or unsafe goods against manufacturers (and usually also importers), even if the harmed user lacks a contractual relationship.⁸⁰ This development has generally been welcomed, particularly as a means of addressing Type II risks.⁸¹

One rough analogy in consumer lending would be Australia’s post-GFC imposition of ‘suitability’ requirements not only on suppliers, but also on intermediaries such as mortgage brokers, under the new *NCCP Act*:

Suitability began in contract [‘fitness for purpose’ in sales of goods, under 19th century Anglo-Commonwealth common law and codifications]. From an implied contractual term dependent on the acquirer making known the purpose [to the direct seller, before the supply], there is now an affirmative conduct obligation. This obligation arises once the potential borrower may enter a contract. The obligation rests on the credit assistant (broker) and on the credit provider. The person who provides credit assistance (which includes advice) or credit has an obligation to do two things. The first is to discover the objectives and requirements — that is, the purpose — of the prospective acquirer. The second is to suggest or provide only suitable credit. This positive obligation is expressed in the negative. That is, the provider must assess whether the credit

⁷⁹ See, respectively, Luke Nottage, *Product Safety and Liability Law in Japan: From Minamata to Mad Cows* (Routledge, 2004) 23–69; Robert Leflar and Futoshi Iwata, ‘Medical Error as Reportable Event, as Tort, as Crime: A Transpacific Comparison’ (2006) 12 *Widener Law Review* 189, 195.

⁸⁰ Nottage, above n 77; David Harland and Luke Nottage, ‘Conclusions’ in Jocelyn Kellam (ed), *Product Liability in the Asia-Pacific* (Federation Press 3rd ed, 2009) 559; Geraint Howells and David Owen, ‘Products Liability in America and Europe’ in Howells, Ramsay and Wilhelmsson, above n 10, 224.

⁸¹ Sarumida, above n 77. See also Itsuko Matsuura, ‘Product Liability law and Japanese-style Dispute Resolution’ (2001) 35 *University of British Columbia Law Review* 135. She emphasises that Japan’s Product Liability Law (No 97 of 1994) was important to expand protection for (effectively) low-probability risks with potentially major consequences, namely more isolated accidents involving complex manufactured goods such as consumer electronics.

is unsuitable. It will be both a civil and criminal offence to provide or suggest an unsuitable credit contract.⁸²

In addition, if the borrower ends up with an unsuitable credit contract, the borrower can apply for an injunction, seek compensation or a declaration that the contract is void, or seek a contractual variation (ss 177–179). Thus, Australia's recent consumer credit legislation mobilises both private and public law incentive effects with the aim of preventing the supply of 'unsafe' consumer loans. By contrast, the obligation to provide financial services, general services and consumer goods that are 'fit for purpose' still usually only has private law consequences.⁸³ However, since the 1970s, Australia's general consumer product legislation does assist injured individuals to bring private law claims if harmed by goods supplied in breach of safety standards or other measures ordered by regulators.⁸⁴ There have also been a few cases recently where plaintiffs have brought private law (tort) claims against providers of unsafe goods based on violations of duties imposed by other legislation. It then becomes a matter of statutory intention as to whether or not that other legislation was intended to trigger only public law consequences.⁸⁵

A clearer dichotomy seems to exist in Japan's legislation re-regulating unsecured consumer loans. Credit suppliers must conduct credit checks (using information from a credit bureau), assess ability to repay, not unduly solicit loans, and not lend if this would bring total indebtedness to more than one third of gross income.⁸⁶ All these are expressed, at least, as merely public law obligations. That is, violations attract administrative and criminal sanctions, but not necessarily any private law consequences. But it remains to be seen whether Japanese courts will infer such consequences as well.⁸⁷ Although this question also depends on the implied intentions of the legislators, courts in Japan have been very reluctant to

⁸² Gail Pearson, 'Reading Suitability Against Fitness for Purpose — The Evolution of a Rule' (2010) 32 *Sydney Law Review* 311, 331. The analogy is only rough not just because of the different definitions of 'manufacturer' (including 'importer' and certain other intermediaries) under product liability legislation (see for example the *Australian Consumer Law*, pt 3–5) compared to the definitions of credit provider or assistant. More importantly, product liability assumes no or limited opportunity for direct contact between them and consumers. Accordingly, the requirement to provide goods that are not defective or unsafe derives from the general 'merchantability' requirement implied in contract law (ie, that goods be suitable for common or usual purposes — including safe use), rather than the implied term of fitness for a specific purpose disclosed before the supply.

