

BANKRUPTCY LAW AS SOCIAL LEGISLATION

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I. INTRODUCTION

Bankruptcy law is generally thought of as being purely economic in nature.¹ For corporate bankruptcy law, this generalization is largely correct, as corporate bankruptcy is grafted onto a preexisting framework of limited liability corporation law. For consumer bankruptcy law, however, this belief conceals the realization that bankruptcy law is also, if not primarily, social legislation.² When individuals file for bankruptcy, they obtain relief from debts incurred or have their debts entirely forgiven. Essentially, this process creates a system of legalized post-contractual opportunism.³ This post-contractual opportunism is justified in large part by the moral judgment that an honest but unfortunate debtor should be entitled to a discharge of debts.⁴ Although some recent scholars have examined the moral foundations of consumer bankruptcy law, these discussions focus almost exclusively on the moral foundations of the fresh start and ignore the larger moral and social issues raised by bankruptcy law.⁵ Bankruptcy law is not just

1. See, e.g., THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 5 (1986) ("This role of bankruptcy law [how assets are used]—historically its original function—is that of bankruptcy as a collective debt-collection device, and it deals with the rights of creditors [The] goal is to permit the owners of assets to use those assets in a way that is most productive to them *as a group* in the face of incentives by individual owners to maximize their own positions. . . . Bankruptcy law, at its core, is concerned with reducing the costs of conversion.").

2. Cf. *id.* at 229 ("Discharge may be viewed as a form of limited liability for individuals—a legal construct that stems from the same desires and serves the same purposes as does limited liability for corporations.").

3. See, e.g., Lawrence H. White, *Bankruptcy as an Economic Intervention*, 1 J. LIBERTARIAN STUD. 281, 283-84 (1977) (discussing loans as contracts giving the creditor a right to payment from the debtor or a lien on his property—a contract that bankruptcy provisions interfere with and debtors take advantage of by "resort[ing] to bankruptcy rather than tighten[ing] their belts to meet obligations").

4. See, e.g., Peter C. Alexander, *With Apologies to C.S. Lewis: An Essay on Discharge and Forgiveness*, 9 J. BANKR. L. & PRAC. 601, 601-02 (2000) (stating that the "central purpose" of bankruptcy is to "forgive the indebtedness of the honest but unfortunate individuals who seek protection from their creditors").

5. See *id.* at 601-02; see also KAREN GROSS, *FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM* 2 (1997) (providing "justification for the fresh start for individual and business debtors, based on notions of forgiveness and rehabilitation"); Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515, 529 (1991) (discussing the granting of "financial relief, the fresh start" as an "ethical and moral response" to the inability to pay debt). But see Todd J. Zywicki, *With Apologies to Screwtape: A Response to Professor Alexander*, 9 J. BANKR. L. & PRAC. 613, 614 (2000) [hereinafter Zywicki, *Screwtape*] (discussing the

economic legislation, but social legislation that establishes “how far individuals should be expected to go on carrying responsibilities that have grown onerous.”⁶ This article examines the idea of bankruptcy law as social legislation, investigating the implicit moral and social judgments embedded in bankruptcy law and in the recent arguments over the propriety of bankruptcy reform legislation.

II. THE MORAL CONSEQUENCES OF BANKRUPTCY

Individual bankruptcy has been morally condemned throughout most of human history. Debtor’s prisons, for example, remained the dominant response to bankruptcy through most of the world until recent times.⁷ The severity of the moral and legal condemnation traditionally associated with bankruptcy reflects the gravity of the act. In part, this morality reflects the fact that for most of human history, and during the formative period of both our psychological makeup and most major religious codes, individuals lived in static economies.⁸ Wealth was a fixed pool that could be redistributed, but there was no sense in which wealth could be invested, thereby generating greater social wealth in the future.⁹ As a result, there was also no sense in which money could be borrowed and lost in an entrepreneurial activity designed to increase wealth.¹⁰ Borrowing was purely a short-term transfer from the lender to

moral problems inherent in failing to condemn the actions of those who break their promises and emphasizing a moral code that places value on debt repayment). While the policy of giving individuals a fresh start may be deemed important, this policy does not usually extend to corporations. JACKSON, *supra* note 1, at 4.

6. David Frum, *Bankruptcy Reform is a Moral Issue*, WALL ST. J., Feb. 11, 2000, at A14. Scott Norberg has observed that the debate over bankruptcy reform echoes themes of a *kulturekampf*, a cultural and moral battle between competing worldviews. Scott F. Norberg, *Consumer Bankruptcy’s New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 417 (1999).

7. See John M. Czarnetzky, *The Individual and Failure: A Theory of the Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 423-25 (2000) (discussing the “harshly punitive” nature of the English law of creditors’ remedies during the 14th century).

8. See MICHAEL NOVAK, *THE SPIRIT OF DEMOCRATIC CAPITALISM* 306 (1982) (describing all economies existing prior to the Industrial Revolution as “relatively” static).

9. *Id.* (stating that the “central concern of static economies, like the medieval one” was the “fixing of just prices and wages” as “capital did not produce new wealth” in medieval economies) (citation omitted in original).

10. Cf. F.H. Buckley & Margaret F. Brinig, *The Bankruptcy Puzzle*, 27 J. LEGAL STUD. 187, 193 (1998) (contrasting the “feudal debtor” with “few opportunities for advancement” with the modern investor who may “lever up, take risks, and encounter the reversals that propel them into bankruptcy”).

the borrower and the borrower was expected to repay it. A debtor therefore had no good explanation for why he might later be unable to repay the loan. The failure to do so was therefore traditionally considered a form of fraud or theft, punishable by similarly severe sanctions.¹¹ A legal discharge of debts through bankruptcy did not exist.

In a static economy, the idea of charging interest was condemned as making money off money.¹² It was viewed as a zero-sum redistribution from debtor to creditor just as bankruptcy was seen as a zero-sum redistribution from creditor to debtor. Only when the concept of economic progress and the understanding of investment and capital growth became established did the idea of charging interest become morally acceptable.¹³ Given the modern appreciation of investment as the source of economic growth, it is understandable why bankruptcy is taken for granted in the context of business investment. Although bankruptcy may now be acceptable in the business context, bankruptcy remains suspect in many countries and legal systems as a remedy for individuals.¹⁴

The opprobrium of bankruptcy is easy to understand. Incurring a debt creates a contractual and moral obligation to repay that debt. The failure to repay a debt usually exposes the debtor to severe legal sanctions. Today, default entitles a lender to seize the debtor's nonexempt property in satisfaction of the

11. In England, for example, debtors could be imprisoned for failure to pay a debt; the debtor was regarded as a thief. This state of affairs continued until the 19th century. White, *supra* note 3, at 281-82. For similar reasons, the sin of usury was often condemned as harshly as bankruptcy. See NOVAK, *supra* note 8, at 116, 306 (1982).