⁸³ See, respectively, *ASIC Act 2001 (Cth)* s 12ED(2); *Australian Consumer Law* s 61. This older-style statutory obligation also depends on the specific purpose being disclosed in advance by the acquirer, and the latter's reasonable reliance on the supplier then providing a fit (ie suitable) good or service.

⁸⁴ See *Australian Consumer Law* ss 106(7), 119(3) and 127(3): the harm is presumed to have been caused by the goods supplied in violation of the measure. This reverses the burden of proof in product liability claims under pt 3–5, which put the onus on the injured consumer to prove that the goods were defective or unsafe.

⁸⁵ Jocelyn Kellam and Luke Nottage, 'Happy 15th Birthday, TPA Part VA! Australia's Product Liability Morass' (2007) 15 *Competition and Consumer Law Journal* 26.

⁸⁶ *Moneylenders Law*, Arts 13 and 13-2. A similar regime is also now applied to credit card issuers and sales credit providers, with certain modifications regarding the maximum permitted amount of credit: *Instalment Sales Law* (No 59 of 1961), arts 30-2, 30-2-2, 35-3-3, 35-3-4.

⁸⁷ Cf Andrew Pardieck, 'Japan and the Moneylenders: Activist Courts and Substantive Justice' (2008) 17 *Pacific Rim Law & Policy Journal* 529.

allow private law actions for breaches of consumer protection regulations — particularly compared to German law, which has otherwise generally had a strong influence on both administrative and civil law in Japan.⁸⁸ In one respect, however, the situation is very clear under the Japanese statutory regime. If a loan contract exceeds the interest rate cap of 20 per cent, it now always generates criminal law sanctions for the lender.⁸⁹ However, the payment obligation is also void in respect of the excessive interest component (15, 18 or 20 per cent, depending on the amount of the principal), so the borrower has no private law obligation to pay that component. Thus, the Japanese legislator has also partially mobilised *both* public and private law to incentivise lenders not to supply ‘unsafe’ credit at particularly high interest rates.

Thus, the risk-based approach to different forms of intervention (outlined above and in Table 1) can be refined and developed in these ways to assess the possibilities and challenges in combining different mechanisms to incentivise safety activities of suppliers of consumer credit, as well as for consumer goods. Policy-makers should also take into account possibly different risk cognition patterns among different groups within any given society, let alone among different countries, as outlined in part III above. As a further complication, an assessment of the various main mechanisms providing incentives to supply safe goods and services must examine more closely the relative costs and benefits of each mechanism and sub-mechanism, and of their various possible combinations.

It may seem superficially attractive, for example, for governments to expand private law remedies while reducing direct regulation by public authorities. That was already part of the rationale for enacting Japan’s Product Liability Law in 1994. It was envisaged that expanded scope for private law relief would offset any diminution of *ex ante* regulation. The World Trade Organization Agreements had been signed in 1994, significantly liberalising trade in goods and expanding the potential for states to claim against others if product safety regulations constituted disguised trade barriers.⁹⁰ More broadly, since 2001 the Japanese government has promoted a suite of ambitious justice system reforms, substituting *ex ante* public regulation in favour of more indirect socio-economic ordering achieved through the threat of *ex post* relief pursued by individual claimants. Making such claims credible has meant reforms not only to substantive law, but also to procedural law and many other legal institutions, including liberalisation of the legal profession and a related system of new postgraduate ‘law school’ education.⁹¹

Yet, especially after the GFC, there is growing concern about the overall costs of operating this new system of justice. A rather different public-private balance does seem to have emerged, but there seems little chance of much further

⁸⁸ Marc Dernauer, *Verbraucherschutz in Japan [Consumer Protection in Japan]* (Mohr Siebeck, 2008).

⁸⁹ *Shusshi-ho or Law on Investments, Deposit Taking and Other Financial Transactions* (No 195 of 1954), art 5(2).

⁹⁰ Nottage, above n 77.

⁹¹ Daniel Foote, ‘Introduction and Overview: Japanese Law at a Turning Point’ in Daniel Foote (ed), *Law in Japan: A Turning Point* (University of Washington Press, 2007) xix.

diminution in the role of the state over the foreseeable future.⁹² In fact, Japan has already re-regulated consumer product safety following a series of major safety failures since 2000, as well as introducing stiffer public regulation of consumer credit from 2006, rather than further reforms primarily aimed at bolstering private law remedies and the judicial system.⁹³ Against that background and, more recently, with the lessons learned from the GFC, calls to rely more on market mechanisms to secure safe goods and safe credit are also unlikely to seem very plausible, although corporate Codes of Conduct and other forms of Corporate Social Responsibility have proliferated in Japan.⁹⁴

B Public Regulation for the Safety of Consumer Goods – and Credit?

It is admittedly difficult to add a detailed assessment of relative short- and long-term costs involved in the various major mechanisms that can generate incentives to supply safe goods or services. However, the problem can partially be sidestepped when it comes to considering legislative enactments. This is because statutes themselves typically cost little to create, compared to their implementation — either through regulatory enforcement activity or claims pursued through the courts. It is therefore relatively easy for governments to add regulatory powers in the field of ‘post-sale’ consumer product safety, for example, because the government is not generally bound actually to enforce them. This rather cynical perspective perhaps helps to explain how quite similar regimes have emerged in Australia and its major trading partners.⁹⁵

⁹² See, eg, Luke Nottage, Leon Wolff and Kent Anderson (eds), *Corporate Governance in the 21st Century: Japan's Gradual Transformation* (Edward Elgar, 2008); Tanase, above n 66; Leon Wolff, Luke Nottage and Kent Anderson (eds), *Who Judges Japan? Popular Participation in the Japanese Legal Process* (Edward Elgar, 2011). Despite these difficulties, the government may keep proclaiming the need for a more vibrant judicial system and private law relief mechanisms, as part of a broader political program promoting citizen autonomy and empowerment. Such political values, largely independent of economic rationales, remain a powerful factor behind the introduction of a new quasi-jury system for serious criminal cases: Kent Anderson and Mark Nolan, ‘Lay Participation in the Japanese Justice System’ (2004) 37 *Vanderbilt Journal of Transnational Law* 935.

⁹³ See generally Luke Nottage, ‘The ABCs of Product Safety Re-regulation in Japan: Asbestos, Buildings, Consumer Electrical Goods, and Schindler’s Lifts’ (2006) 15 *Griffith Law Review* 242; Kunihiko Nakata, ‘Recent Developments in Japanese Consumer Law’ (2009) 27 *Penn State International Law Review* 803. Certain types of consumer transactions can attract injunctive relief claims since 2006 reforms, but only by government-accredited consumer groups; and new collective action procedures for claiming damages are still being considered.

⁹⁴ Adam J Sulkowski, S P Parashar and Lu Wei, ‘Corporate Responsibility Reporting in China, India, Japan, and the West: One Mantra Does Not Fit All’ (2008) 42 *New England Law Review* 787. See also, Nippon Keidanren, Japan Business Federation, *Charter of Corporate Behavior & its Implementation Guidance* (Japanese Business Federation, 2010) [trans of *Kigyo-Kodo-Kensho Jikko-no-Tebiki*] (6th ed, 14 September 2010).

⁹⁵ Adapted from Nottage, above n 77, 269 (containing details of the respective legislative history).

Table 2: Comparing the Introduction of Consumer Product Safety Regulations

Feature	US	UK	EU	Japan	Australia
Standards	1972 (and '81)	1961	1992	1973	1974
Bans	1972	1978	1992	1973	1974
Warnings	1972	1978	1992	-	1974
General Safety Provision ('GSP')	-	(1994)	1992	-	-
Recalls	1972	(2006)	1992 and 2001	1973	1986
Information disclosure	1972 and 1990	(2006)	2001	2006	2010

Thus, all these jurisdictions now have provisions allowing regulators to:

- (1) set certain mandatory safety standards (requiring goods to meet certain thresholds for physical components or performance, or to provide certain warnings or information to consumers so they can themselves minimise adverse effects from otherwise risky products);
- (2) ban goods if causing or likely to cause serious harm; and
- (3) order recalls of such goods.

Yet these powers cost much more to invoke than to enact, and so far have been quite infrequently applied by regulators in all these jurisdictions.