12. See NOVAK, *supra* note 8, at 116 (discussing the "long tradition of hostility toward lending money for profit").

13. NOVAK, *supra* note 8, at 306 ("[O]nce capital became creative and its utility in economic progress became clear, moral interpretation was obliged to shift ground."). The changing attitude toward "commercial" debtors was evidenced by such practices as separate bankruptcy statutes for commercial and non-commercial debtors. In England, a non-commercial debtor was viewed as a thief as late as the 19th century. In contrast, a bankruptcy statute for the "involuntary" bankruptcies of commercial debtors was established in 1542 under Henry VIII. White, *supra* note 3, at 282. Bankruptcy law was distinguished from insolvency law, which was the law applied to non-commercial debtors. *Id.* Even in the early stages of English commercial bankruptcy law, however, a commercial debtor could be imprisoned. *Id.*

14. For instance, Israel experienced a "massive increase" in the number of debtors being imprisoned as recently as the early 1990s. Rafael Efrat, *The Evolution of the Fresh-Start Policy in Israeli Bankruptcy Law*, 50 VAND. J. TRANSNAT'L L. 49, 50-51 (1999). A bankruptcy reform law passed in 1996 was "the first ideological shift in Israeli history from a relatively conservative view to a more liberal view of the fresh start policy." *Id.*

debt.¹⁵ In addition to legal obligations and sanctions, borrowing imposes various moral obligations, whether self-imposed or enforced by society.¹⁶ The debtor, for example, has a moral, as well as legal, obligation to allocate his property to the payment of his debts and generally cannot convey his property without reasonable consideration in return.¹⁷ Thus, when someone borrows twenty-five dollars from you and fails to repay it, you are not simply out twenty-five dollars, but you suffer moral outrage independent of the amount borrowed. The breach of the promise and the failure to recognize and reciprocate the good deed triggers a sense of moral indignation related to the breach of trust itself, regardless of the amount borrowed.¹⁸ The emergence of this moral indignation is “aroused by the perception of injustice; as such, it is part of the emotional underpinning of human morality. The outraged reaction that it may trigger serves to clarify that altruism is not unlimited: it is bound by rules of mutual obligation.”¹⁹ Thus, when a lender extends credit to a borrower, the lender trusts the borrower to repay the amount borrowed and such trust relationships inevitably carry with them an element of moral obligation.²⁰

In many ways, this web of reciprocal promises between lender and borrower symbolizes the essence of what it means to be human and to live in a human society. Because of long life spans, intelligence, and stable and egalitarian social structures in

15. A debtor seeking relief has two options under the Bankruptcy Reform Act (the “Code”). He may liquidate under chapter 7 of the Code, and his non-exempt assets will be sold in a liquidation sale. After the sale, he will be relieved of the vast majority of his debts, even those that remain unpaid. *See* 11 U.S.C. §§ 701-766 (1994 & Supp. V 1999). Alternatively, an individual can file for reorganization, usually under chapter 13. Reorganization allows him to keep his assets, but he must pay his creditors at least as much as they would have received under a chapter 7 proceeding. *See id.* §§ 1301-1330.

16. *But see* David Gray Carlson, *Debt Collection as Rent Seeking*, 79 MINN. L. REV. 817, 842 n.57 (1995) (“It is sometimes thought that debtors are weak and creditors powerful. This may be so at the time a loan agreement is negotiated, but quite the opposite is true when the debtor is broke and has nothing to gain from prudent management of assets.”).

17. *Cf.* Todd J. Zywicki, *Rewrite the Bankruptcy Laws, Not the Scriptures: Protecting a Bankruptcy Debtor’s Right To Tithe*, 1998 WIS. L. REV. 1223, 1226 [hereinafter Zywicki, *Rewrite*] (discussing the legal problems facing bankruptcy debtors who have a religious conviction regarding tithing).

18. It is not merely coincidence that the word “credit” is derived from the Latin word for “trust.” THE OXFORD ENGLISH DICTIONARY 1138 (2d ed. 1989).

19. FRANS DE WAAL, *GOOD NATURED* 159 (1996).

20. Rafael Efrat, *The Moral Appeal of Personal Bankruptcy*, 20 WHITTIER L. REV. 141, 162-67 (1998) (discussing Judaism, Christianity, Islam and Hinduism and the moral obligation to repay debts within each religion).

which our human ancestors evolved, humans have developed powerful mental, social, and institutional structures to generate gains from reciprocal trade and reciprocal interactions.²¹ The ability to create and maintain long-term exchange relationships is rooted in human nature.²² Humans feel a natural affinity to satisfy their promises and expect the same from others. This is evidenced by the fact that performing one's financial obligations is universal among human societies. Reciprocity serves as a cornerstone of morality, whether in advanced western societies or primitive hunter-gatherer bands.²³ It is also a tenet of most religions.²⁴ For example, "Christianity, Islam, Judaism and Hinduism clearly foster in their believers a moral code that emphasizes the importance of debt repayment, and hence, the avoidance of bankruptcy at all costs."²⁵ The "Golden Rule," itself a rule of reciprocity, is not an open-ended admonition to do good, but a rule that exemplifies the reciprocity that underlies the social and economic system.²⁶ Implicit in this is a command to reciprocate and to fulfill one's promises and obligations

21. See ROBERT TRIVERS, *SOCIAL EVOLUTION* 386-96 (1985) (discussing the development of "reciprocal altruism" among humans over time); see also Todd J. Zywicki, *Bankruptcy and Reciprocity: An Evolutionary Analysis of Promise-Keeping, Norms, and Bankruptcy Law* 19-29 (George Mason Univ. Sch. of Law, Working Paper, 2001) [hereinafter Zywicki, *Bankruptcy and Reciprocity*]. See generally ROBERT WRIGHT: *NONZERO: THE LOGIC OF HUMAN DESTINY* (2000) (applying the concept of the "non-zero-sum" game to explain biological and social development).

22. See MATT RIDLEY, *THE ORIGINS OF VIRTUE: HUMAN INSTINCTS AND THE EVOLUTION OF COOPERATION* 65 (1997) ("But the lesson for human beings is that our frequent use of reciprocity in society may be an inevitable part of our natures: an instinct. We do not need to reason our way to the conclusion that 'one good turn deserves another,' nor do we need to be taught it against our better judgments. It simply develops within us as we mature."); JAMES Q. WILSON, *THE MORAL SENSE* 105 (1993) (discussing the natural development of conscience and noting that those with "the strongest conscience" will be those "with the most powerfully developed affiliation").

23. See DONALD BROWN, *HUMAN UNIVERSALS* 139 (1991) (asserting that the "Universal People" employ reciprocity as a "key element in their morality").

24. See Zywicki, *Screwtape*, *supra* note 5, at 614-15.

25. Efrat, *supra* note 20, at 167. According to *Psalms* 37:21, "The wicked borroweth and payeth not again."

26. Both the Jewish and Christian variations of the "Golden Rule" are rules of reciprocity, even though the particular obligations imposed are couched in different terms. The Jewish version provides a negative instruction to withhold harm; the Christian version imposes an affirmative obligation to act. See, e.g., Louis Jacobs, *Greater Love Hath No Man . . . The Jewish Point of View of Self-Sacrifice*, in *CONTEMPORARY JEWISH ETHICS* 175, 175-76 (Menachem Marc Kellner ed., 1978) ("[W]hile Christianity is based on the concept of love, Judaism is based on justice. Love demands that a friend give his life for his friend; justice, that his life is not his own to dispose of. . . . [In Judaism], [a]ll men . . . [are] under obligation to assist his neighbor's self-development, so far as he can. But just as I have no right to ruin another man's life for the sake of my own, so I have no right to ruin my life for the sake of another's.").

whenever possible. Most people believe that bankruptcy law should reflect these moral intuitions.²⁷ Bankruptcy should be an instrument of forgiveness for those in need, but it should not be a vehicle for abuse or for frivolous avoidance of moral and contractual obligations.

While moral intuitions against bankruptcy may be universal among societies, they are less than universal among individuals. In the United States, some 1.3 million families file bankruptcy every year.²⁸ These numbers have exploded during an era of unprecedented prosperity and economic security in the United States.²⁹ Clearly, the rising tide of personal bankruptcies of recent years is not being driven by economic distress, job loss, and the like, although the exact causes of the boom remain open to further investigation.³⁰ The widespread perception on the part of the public is that the bankruptcy system is a scam for abusive debtors to escape their financial obligations; this perception has undermined public confidence in the bankruptcy system.³¹ Rather than limiting bankruptcy relief to those in need, the current bankruptcy system provides

27. RIDLEY, *supra* note 22, at 65-66 (“[O]ur frequent use of reciprocity in society may be an inevitable part of our natures: an instinct. We do not need to reason our way to the conclusion that ‘one good turn deserves another’, nor do we need to be taught it against our better judgments. It simply develops within us as we mature, an ineradicable predisposition, to be nurtured by teaching or not as the case may be.”).