A more noticeable divergence (shaded in Table 2 above) relates to information disclosure duties imposed on suppliers, requiring them to inform regulators after becoming aware that goods have caused product-related accidents. The US was quick to impose such an obligation (in its *Consumer Product Safety Act 1972*, revised in 1990); but it has had reduced practical significance given that nation's unique reliance on (private law) product liability suits as a mechanism to address and publicise possible safety risks.⁹⁶ The EU included a disclosure requirement in its revised General Product Safety Directive (2001/83/EC). It was to be incorporated into the law of each member state by 2004, although the UK only implemented the reform in 2006 (as indicated by parentheses in Table 2). That was also the year in which Japan's Consumer Product Safety Law (No 31 of 1973) added a disclosure obligation on suppliers, albeit more limited in scope. It is triggered by (a) actual accidents known in fact to suppliers, not also (as in the EU) all serious risks of accidents reasonably known to suppliers; or (b) certain hazards specified by regulations (currently, fires and carbon monoxide emissions), even if fortunately no harm ensues. It took Australia until 2010 to enact a disclosure

⁹⁶ On the unique importance of product liability law in the US, see Mathias Reimann, 'Liability for Defective Products at the Beginning of the Twenty-First Century: Emergence of a Worldwide Standard?' (2003) 51 *American Journal of Comparative Law* 751. On broader differences in its attitudes towards consumer protection, compared to (especially continental) Europe, see James Q Whitman, 'Consumerism Versus Producerism: A Study in Comparative Law' (2007) 117 *Yale Law Journal* 340; Ramsay, above n 10, 375–80.

obligation, but this is even narrower in scope — limited to known accidents (not mere risks) causing serious injury or illness (excluding slow-onset illnesses).⁹⁷

One explanation for these cross-jurisdictional differences in scope, and delays in introducing them, could lie in the political power of industry compared to consumer groups. But another factor is that any such obligations to disclose accident data to the regulators are much more likely to require extra government capacity to deal with the influx of information. In turn, this implies an immediate and readily identifiable extra budget allocation — something that may not have been politically palatable, especially in pre-GFC deregulatory environments.

Similar considerations could apply even to the ‘General Safety Provision’ (GSP) introduced in the EU from the 1990s, but not yet in Australia, Japan or the US. A general requirement like this, namely not to supply unsafe goods, would seem more ominous to industry groups compared to duties to comply with some narrowly defined minimal safety standards. But it would also tend to create pressure for significantly more resources for regulators to monitor and sanction breaches of the new broad GSP. While some political scientists expect regulators always to welcome and press for more budget and power, even that (controversial) theory would need to acknowledge that other groups (even within government) can often effectively resist ‘costly’ innovations.⁹⁸ This is particularly likely where, as in Australia from the mid-1990s, new regulations are essentially only to be introduced upon proof that the benefits outweigh the costs.⁹⁹

Yet such practical considerations have not prevented a raft of consumer law reforms in Australia since 2009, outside the product safety field. For example, the *Australian Consumer Law* adds new regulatory powers such as ‘substantiation notices’ (s 219), ‘infringement notices’ (s 134A) and the possibility of banning businesspeople from directorships (s 248).¹⁰⁰ The Productivity Commission’s Report that prompted these reforms drew partly on the ‘regulatory enforcement pyramid’ model proposed by Ayres and Braithwaite in the early 1990s.¹⁰¹ Derived from game theory as well as Braithwaite’s own experience in the consumer movement, that model emphasises the need for regulators to respond to a non-compliant firm with a minimum level of sanctions, so as to be able to escalate to higher sanctions if the firm remains recalcitrant. Restoring and maintaining cooperative relations in this way implies that the regulator should have at its disposal a panoply of graduated sanctions.

⁹⁷ Harland and Nottage, above n 80; *Australian Consumer Law*, ss 131–132 (applicable from 1 January 2011). Cf broader duties enacted in Canada: Luke Nottage, ‘Suppliers’ Duties to Report Product-Related Accidents under the New Australian Consumer Law: A Comparative Critique’ [June–August 2011] *Commercial Law Quarterly* 3.

⁹⁸ Pre-GFC financial markets (de)regulation in the US and the UK are good examples. See *Financial Crisis Inquiry Report*, above n 3; DiLorenzo, above n 54; and more generally Ramsay and Williams, above n 3.

⁹⁹ See generally, Bronwen Morgan, *Social Citizenship in the Shadow of Competition: The Bureaucratic Politics of Regulatory Justification* (Ashgate, 2003). The Productivity Commission (above n 35, 188) concluded that this onus had not been discharged in the case of a GSP for Australia.

¹⁰⁰ Corones, above n 8 [13.270], [13.285], [13.1315].

¹⁰¹ Cf, Productivity Commission, above n 35, 227–55 (especially 228) with Ayres and Braithwaite, above n 16.

This theory also appears to have been influential in corporate and securities law reform. It is also consistent with Australia's credit law reforms in 2009, which provide for both civil and criminal penalty options for regulators responding to lenders who provide unsuitable credit.¹⁰² The theory is probably attractive to contemporary legislators because it holds the promise of achieving more effective compliance without regulators actually having to invoke severe (and more costly) sanctions. However, recent empirical research into Australia's recent corporate law reforms suggests that regulators do need to maintain enforcement activity in order to make the model operate credibly and effectively.¹⁰³ Moreover, in our view, the regulatory enforcement pyramid model also requires good information flows between firms and regulators, so that the latter know when to threaten and even to apply the more stringent sanctions.

Thus, from this perspective, Australia's new obligations on suppliers to disclose product-related accident data are to be welcomed, especially if the new requirements are properly enforced and regulators are prepared occasionally to escalate sanctions (for example, ordering bans or recalls). Yet the same perspective also uncovers a major gap in consumer credit regulation in Australia, Japan and elsewhere. Despite many reforms, nowhere do we find any specific obligation on lenders to disclose information *to regulators* about 'accidents' or risks later befalling their borrowers. Instead, credit regulation remains fixated — arguably, over-fixated — on information disclosure directly *to borrowers*, before or when the loan contract is concluded.¹⁰⁴ However, if credit suppliers had to disclose information about problematic patterns emerging from their loan portfolios — as product suppliers now generally must do, regarding general consumer goods — then regulators could operate a more effective enforcement pyramid and achieve better cooperative relations with regulated firms.

It may appear more difficult to implement this additional disclosure requirement in the case of consumer credit. The problem derives primarily from an unusual feature of credit services compared with tangible goods: the borrower is not only a customer purchasing the service, but also a potential source of costs to the lender as the provider of the service. Thus, on the one hand, the lender will typically experience any disclosure of its default rates as equivalent to uncovering its cost structure. On the other hand, the borrower will be concerned about his or her privacy if obliged to deliver detailed information about his or her financial performance and other indicators of potential stress, even if this information may be aggregated and reviewed by the lender as part of a reporting obligation *vis-à-vis* the regulator.

However, the problem should not be insurmountable if the reporting requirement is appropriately limited. Particularly in Japan, for example, a new duty requiring disclosures from lenders to regulators could be triggered by especially

¹⁰² Pearson, above n 82.

¹⁰³ Michelle Welsh, 'Continuous Disclosure: Testing the Correspondence Between State Enforcement and Compliance' (2009) 23 *Australian Journal of Corporate Law* 206; see also Vicky Comino, 'The Challenge of Corporate Law Enforcement in Australia' (2009) 23 *Australian Journal of Corporate Law* 233.

¹⁰⁴ Paterson, above n 48.

high levels of suicides among a firm's borrowers.¹⁰⁵ More generally, disclosure could be required if borrowers experienced higher levels of insolvencies than usual in the industry sub-sector or even for that particular lender. Disclosure duties could be made more manageable for credit suppliers by limiting them to quite specific adverse outcomes along these lines, rather than broader 'serious risks' of such outcomes.¹⁰⁶

Admittedly, borrowers may become insolvent or commit suicide for many reasons, which are not necessarily directly related to the features of their loans. However, we can allow for this by limiting the new disclosure obligations to situations where rates are unusually high by historical standards. Similar difficulties can also arise concerning adverse health outcomes that may be associated with unsafe goods, but one compromise (as under Japan's *Consumer Product Safety Law*) is to not require disclosure if the accident is 'clearly' not related to the product. A similar solution could be extended to a new duty on suppliers of consumer credit.