28. John C. Henry, *Senate Limits Homestead Exemption in Bankruptcy Reform Bill*, HOUS. CHRON., March 16, 2001, at A1.

29. Individual bankruptcy filings rose from 812,898 in 1993 (after the most recent recession) to 1,217,992 for 2000. See ABI World, *U.S. Bankruptcy Filing Rates*, American Bankruptcy Institute, at <http://www.abiworld.org/stats/newstatsfront.html> (last visited May 23, 2001). This era was marked by low unemployment, steady economic growth, rapid increases in household wealth, and great prosperity in general. See also Buckley & Brinig, *supra* note 10, at 187 (noting similar pattern during 1985-1991 period and observing, “One of the greatest puzzles in American bankruptcy law is how to account for the run-up in consumer filings from 1985 to 1991 One might expect to see an increase in filings during an economic downturn, such as the Great Depression. However, the run-up that began in 1985 coincided with the Reagan economic recovery and crested with the 1991 recession”).

30. See Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177, 242-48 (1999) (stating that many of the factors typically advanced as causes of bankruptcy, such as job layoffs, downsizing, medical costs, and uninsured auto accidents, lack empirical support).

31. The National Consumers League conducted a poll that showed that 71 percent of Americans believe that it is “somewhat” or “much too” easy to file bankruptcy. *Survey Shows Confusion on Current Bankruptcy Laws*, National Consumers League, at <http://www.natconsumersleague.org/bankrupt.htm> (last visited May 10, 2001). The poll also reflected a lack of understanding of the current bankruptcy system by most Americans. Two of three Americans believe that most people must repay a portion of their debts under the current system. In reality, most people declare bankruptcy under chapter 7, which usually allows debts to be erased. *Id.*

opportunities for ruthless and mischievous debtors to hide assets and avoid repayment of debts that could be repaid.³² Widespread abuse of the bankruptcy system mocks our moral code, turning a system of forgiveness into a system of opportunism.

III. THE SOCIAL CONSEQUENCES OF BANKRUPTCY

Recognizing the moral consequences of bankruptcy also illuminates the social consequences of bankruptcy. As noted, bankruptcy is legalized post-contractual opportunism. Bankruptcy represents the repudiation of a promise made to repay a financial benefit bestowed. Therefore, 1.3 million bankruptcies each year can be understood as 1.3 million families rejecting their financial promises. Some seven to ten percent of these individuals make more than the national median income and could repay a substantial portion of their debts with minimal hardship but choose not to do so.³³

It should be evident that having individuals breaking promises on such a widespread scale will have powerful implications for society. The rejection of economic obligations by filing bankruptcy tears at the web of reciprocal relationships that underlies society, the free market economy, and democratic politics. Widespread opportunism and irresponsibility in one area of society, therefore, has consequences for other areas of society.

A healthy, free, and prosperous society can be imagined as a three-legged stool, all three legs of which are necessary for society and individuals within that society to prosper. The three legs are (1) a market economy, (2) democratic politics under a rule of law, and (3) healthy institutions of civil society that inculcate habits of reciprocity and personal responsibility in one's citizens.³⁴ Each leg is dependent on the strength of the

32. See, e.g., White, *supra* note 3, at 284 (noting that credit purchases of debtors more than triple between the fourth and second months prior to filing for bankruptcy); see also Frum, *supra* note 6, at A14 ("Americans are going bankrupt not because they're economically hard-pressed, but because they have figured out that bankruptcy today is neither uncomfortable nor embarrassing. Under the 1978 Code, you can go bankrupt and keep the house, the car and the retirement account. You can use bankruptcy to evade alimony, rent and college loan payments.").

33. See Jones & Zywicki, *supra* note 30, at 186-92.

34. See NOVAK, *supra* note 8, at 14 (listing a "democratic polity, an economy based on markets and incentives, and a moral-cultural system which is pluralistic and, in the largest sense, liberal" as the three elements necessary for "democratic capitalism"); see also PETER J. BOETTKE, CALCULATION AND COORDINATION: ESSAYS ON SOCIALISM AND

other legs, and each leg must work together with the other legs to bear the burden of supporting freedom, prosperity, and individual happiness. Habits of cooperation and morality acquired in one area of life are transferred to other areas of life. Thus, these habits become mutually reinforcing through their extension throughout society. Engaging in works of charity and public-spirited behavior inculcates habits of reciprocity and respect that enrich democratic politics and ethical business practices. In turn, respecting economic obligations builds respect and interconnectedness with other citizens in the political and social sphere. Finally, democratic politics and the rule of law should build a respect for the autonomy of our fellow citizens, again inculcating habits into our economic and social relations. All three spheres of human life seek to build habits of responsibility, morality, and reciprocity that we carry throughout our lives as individuals and citizens. As Dr. Frans de Waal has explained, "Individuals with the mental capacity to keep track of given and received favors can apply this capacity [of reciprocity] to almost any situation. . . . Once a quid pro quo mindset has taken hold, the 'currency' of exchange becomes secondary. Reciprocity begins to permeate all aspects of social life."³⁵

Social trust is essential to efficient economic activity. Greater social trust reduces the need to rely on costly institutions such as law to ensure performance of obligations.³⁶ When economic participants cannot be trusted, participants are forced to take on additional costs of enforcing promises.³⁷ Economists have just recently begun to recognize the importance of social trust in greasing the wheels of commerce and in creating a prosperous economy.³⁸ Societies with higher degrees of social trust tend to

TRANSITIONAL POLITICAL ECONOMY 5 (2001) ("Unless all three legs [of the stool] are equally strong, the bar-stool will not be able to stand when we sit on it.").

35. DE WAAL, *supra* note 19, at 153-54.

36. Cf. Zywicki, *Bankruptcy and Reciprocity*, *supra* note 21, at 28 ("For centuries commerce [based largely on promise-keeping] existed outside of the jurisdiction of any political authority. . . . Modern commercial law was invented and enforced not by governments, but by merchants themselves. Only later did government try to take it over, and with mostly disastrous results.").

37. Cf. Kenneth J. Arrow, *Gifts and Exchanges*, 1 PHILOSOPHY & PUB. AFF. 343, 357 (1972) ("Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can plausibly be argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.").

38. See Zywicki, *Bankruptcy and Reciprocity*, *supra* note 21, at 19-29 (summarizing studies on human reciprocity and trust and their relation to the propensity for individuals to cooperate).

grow faster economically and are wealthier overall than low-trust societies since there is less need to supply resources to monitor and enforce promises and more resources to invest in economic expansion.³⁹

Less commonly recognized, but equally important, is that probity and responsibility in carrying out one's economic affairs has a salutary effect on social relations. Economic activity marked by opportunism and suspicion undermines social trust and a sense of community. Adam Smith observed in the eighteenth century, "Whenever commerce is introduced into any country, probity and punctuality always accompany it. These virtues in a rude and barbarous country are almost unknown."⁴⁰ Economic exchange rewards those who develop habits of responsibility, reciprocity, and morality.⁴¹ Habits of reciprocity learned through economic exchange carry over to social interactions just as habits of reciprocity learned in civil society enrich and reinforce economic activity.

Thus, it is likely that just as high levels of social trust lead to more economic growth, economic growth leads to greater levels of social trust. When economies are stagnant, individuals and interest groups are locked into zero-sum rent-seeking conflicts over dividing shares of an existing pie. When economies are growing, however, individuals usually obtain a greater return from engaging in positive-sum economic activities and have less

39. Cf. PAUL J. ZAK & STEPHEN KNACK, TRUST AND GROWTH 3, 13-15 (Claremont Graduate Inst. & Am. Univ., Working Paper, 1998), available at http://papers.ssrn.com/paper.taf?abstract_id=136961 (discussing a study of trust relationships between brokers and their clients and the increased time and cost spent monitoring brokers' activities when trust is low). Along similar lines, the Zak and Knack study concluded that a society conducting transactions among people with fewer differences will have higher degrees of trust and, thus, higher consumer income. See *id.* at 15.

40. Adam Smith, *Lecture on the Influence of Commerce on Manners*, reprinted in REPUTATION: STUDIES IN THE VOLUNTARY ELICITATION OF GOOD CONDUCT 17, 17 (Daniel B. Klein ed., 1997).

41. See JOHN MUELLER, CAPITALISM, DEMOCRACY AND RALPH'S PRETTY GOOD GROCERY 6-7 (1999) (discussing capitalism as a system that, by its very nature, rewards important virtues such as honesty and productiveness); see also JOHN P. POWELSON, THE MORAL ECONOMY 176 (1998) ("[T]he durability of sound [economic] policies depends on their not being imposed from above but on the morality of masses of people and their agreement to abide by rules they themselves have composed, for their own mutual betterment."); F.H. Buckley, *Culture and Liberty*, 19 QUINNIPIAC L. REV. 665, 668 (2000) ("Before criticizing one set of rules, one ought to consider the alternatives, and the alternatives to free market virtues are sometimes rather nasty. All the evidence suggests that Soviet efforts to build a new socialist man did not produce people who were more gentle and less opportunistic. Just the opposite, if anything."); Donald McCloskey, *Bourgeois Virtue*, 63 AM. SCHOLAR 177, 183 (1994) ("A market economy looks forward and therefore depends on trust.").

incentive to engage in zero-sum struggles. When everyone is a potential customer or trading partner, this undoubtedly influences one's social behavior as well as one's economic behavior since "[t]rust is as vital a form of social capital as money is a form of actual capital. . . . Trust, like money, can be lent . . . and can be risked, hoarded or squandered. It pays dividends in the currency of more trust."⁴²

Social trust and reciprocity are equally important for democracy and the rule of law to prosper.⁴³ The rule of law itself is rooted in notions of reciprocity, namely that political rulers and subjects owe reciprocal obligations to one another. This concept underlies the birth of the concept of the rule of law in Western Europe and its eventual evolution into the concept of constitutions that bind sovereign and subject alike.⁴⁴ Similarly, democracy is tolerable as a system of government in a regime of reciprocity. Absent reciprocity, permanent majorities would plunder minorities at will, thereby rendering democracy a means of repression rather than freedom.⁴⁵ A politics of rent-seeking and wealth redistribution gives rise to political habits of envy and distrust, tending to undermine the efficiency of government operations and social harmony.⁴⁶

Just as cooperation in one sphere of life spreads and reinforces cooperation in other spheres of life, non-cooperation spreads and reinforces non-cooperation in other spheres. If one leg of the three-legged stool is weak, it places pressure on other legs, which soon yield as well. Thus, it is well recognized that corrupt and dictatorial politics undermine economic exchange and social trust.⁴⁷ Weak relations of morality and civil society

42. RIDLEY, *supra* note 22, at 250.

43. *Cf.* THE FEDERALIST No. 11, at 128 (Alexander Hamilton) (Isaac Kramnick ed., 1987) (discussing the importance of cooperation and the avoidance of in-fighting in achieving a powerful national economy).

44. For a good discussion of the birth of the Western legal tradition and the foundation of constitutions and the rule of law in the concept of reciprocity, see HAROLD J. BERMAN, LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION 520-58 (1983).

45. See generally Todd J. Zywicki, *The Nature of the State and the State of Nature: a Comment on Grady & McGuire's Paper*, 1 J. BIOECONOMICS 241 (1999) (presenting a model of constitutional evolution based on an understanding of competing interests).

46. See generally FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM (1944) (discussing socialism as a abandonment of the principal of freedom in economic affairs, without which political and personal freedom cannot exist).

47. *Cf.*, e.g., EVERETT CARLL LADD, THE LADD REPORT 91-92 (1999) (discussing the importance of associations in society and a government that encourages and allows them and stating that the two are "causes and effects that unceasingly create each other")

provide shallow soil for planting the seeds of economic and political freedom. For example, Poland's relative success in transitioning to a free economy and democratic politics, as compared to Russia, is in part attributable to the fact that the Catholic Church and labor unions continued to flourish in Poland even during the Communist era.⁴⁸ These institutions of civil society provided a structure of morality and institutional legitimacy that inculcated the social trust on which economic and political freedom could grow. By contrast, low-trust societies such as Russia, which have a history of weak civil society and weak protection of property rights, have found it much more difficult to transition to freedom.⁴⁹

For low-trust societies, it can be extremely difficult to break out of this "low-trust" trap, with all the pathologies it manifests. Low levels of social trust spawn economic and political corruption, which make it difficult to use these mechanisms to compensate for the absence of strong trust relationships. In turn, weak political and legal institutions undermine the enforceability of contracts, hampering economic activity and the reliability of contracts. Just as patterns of cooperation, trust, and reciprocity are self-reinforcing, patterns of non-cooperation, distrust, and cheating can become self-reinforcing.⁵⁰ Robert Putnam, a noted professor of public policy from Harvard University, similarly observes:

Stocks of social capital, such as trust, norms, and networks, tend to be self-reinforcing and cumulative. Virtuous circles result in social equilibria with high levels of cooperation, trust, reciprocity, civic engagement, and collective well-being. These traits define the civic community. Conversely, the absence of these traits in the *uncivic* community is also self-reinforcing. Defection, distrust, shirking, exploitation, isolation, disorder,

(quoting ALEXIS DE TOCQUEVILLE, 2 DEMOCRACY IN AMERICA 108 (Vintage Books 1990) (1840)).

48. Cf. MARK BRZEZINSKI, THE STRUGGLE FOR CONSTITUTIONALISM IN POLAND 73-74 (1998) (discussing the opposition of church and lay intelligentsia to communism and noting their collaboration with workers' groups).

49. See RICHARD PIPES, PROPERTY AND FREEDOM 160 (1999) (contending that the critical factor in Russia's failure to develop rights and liberties was "the liquidation of landed property in the Grand Duchy of Moscow, the principality which in time conquered all Russia").

50. See RIDLEY, *supra* note 22, at 250 ("Trust and distrust feed upon each other.").

and stagnation intensify one another in a suffocating miasma of vicious circles.⁵¹

Thus, the destruction of trust and reciprocity in one area of society can have profound and far-reaching consequences for other areas of society.

This demonstrates the potential social costs of widespread personal bankruptcy. An individual's willingness to break promises in one area of life may tend to spill over and undermine personal responsibility and reciprocity in other areas of life. It has been observed, for example, that there is a strong correlation between bankruptcy filing rates and divorce rates in a cross-section analysis.⁵² The existence of this correlation suggests that both bankruptcy and divorce can be understood as being caused by an independent variable, namely an individual's propensity to keep promises when those obligations become costly or difficult to maintain. In fact, serial bankruptcy filers describe their experience in words virtually identical to serial divorce filers. Six-time bankruptcy filer Fitzgerald Giscombe of Brooklyn confessed, "It gets easier each time. . . . The psychological part of it has changed."⁵³

It is generally accepted that one of the factors driving the upward trend in bankruptcy filing rates in recent decades has been a general decline in the social stigma associated with filing bankruptcy.⁵⁴ Senator Daniel Patrick Moynihan observed that there is a tendency to "define deviancy down" in a society where behavior previously defined as deviant becomes too widespread.⁵⁵ This tendency to "define deviancy down" is evident

51. ROBERT D. PUTNAM, *MAKING DEMOCRACY WORK: CIVIC TRADITIONS IN MODERN ITALY 177* (1993).

52. See Buckley & Brinig, *supra* note 29, at 205. This thesis should be distinguished from a separate argument that divorce *causes* bankruptcy by bringing on financial distress. As the discussion in the text indicates, the argument here is that the two are *correlated*, and that both can be viewed as being caused by the independent variable of one's propensity to keep promises.