Another practical issue concerns how suppliers would know about serious problems such as suicides or insolvencies as potential triggers for disclosure to regulators. Yet the situation should be simpler for lenders as they are in long-term contractual relationships with borrowers, and therefore can know (or readily infer) that something is amiss when they end up having to deal with the borrower's trustee in bankruptcy or the executor of the deceased's estate. By contrast, direct suppliers of consumer goods under one-off sales — let alone the original manufacturers — are more likely not to know that accidents have occurred. Despite this, many jurisdictions now impose disclosure duties on them — either when suppliers become actually aware of accidents (as in Australia and, generally, in Japan), or when they ought to become aware of them (as in the EU). The former approach may provide an incentive for 'wilful blindness'. The latter encourages

¹⁰⁵ Mass suicides were also allegedly linked to over-indebted borrowers recently in Andhra Pradesh, prompting many recommendations for reform (including caps on interest): Reserve Bank of India, *Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector* (January 2011). In the UK, the FSA already requires providers of secured consumer credit to make monthly activity reports, in the context of a recently introduced 'meta-regulatory' obligation to 'treat customers fairly' — or risk escalating sanctions, ending in de-licensing. This indeed involves 'a form of ex ante regulation': Ramsay and Williams, above n 3, pt IV. Australia's *NCCP Act 2009* (Cth) also already requires all credit licensees to lodge 'compliance certificate' (s 53), with the regulator expecting them to keep records of monitoring and reporting (see Australian Securities and Investment Commission, *Annual Compliance Certificates for Credit licensees*, Australian Securities and Investment Commission, <<http://www.asic.gov.au/asic/asic.nsf/byheadline/Annual+compliance+certificates+for+credit+licensees?openDocument>>). Licensees must also belong to an approved External Dispute Resolution Scheme for consumer complaints (s 47(1)(ii), with reg 39 requiring Schemes to provide for reporting of 'systemic issues'. This can provide another avenue for regulators to find out about unusual patterns in consumer credit markets. For bankruptcies subject to formal proceedings, there also already exists a searchable National Personal Insolvency Index; see Insolvency and Trustee Service Australia, *National Personal Insolvency Index* (17 November 2011) Insolvency and Trustee Service Australia, <<http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/creditors-%3Enpii>>.

¹⁰⁶ Thus, in this respect and at least initially, the regime would be closer to the narrower one operating in Japan or especially Australia for disclosure of consumer *product* related data, rather than the regime in the EU. See Nottage, above n 97.

suppliers actively to seek out and monitor information, but at additional cost, and perhaps for little gain in the context of a new duty on credit suppliers. Consequently, it is probably better for policy-makers — at least initially — to limit the disclosure obligation to situations where lenders are actually aware of unusually high levels of suicides or insolvencies

Overall, such disclosures could set off warning bells for credit regulators, prompting them to scrutinise a firm's (or even an industry's) lending practices and terms more closely — and to enforce more effectively. For example, in Australia civil or even criminal penalties are incurred if lenders turn out to have been providing unsuitable levels or types of credit. Regulators could also make much, or perhaps all, of this disclosed information available to the general public — albeit adding summary analysis to minimise 'information overload', particularly among non-experts. This would have several benefits. First, consequent extra public scrutiny would encourage regulators to take reports received from lenders more seriously and to undertake follow-up enforcement activities, which recent empirical research (in the corporate law context) suggests is also necessary to keep the overall regulatory enforcement pyramid working effectively. Second, the regulators' public disclosure of 'accident' reports received from lenders would help put other borrowers 'on notice' about evolving potential risks. Much is now being written, particularly from a behavioural law and economics perspective, about the ineffectiveness of pre-contract disclosure directly from lenders (or intermediaries, like brokers) to borrowers. Part of the problem is that the information or warnings provided tend to be broadly worded.¹⁰⁷ By contrast, allowing borrowers (or consumer groups) to access information about more specific problems, provided initially by lenders to regulators, should help make the risks involved more salient for potential borrowers.¹⁰⁸

This new information disclosure obligation on lenders would fill a major gap in the regulatory enforcement regime for consumer credit. That regime is indeed now drawing much closer to the regime for consumer product safety in other major respects. First, for example, credit regulation typically already has analogues to mandatory safety standards for goods. Lenders are required to make disclosures directly to borrowers, just as regulators can demand that manufacturers and others affix warning labels or provide specified information when supplying consumer goods. Second, to maintain product safety, regulators can order that goods include certain components or features, or allow manufacturers to find alternative or additional ways to achieve mandated performance standards. Similarly, credit suppliers may be required to include certain substantive terms in their loans contracts. More commonly, credit regulators specify that other terms *cannot* be included. For example, in loan contracts concluded anywhere in Australia from 2011, and in Japan since 2000, overly one-sided or unfair terms are

¹⁰⁷ See for example Ramsay, above n 10 at 385–9; see generally Productivity Commission, above n 35 at ch 11.