53. Daniel Dunaief, *'Easy' US Bankruptcy Attached*, S. CHINA MORNING POST, May 31, 1998, at 10.

54. See David B. Gross & Nicholas S. Souleles, *An Empirical Analysis of Personal Bankruptcy and Delinquency* 21-23 (Univ. of Pa. & Univ. of Chi., Working Paper No. 98-28-B, 1999) (assessing a variety of factors related to the increase in bankruptcy filings and concluding that "standard default models appear to have missed an important, systemic and time-varying default factor . . . consistent with the stigma effect"); see also Jones & Zywicki, *supra* note 30, at 215-21. The extent of this influence on bankruptcy filings is difficult to quantify; nonetheless, few would doubt that it has played at least some role in escalating bankruptcy filings.

55. Daniel Patrick Moynihan, *Defining Deviancy Down*, 62 AM. SCHOLAR 17, 19 (1993).

in recent changing social attitudes toward bankruptcy. Individual bankruptcy has become so widespread that the shame traditionally associated with it has largely disappeared. As one bankruptcy filer stated in a CNN interview:

When I found out—this was watching it on the news, on the newspapers—that more and more people are doing it [filing bankruptcy], and . . . it's not just a middle class you know, upper class too—rich people—everybody's doing it. And . . . I said: Why not me? You know, I'm just one more of them.⁵⁶

The tendency to define bankruptcy deviancy down is especially prevalent in high-bankruptcy communities where bankruptcy-filing rates run as high as four to five percent of the population.⁵⁷ In Memphis, the “bankruptcy capital of America” with annual filing rates exceeding four percent of the city's population, bankruptcy is “a way of life” and there is a “culture of bankruptcy.”⁵⁸ In fact, a whole network of institutions and norms have developed to serve this group.⁵⁹ As Senator Moynihan predicts, where deviant behavior is so widespread as to become commonplace, there is a natural tendency to reclassify the scope of deviant behavior so as to limit the number of individuals tagged for social condemnation.⁶⁰

Because the current bankruptcy system rewards short-term and irresponsible behavior, while penalizing those who live within their means, it is not surprising that an increasing number of Americans choose the short-term chance to walk away from their debts rather than the long-term challenges of living within their means and paying off their responsibilities. In his profound study of consumer credit in America, Lendol Calder observed that consumer debt was traditionally a disciplining device that forced people to take on responsibility, work hard, and become a productive member of society.⁶¹ Although retailers offered the promise of “easy payments” for purchasing goods, those payments were anything but “easy.”⁶²

56. *Your Money with John Metaxas* (CNNfn television broadcast, Jan. 18, 1999).

57. Kim Clark, *Why So Many Americans Are Going Bankrupt*, FORTUNE, Aug. 4, 1997, at 24-25 & tbl.

58. *Id.*

59. *Id.*

60. See Moynihan, *supra* note 55, at 19.

61. See LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 28-29 (1999).

62. *Id.*

Once an individual hitched himself to the yoke of mortgage payments and the harness of fulfilling his credit obligations, he was committed to working hard to finance this consumption. Before easy bankruptcy, therefore, access to credit forced individuals to live within their means and to work hard to meet their obligations:

Most people responding to the allure of “little easy payments” have found that the indebted way of life forces enough external disciplines on them that the culture of consumption is preserved from its own reckless imperatives. Installment financing saddles borrowers with a strict schedule of payments. To satisfy their obligations, modern consumers are forced to commit themselves to regimens of disciplined financial management. In this way, consumer credit has limited the hedonistic impulse within consumerism, while preserving the relevance of traditional values such as “budgeting,” “saving,” “hard work,” and even “thrift.” Thus, consumer credit has done for personal money management what Frederick W. Taylor’s scientific management theories did for work routines in the factory. It has imposed strict, exogenous disciplines of money management on consumers, in the interest of improving their efficiency in the “work” of being a consumer. Because “easy payments” turned out to be not so easy—work and discipline were required to pay them—consumer credit made it easy for Americans to think of consumption as “work,” which greatly eased the passage from a society oriented around production to a society dedicated to consumption. By preserving the relevance of many nineteenth-century producer culture values, it made the culture of consumption less a playground for hedonists than an extension of Max Weber’s “iron cage” of disciplined rationality.⁶³

It was only after easy *bankruptcy* that consumer credit made it easy for individuals to live beyond their means. There still remains only one way for individuals to incur large consumer debts—by making conscious decisions to spend more than they have. Citibank does not force an individual to buy a larger home or a fancier car than he can afford. In the easy bankruptcy world, however, consumer debt is no longer a disciplining device but an opportunity for profligate spenders to live beyond their means and to impose the costs of doing so on those who

63. *Id.*

live responsibly. As Lynn LoPucki, a professor at UCLA Law School, observes:

Consumer bankruptcy contradicts the morality of Aesop's fable [of the grasshopper and the ant]. Today's ants eat beans at home, don't buy the kids new sneakers, and don't try to buy the new house until they have stable jobs and down payments. They hang onto the jobs, even when the going gets tough, particularly if the jobs come with health insurance. The grasshoppers eat at the pizza parlor on Friday night and buy the new sneakers and the houses. They quit their jobs when the going gets tough. The fallout lands on their credit cards. When winter comes, they discharge the credit card debt in bankruptcy. The ant played by the rules, the grasshopper didn't. In the end, consumer bankruptcy made them equals.⁶⁴

Calder and LoPucki's observations highlight the central insight that bankruptcy is at least as much a moral and cultural issue as an economic issue. The modern bankruptcy system mocks traditional values of thrift, personal responsibility, and maintaining promises.

IV. BANKRUPTCY, POLITICS, AND CIVIL SOCIETY

As noted above, society can be envisioned as a three-legged stool resting on the elements of a free economy, constitutional democracy under a rule of law, and a healthy morality and civil society. The link between consumer bankruptcy and the economy is obvious. This section will discuss the ways in which bankruptcy is intertwined with developments in politics and civil society.

64. Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 AM. BANKR. L.J. 461, 464 (1997). Actually, current law makes the grasshopper better off than the ant, as the grasshopper has already consumed many of the goods and services purchased and will be able to retain most of the other goods purchased. Amazingly, among the recommendations of the National Bankruptcy Review Commission was to allow bankrupts to keep even more of the property purchased prior to bankruptcy, such as by allowing the avoidance of *all* security interests (including purchase money) for household goods under \$500. See NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY, THE NEXT TWENTY YEARS* § 1.5.4, 263-73 (1997); see also LoPucki, *supra*, at 471 n.42 (discussing the National Bankruptcy Review Commission's proposal).

A. Bankruptcy and Civil Society

Legal scholars have only recently begun to seriously study civil society.⁶⁵ Civil society broadly refers to the network of voluntary and intermediary institutions such as families, churches, clubs, and the like that link individuals to larger groups of collective actors.⁶⁶ These intermediary institutions can be understood as the modern-day equivalents to the “little platoons” extolled by Edmund Burke as the building blocks of society.⁶⁷ This network of institutions links individuals in collective, non-exchange transactions and provides “schoolhouses” acculturating habits of social responsibility and cooperation into individuals.

Robert Putnam has recently sounded an alarm regarding the state of civil society in America, concluding that Americans have largely disengaged from active civic involvement.⁶⁸ Putnam argues that there has been a general downward trend since World War II in Americans’ willingness to be civically engaged.⁶⁹ The lack of civic engagement has been problematic for democracy, the economy, and individual happiness. Although much of Putnam’s analysis has been heavily and appropriately criticized,⁷⁰ Putnam’s insights about the importance of civil society institutions and the links between civil society and other aspects of social and economic life are more important for current purposes.

If it were true that there has been a general decline in the robustness of civil society, one might expect the impact of such to be reflected in attitudes toward bankruptcy and bankruptcy filing rates. Frivolous resort to bankruptcy represents a repudiation of obligations owed to other members of society and the economy. Thus, as individuals reduce their social connectedness, this would be expected to lead to an increased

65. See, e.g., Symposium, *Legal and Constitutional Implications of the Calls to Revive Civil Society*, 75 CHI-KENT L. REV. 289 (2000) (addressing the legal ramifications of recent calls to renew civil society).

66. Linda C. McClain & James E. Fleming, *Foreword: Legal and Constitutional Implications of the Calls to Revive Civil Society*, 75 CHI-KENT L. REV. 289, 289 (2000).

67. EDMUND BURKE, *REFLECTIONS ON THE REVOLUTION IN FRANCE* 41 (J.G.A. Pocock ed., Hackett Pub. Co. 1987) (1790).

68. See ROBERT D. PUTNAM, *BOWLING ALONE* 249-50 (2000).

69. *Id.*

70. See, e.g., LADD, *supra* note 47, at 91-92, 118 (agreeing with Putnam that “trust and engagement are two facets of the same underlying factor—social capital,” but disagreeing that “national confidence and social trust are in retreat”) (citation omitted).

propensity to engage in opportunistic behavior with economic trading partners. Many of the trends spotted by Putnam, for example, can be observed in the context of bankruptcy. Among the various trends and groups analyzed by Putnam, perhaps most interesting for current purposes is his emphasis on the role played by the ascension of the “baby boom” generation to a position of leadership in American society.⁷¹ Such generalizations are, of course, quite crude. Nonetheless, Putnam raises some interesting questions that may shed light on the role of bankruptcy law as social legislation.

Putnam argues that as much as one-half of the decline in civic-mindedness can be attributed to one simple factor: the replacement of the World War II generation, which was unusually civic-minded, with the baby boom generation, which is unusually non-civic-minded.⁷² As an explanation for a decline in civil society, this conclusion is tautological. As a description, however, it is quite useful. For, as will be discussed, these trends in civil society by the Baby Boomers are reflected in similar trends by Baby Boomers in bankruptcy filing and financial responsibility. If bankruptcy were a matter of social and moral norms, then it would be expected that a decline in promise-keeping commitments would tend to coincide with a decline in civic-mindedness among the leading generation.

In general, civic engagement increases with an individual's age; however, when people reach their middle years, it decreases.⁷³ Around age thirty-five to fifty, civic engagement is at its apex.⁷⁴ Unlike previous generations of Americans, however, Baby Boomers have not moved into positions of social leadership during their middle years. Putnam observes that

as baby boomers passed through the normal civic life cycle . . . America should have experienced waves of increasing civic involvement, as the boomers ascended the normal life cycle of rising community involvement. . . . So far, however, none of those past waves of civic engagement has materialized [A]ll these forms of civic involvement and more besides have declined largely, if not exclusively, because of the inexorable

71. PUTNAM, *supra* note 51, at 249-50.

72. *See id.*

73. *Id.* at 249 fig.70.

74. *Id.*

replacement of a highly civic generation by others that are much less so.⁷⁵

Thus, the Baby Boom generation has distinguished itself through its historically low levels of civic engagement and unwillingness to contribute resources to building the institutions of civil society and the purposes those institutions fulfill.

This pattern is mirrored in the context of bankruptcy and financial responsibility. Although they are at their earnings peak, Baby Boomers have distinguished themselves by their financial irresponsibility and propensity to file bankruptcy. Although Baby Boomers comprise about thirty-nine percent of the adult population in the country, they comprise roughly fifty-five percent of bankruptcy filers.⁷⁶ As compared to earlier generations of Americans, middle-aged Baby Boomers have shown strikingly low levels of savings and personal wealth, and strikingly high levels of personal bankruptcies.⁷⁷ One study concludes that more than half of American baby boom workers have less than \$30,000 saved for retirement and one-fourth or more are not participating in a 401(k) or defined benefit plan of any kind.⁷⁸ In short, the Baby Boomers appear to be an especially pathological generation for American society across the board, as reflected in economic, social, and political behavior.

Participation in the community is directly correlated to interpersonal trust in a community.⁷⁹ In turn, interpersonal trust is the glue that holds together a free economy and democratic politics.⁸⁰ Recall Adam Smith's insight that the habits of trust, respect, and responsibility inculcated by commerce soften habits

75. *Id.* at 250.

76. TERESA A. SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS* 39 (2000). In fact, the number of Baby Boomers may be as high as 63%, depending on the dates used to describe the Baby Boom generation. *Id.* at 304 n.38.

77. *Id.* at 39-40 (discussing the financial instability of the baby boomers as a generation and theorizing as to some of the potential contributing factors).

78. See Gene Meyer, *Making Up Lost Time: Setting Priorities Can Help You Catch Up on Retirement Savings*, CHI. TRIB., Dec. 21, 2000, at C1.

79. Corwin Smidt, *Religion and Civic Engagement: A Comparative Analysis*, 565 ANNALS 176, 183 (1999) ("[T]he more individuals participate in their communities, the more they trust others, but, in addition, the more that they trust others, the more they participate in their communities.").

80. Lawrence E. Mitchell, *Trust and the Overlapping Consensus*, 94 COLUM. L. REV. 1918, 1918 (1994) ("What binds the overlapping consensus? When all is said and done, the answer appears to be trust. Interpersonal trust among the members of a reasonably just society and their trust in the institutional values of the social structures and political mechanisms they construct and control are at the heart of what keeps this society together.").

and build social harmony. Experiments have found that the degree of an individual's social connections is correlated to an individual's trustworthiness and level of trust in others.⁸¹ This suggests that as the more self-absorbed and socially unengaged Baby Boomers have become the dominant consumer forces in the economy, the quality of trust relations in society has declined. This is consistent with the observed heightened financial irresponsibility of Baby Boomers as compared to their cohorts in earlier generations.⁸²

Fortunately, there is some evidence to suggest that members of so-called "Generation X" reject the social and financial irresponsibility of the Baby Boomers.⁸³ Civic involvement appears to be rebounding among Generation X.⁸⁴ Disappointed by the self-indulgence of Baby Boomers, members of Generation X preach the virtues of individual and financial responsibility and greater civic involvement.⁸⁵ Somewhat surprisingly, there may be room for optimism that the rise in personal bankruptcy filings among the middle-aged Baby Boomers may be temporary and generational, and that the ascendancy of the more financially and personally responsible Generation X may retard some of the upward spiral in bankruptcies.

Some social observers have recognized that there are links between individuals' attitudes toward personal, social, and economic responsibility. A generation which lacks respect for promises and reciprocity manifests itself in a number of different social and economic arenas:

There is a perennial and unobtrusive view that morality consists in such things as telling the truth, paying one's debts, respecting one's parents and doing no voluntary harm to

81. See, e.g., Edward L. Glaeser et al., *Measuring Trust*, 115 Q.J. ECON. 811, 840 (2000) ("[S]ocial connection strongly predicts trustworthiness and weakly predicts trust.").