¹⁰⁸ It would therefore be better to adopt the transparent approach taken under the consumer product safety information disclosure regime enacted by Japan in 2006 rather than that taken by the *Australian Consumer Law* (s 132A), which essentially requires regulators to keep confidential accidents reports received by suppliers. See the reports displayed via <<http://www.caa.go.jp/safety/index.html>>. See Nottage, above n 97.

now void.¹⁰⁹ Moreover, in some Australian states and throughout Japan, interest rates exceeding specified levels are void — and also attract criminal sanctions.

Third, under Australia's new *NCCP Act*, there is even now a rough analogue to a GSP. Article 3(1) of the EU's General Product Safety Directive requires suppliers to supply only 'safe' goods, while the *NCCP Act* requires lenders to make loans which are 'not unsuitable'.¹¹⁰ The same is true with Japan, where the legislative amendments in 2006 generally prohibit lending of 'an amount that will exceed the ability of the borrower to repay'.¹¹¹ It is ironic that Australian (and Japanese) borrowers now obtain better protection in this respect than Australian (and Japanese) users of general consumer goods. In light of this development in consumer credit regulation, the Australian government should revisit its Productivity Commission's recommendation in 2008 not to include a GSP within the product safety regulation scheme of the *Australian Consumer Law*.¹¹² Meanwhile, however, if Australian regulators do later find consumer goods to be 'unsafe', at least they can ban their supply or order a mandatory recall (ss 109, 114 and 122). Rather similarly, consumer loans found to be unsuitable can attract civil and criminal penalties under the *NCCP Act*.

Thus, our proposal for a new obligation on suppliers of consumer credit to alert regulators about abnormal risks arising after the supply of their services, paralleling duties on many consumer goods suppliers worldwide nowadays, would help bring both regimes closer together. It responds to the more general arguments for such an alignment made by Warren and others over recent years, pointing out many common features of consumer credit services and consumer goods, drawing especially on information and behavioural economics (parts II B and II C).

¹⁰⁹ See, eg, Paterson, above n 48; Luke Nottage, 'Consumer Law Reform in Australia: Contemporary and Comparative Constructive Criticism' (2009) 9 *Queensland University of Technology Law and Justice Journal* 111. Admittedly, the starting point in both countries is simply that the unfair term is void as between the parties, protecting the consumer if the firm tries to enforce the term. Nonetheless, if a court declares a term to be unfair, continued usage constitutes a contravention of the *Australian Consumer Law* and therefore attracts further regulatory sanctions. The same is true of terms subject to successful injunction actions under *Japan's Consumer Contract Law* (No 61 of 2000), if suppliers persist in using them.

¹¹⁰ However, Pearson (above n 82) does suggest that framing the obligation on credit suppliers in the negative may allow scope for it to be interpreted more narrowly than if it had been phrased simply as an obligation to 'provide "suitable" credit' — as with 'suitable' consumer goods. For a proposal for a general suitability requirement in US consumer credit law, see Engel and McCoy, above n 52.

¹¹¹ *Moneylenders Law*, art 13-2(1). Indeed, the case of total loans exceeding one third of the borrower's annual gross income is listed as an example of such 'unsuitable' lending. The latter 'backstop' bright-line rule represents a closer analogue to the GSP in the case of tangible goods, by essentially defining 'unsafe' credit for an entire category of borrowers (those whose overall indebtedness exceeds one third of income) even if a borrower's specific circumstances may make loans beyond that threshold manageable or 'suitable'. (Similarly, assessments of product safety take into account the intended and reasonably foreseeable user groups.) As noted above (n 82), a general 'suitability' requirement instead focuses on the individual circumstances of the consumer.

¹¹² Productivity Commission, above n 35, 188. One possible compromise, suggested by the Commission in its earlier Report, might be to apply extra sanctions to a firm whose 'products are later banned or subject to a mandatory recall as "unsafe"'. This will encourage firms to supply only goods which are 'not unsafe': see Luke Nottage, 'Reviewing Product Safety Regulation in Australia — and Japan?' (2005) 16 *Australian Product Liability Reporter* 100.