82. Thomas Sowell, *Boomers . . . and Boomerangs*, WASH. TIMES, Aug. 1, 1999, at B1 ("There was a time when any adult who had gone out into the world would be embarrassed to come back and live with his parents, much less bring his or her family too. Today, this is such a common occurrence among the Baby Boomers that there is a word for grown children who leave home and then come back—"boomerangs.").

83. *Talk of the Nation: Why Americans are Saving Less and Spending More* (NPR radio broadcast, July 7, 1999) (noting that members of Generation X are more vigilant than Baby Boomers about saving).

84. *Id.*

85. Cf. WILLIAM STRAUSS & NEIL HOWE, *GENERATIONS: THE HISTORY OF AMERICA'S FUTURE, 1584 to 2069*, at 320 (1991) ("[Members of Generation X] see no welcome mat on their economic future Money means survival, and for a generation whose earliest life experiences have taught them not to trust others, survival must come first.").

anyone. Those are all things easy to say and hard to do; they do not attract much attention, and win little honor in the world. . . . [It] is a humble notion, accessible to every child, but its fulfillment is the activity of a lifetime of performing the simple duties prescribed by it. This morality always requires sacrifice.⁸⁶

David Frum, a senior fellow at the Manhattan Institute, has similarly remarked on the connection between bankruptcy and morality. As Frum observes, "It's not a coincidence that this weakening of the sense of financial obligation occurred just [as] Americans were diminishing their feelings of obligation to family, community, and nation."⁸⁷ Frum contends that in the 1970s, "the limits of financial responsibility were dramatically reduced, to the point where a great many people shrugged off the very idea that paying debts is a moral obligation."⁸⁸ As noted, however, there is a general backlash against the Boomer ethics of social and financial irresponsibility. Frum sees this new ethic of personal responsibility as animating the call for restoring greater balance to the bankruptcy laws through bankruptcy reform. Frum notes that just as the weakening of financial obligations accompanied the weakening of other social obligations in the 1970s, "then it may be that the moderate tightening of the bankruptcy law Congress now contemplates is an indicator that society is turning its back on the 1970s ethic of self in favor of a reinvigorated ethic of duty."⁸⁹ Thus, the rehabilitation of civil society and moral duty that has accompanied the passing of the Baby Boomers may provide hope that the virtues of financial responsibility may moderate the rising tide of bankruptcy filings.

B. *Bankruptcy and Democracy*

Individual bankruptcy is at best a zero-sum activity, representing a straight wealth transfer from creditors to debtors.⁹⁰ In general, however, it is a negative-sum activity as real

86. ALLAN BLOOM, *THE CLOSING OF THE AMERICAN MIND* 325 (1987).

87. Frum, *supra* note 6, at A14.

88. *Id.*

89. *Id.*

90. Vern McKinley, *Ballooning Bankruptcies: Issuing Blame for the Explosive Growth*, REG., Fall 1997, at 33, 33, available at <http://www.cato.org/pubs/regulation/reg20n4.pdf> (noting that, at least in the short run, discharge is a straight transfer from creditor to debtor).

resources are used in effectuating the transfer. Moreover, at least some bankruptcy losses are passed on to other borrowers and consumers in the form of higher credit costs and higher prices for goods and services.⁹¹

The belief that bankruptcy represents merely a wealth transfer from “rich banks” to “poor debtors” characterizes much of the opposition to bankruptcy reform by individuals who otherwise would hold little interest in the issue.⁹² For instance, Hillary Clinton was an outspoken opponent of bankruptcy reform, at least before her decision to run for the Senate from New York.⁹³ The rhetoric of reform opponents against creditors, and especially credit card issuers, is extreme and reminiscent of earlier populist anti-bank themes in American history that most had thought the country had outgrown long ago.⁹⁴ Clearly, Hillary Clinton and others like her see the issue as one of class warfare pitting the consumer credit industry against consumers and the poor.⁹⁵

Opposition to bankruptcy reform has thus become hitched to a larger social, political, and economic agenda that includes

91. E.g., Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79, 81-82 (2000) [hereinafter Zywicki, *Economics of Credit Cards*] (discussing the “efficiency loss” resulting from credit card users who file for bankruptcy and noting that some of these costs are passed on to other credit card consumers); see also White, *supra* note 3, at 286 (discussing the cost of the “added actuarial risk” that creditors must pass on to responsible users of credit).

92. Thus, it is argued that lender’s losses from consumer bankruptcies come from lender’s “profits.” As a result, “there is no basis to think that fewer defaults would produce lower interest rates for the rest of us.” SULLIVAN ET AL., *supra* note 76, at 255. For a critique of this view, see Zywicki, *Economics of Credit Cards*, *supra* note 91, at 79-83.

93. E.g., Katharine Q. Seelye, *First Lady in a Messy Fight on the Eve of Her Campaign*, N.Y. TIMES, June 27, 1999, at A1 (noting Senator Clinton’s views that the “credit industry should be held equally accountable for making credit easily available to people who cannot pay their bills”).

94. Opponents to bankruptcy reform typically portray the battle as one of the rich corporate giant against the poor, downtrodden, honest individual. E.g., Craig Norris, Editorial, *Bush and Crew*, NEWSDAY, Jan. 15, 2001, at A25 (“The Republican party is owned lock, stock, and barrel by global corporations. Already the GOP is pushing cruel bankruptcy laws through Congress.”); Editorial, *Cruel Bankruptcy ‘Reform’*, PROVIDENCE J., Mar. 15, 2001, at B6 (“Even if it were a good time to fix the system, the bankruptcy bill . . . is distasteful. It goes after low-and middle-class people drowning in debt while protecting a variety of superwealthy deadbeats. . . . [C]redit-card companies that aggressively solicit business from the most vulnerable consumers would be let off the hook. Indeed, credit-card companies stand to make billions in extra profits over the next decade if the bill goes through.”).

95. E.g., Amy Schatz, *Bankruptcy Experts Warn Consumers about Implications of Pending Legislation*, AUSTIN AM.-STATESMAN, Apr. 2, 2001, at J1 (asserting that credit card companies and banks are the primary proponents of the bankruptcy reform and contrasting the profits of these companies with the effects on those filing bankruptcy who will their homes or other assets).

such issues as campaign finance reform, national health care, employment policies, and anti-bank populism. For instance, at the height of the debate over bankruptcy reform, *Time* magazine ran a large article advocating campaign finance reform, using the bankruptcy reform legislation as a case study of the need for reform.⁹⁶ Shoddily researched and riddled with factual errors, *Time's* commitment to campaign finance reform apparently trumped its traditional pretense of journalistic integrity and objectivity. Indeed, the authors of the article went so far as to invent nonexistent provisions of the legislation to make it seem punitive in nature.⁹⁷

Others have tried to argue that bankruptcies have risen in response to holes in America's social welfare net and the widespread availability of consumer credit.⁹⁸ For instance, in *The Fragile Middle Class*, the authors suggest that the explanation for America's high bankruptcy filing rates relative to Western Europe is the comparative generosity of the welfare state there versus here.⁹⁹ They further argue that because of this generous welfare state, Western Europe never "needed" to pass a generous bankruptcy law: "With their extraordinarily protective approach to economic risk, these countries never had anything like an American-style bankruptcy discharge for consumers. With a

96. Donald L. Barlett & James B. Steele, *Soaked By Congress: Lavished with Campaign Cash, Lawmakers are "Reforming" Bankruptcy—Punishing the Downtrodden to Catch a Few Cheats*, *TIME*, May 15, 2000, at 64. Media critic Howard Kurtz has noticed the ways in which the media's commitment to campaign finance reform biased its coverage of bankruptcy reform. See Howard Kurtz, *Reading Green Between the Lines*, *WASH. POST*, Apr. 2, 2001, at C1. For a general review of the media's inaccurate and biased coverage of the bankruptcy reform issue, see *Journalistically Bankrupt*, NAT'L REV. ONLINE, at http://www.nationalreview.com/nr_comment/nr_comment031601c.shtml (Mar. 16, 2001) and William F. Buckley, *Buy Now, Pay Never*, NAT'L REV. ONLINE, at <http://www.nationalreview.com/buckley/buckley031301.shtml> (Mar. 13, 2001).