In addition, we suggest that adding this new disclosure duty should also appeal on cultural risk cognition grounds, as outlined above (part III). Specifically, it would likely affirm the worldview of ‘individualists’, especially if regulators disclosed reports to the public after receiving them from suppliers. In parallel with such a reform, retaining or adding interest rate caps (even if set at high levels) would help make the overall regulatory scheme more palatable for those holding egalitarian or communitarian worldviews, and who therefore adopt different attitudes towards commercial risks (including, arguably, consumer credit risks). This combination of reforms therefore would provide another application of Kahan’s empirically-based political theory. That is, ‘rather than cleansing the law of culturally partisan meanings, lawmakers should infuse it with multiple meanings able to affirm a wide range of competing (emotional) worldviews, while allowing debate on their moral appropriateness’.¹¹³ Our proposed reforms could also thereby open up a new avenue for a broader moral discourse in regulatory settings — not constrained by consequentialist reasoning — aimed only at achieving ‘compliance’ in a narrow sense. Such a ‘compliance trap’ may often end up being ineffective for regulators themselves,¹¹⁴ as well as being dubious from a broader political or societal perspective.

V Conclusions

This article has taken up several major challenges, from an innovative comparative public policy perspective drawing on the experiences of several jurisdictions including Japan. Hopefully it will encourage others to undertake further theoretical and empirical studies along similar lines. Policy-makers need to step back from the GFC and its aftermath, and consider how to avoid future economic crises through better regulating of the ‘retail’ side of financial markets (lending to consumers), not just the ‘wholesale’ side (how banks and others are licensed or raise funds).

Generally, we should reassess the normative implications of various schools of thought partly in light of the evolving empirical evidence. The limits of Chicago School neoclassical economics are increasingly evident in the context, for example, of the rise and partial fall of unsecured consumer lending in Japan. More convincing are the lessons from information and behavioural economics, which have also played a major role in establishing new regulatory frameworks for consumer credit, especially in the US, but not exclusively so. Behavioural economics provides an increasingly powerful rationale for interventions going beyond information disclosure to borrowers, or broader ‘financial literacy’ for

¹¹³ Kahan, above n 1, 101. Arguably, this perspective accounts for the increasingly widespread acceptance of consumer product safety regulations in various forms, including minimum safety standards and accident information disclosure obligations, across major economies as outlined in Table 2 above. Another normative challenge is then to appeal to groups holding different world views, within those economies, by expanding the regulatory tools available for addressing consumer credit risks.

¹¹⁴ See, eg. Christine Parker, ‘The “Compliance” Trap: The Moral Message in Responsive Regulatory Enforcement’ (2006) 40 *Law and Society Review* 591.

consumers.¹¹⁵ Yet further empirical work remains to be carried out within particular countries, and we also need to be aware of the evidence and normative implications emerging from cultural risk cognition studies by Kahan and others. These generally suggest that we should design regulatory regimes (and political processes to produce those regimes) that allow scope to affirm the identities or worldviews of various groups within a society, which tend to perceive risks quite differently. Thus, empirically-informed cultural theory and political theory must be considered as well. From both those vantage points, as well as behavioural economics in particular, there already seems to be greater scope to introduce more ambitious measures to regulate consumer credit markets. These may even include interest rate caps, long ridiculed by Chicago School theorists.

We must also take up the challenge, laid down by Warren and others, of teasing out appropriate analogies between regulating for consumer product safety and for the ‘safety’ of consumer credit services. Useful parallels can be drawn based first on the types of risks found in both spheres. Direct regulation by public authorities, rather than more indirectly through the spectre of private law litigation and reputation-based or other market mechanisms, is particularly appropriate for high-probability risks. Moreover, a closer comparison of product versus services regulation highlights one major gap in the consumer credit arena, even after the GFC. Lenders, unlike many suppliers of consumer goods world-wide nowadays, are still not specifically required to disclose serious post-sale problems to regulators. Yet adding this additional information disclosure obligation would significantly enhance the regulatory enforcement pyramid in the consumer credit field, as it already has in other areas of law. Such a reform also seems to be quite plausibly justified on the basis of cultural risk cognition studies, as well as more conventional behavioural economics.

¹¹⁵ See also Ramsay and Williams, above n 3.