97. For instance, according to the article, "If a child or some other member of the family received medical treatment within 90 days before the bankruptcy filing, the bills could never be written off, no matter how poor the family." Barlett & Steele, *supra* note 96, at 66. Not only was there no such provision in the bill, no such provision has ever existed. See Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001).

98. *How Do We Reduce Consumer Bankruptcy Filings?* 9 CONSUMER BANKR. NEWS 6 (May 18, 2000) ("If we had universal health insurance, the number of people in bankruptcy would drop sharply. If we had much more substantial unemployment protection—one years' worth of wages at the old rate—we would have substantially less people in bankruptcy. . . . If colleges and universities were free, we would have fewer bankruptcies. . . . If we could fix only one thing, I guess health care would be the one for which government intervention would make the biggest difference."); cf. SULLIVAN ET AL., *supra* note 76, at 259 ("These data suggest that the need for a more protective consumer bankruptcy law is directly proportional to the size of the social safety net and the availability of consumer credit.").

99. SULLIVAN ET AL., *supra* note 76, at 257, 259.

bankruptcy system that provided little protection for families in trouble, their consumer bankruptcy filings remained low.”¹⁰⁰ Oddly, they conclude that the presence of a substantial welfare state explains low bankruptcy filing rates in Europe rather than the more obvious explanation to which they allude—the absence of a generous bankruptcy discharge.¹⁰¹ It is difficult to believe that bankruptcy rates are driven more by the relative availability of the social safety net than by the relative generosity of a country’s bankruptcy laws. Moreover, they do not attempt to control for other social factors that appear to be relevant to the bankruptcy filing decision, such as religious beliefs, differences in social norms, and differences in migration patterns and other indicia of social stability in the various countries.¹⁰²

The problem with the authors’ analysis in *The Fragile Middle Class* is that, since its inception, America has been awash in consumer credit and, until the New Deal, America had no welfare state to speak of. Nonetheless, there is little indication that bankruptcy was widespread during the Nineteenth Century. Indeed, the American bankruptcy-filing rate remained relatively stable throughout the latter half of the Twentieth Century until the 1978 Code dramatically loosened the legal restraints on filing for bankruptcy.¹⁰³ The welfare state in 2000 is a lot larger than the welfare state in 1900; nevertheless, bankruptcy-filing rates are substantially higher. The difference, of course, is that during the latter half of the Twentieth Century the bankruptcy laws have been much more generous.¹⁰⁴

In the ultimate “heads I win, tails you lose” argument, they conclude that the real question is “how a government should

100. *Id.* at 257.

101. *Id.* at 257, 259.

102. For instance, the propensity to file bankruptcy rises in cities and other areas where populations tend to be more transient and therefore, in which social bonds are weaker and one’s social reputation is less likely to matter. See Buckley & Brinig, *supra* note 10, at 204. For similar and related reasons, levels of social capital tend to be lower in areas where migration is highest. See Edward L. Glaeser, David Laibson, & Bruce Sacerdote, *The Economic Approach to Social Capital* (Harvard Inst. of Econ. Research, Working Paper, 2001), available at http://papers.ssrn.com/paper.taf?abstract_id=263420.

103. See David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 328 (1999) (“A clear culprit of the rise in bankruptcies is the Bankruptcy Reform Act of 1978 that moved the Code in a decidedly prodebtor direction as part of the “consumer” movement of that period.” (quoting McKinley, *supra* note 90, at 38)).

104. See McKinley, *supra* note 90, at 38-39 (attributing at least part of the blame to the “prodebtor” Bankruptcy Reform Act of 1978).

deal with the risks facing its citizens.”¹⁰⁵ Communitarians, they argue, should favor greater socialism as a means of relieving the pressures on the bankruptcy system.¹⁰⁶ Those who believe that risks should be borne individually, however, should support consumer bankruptcy because it “provides critical relief that heads off social unrest and keeps the maximum number of players in the economic game.”¹⁰⁷ Bankruptcy, they assert, “is the ultimate free-market solution to debt. . . . Bankruptcy is the market-driven choice to deal with privatized, rather than socialized, risk.”¹⁰⁸ The conclusion that bankruptcy is the “free-market solution” to debt is peculiar both in principle and in practice. In principle, this statement is nonsense. Bankruptcy law is the *opposite* of the free-market solution to debt. The free market solution to debt is contract and collection law. Rather, bankruptcy is an *interference* with the free market. Bankruptcy law has been defined as “a system of interventionary legislation which interferes with the ability of individuals freely to establish the terms of loan contracts.”¹⁰⁹ Whatever bankruptcy may be, it is not a market-created institution, but is instead an intervention in the free market regime of freedom of contract.¹¹⁰

The idea of bankruptcy as a “free market” mechanism of individual risk bearing is also strange in practice. According to *The Fragile Middle Class*, to say that bankruptcy is a free-market institution of individual risk bearing is to say that the *lenders* bear the risk of the debtors’ nonpayment, which “forces individual creditors who made voluntary lending decisions to bear the costs of their bad credit decisions out of the profits from their good loans.”¹¹¹ What of those opportunistic debtors who use bankruptcy to defraud creditors or to evade their repayment obligations? Or, what of those debtors who consciously use bankruptcy to support a profligate lifestyle?¹¹² What about debtors who convert nonexempt assets to exempt assets on the eve of bankruptcy, thereby making assets unavailable to

105. SULLIVAN ET AL., *supra* note 76, at 260.

106. *Id.* at 257-60.

107. *Id.* at 260.

108. *Id.*

109. White, *supra* note 3, at 281.

110. *Id.* (“[Bankruptcy] is a system which provides . . . for the coercive elimination of contractual obligations.”).

111. SULLIVAN ET AL., *supra* note 76, at 260.

112. See Stephane Fitch, *Busted!*, FORBES, Oct. 2, 2000, at 154, 157-59 (recounting stories of millionaire bankruptcies).

creditors? In these circumstances, it is absurd to say that the lenders alone are the least-cost bearers of the risk of bankruptcy. It is clear that a system of "individualized risk bearing" should place on the borrower the risk of extravagant living and calculated opportunism. Yes, the market works to force individual creditors to bear the risk of bad lending decisions. However, when the *entire* pool of borrowers becomes more likely to file bankruptcy, holding traditional risk profiles constant, it is nonsensical to place this risk on lenders alone. In a free market system, nothing suggests that a creditor—or, more precisely, other borrowers—should bear the risk that a debtor is going to engage in opportunistic use of bankruptcy and use bankruptcy to divert legitimate creditor collection efforts. Any system of insurance will be subject to problems of moral hazard on the part of the insured party. Bankruptcy is no exception. It is no more logical to call bankruptcy a free-market solution in practice as it is to call it a free-market solution in principle.

In addition to blaming America's weak safety net for America's high bankruptcy rate, the authors assert that the absence of universal health insurance is a leading cause of personal bankruptcies.¹¹³ Similarly, unemployment and "downsizing" are claimed to be leading causes of bankruptcy—even though downsizing is a myth and the unemployment rate has been at best six percent for several years.¹¹⁴ Illustrative of the effort to link bankruptcy with a larger left-wing social agenda is a recent author who argues that the surge in consumer bankruptcies is the result of declining labor union membership.¹¹⁵ Perhaps most amazing in this line of argument was President Clinton's statement when he pocket-vetoed a bankruptcy reform bill at the end of the 2000 Congressional

113. SULLIVAN ET AL., *supra* note 76, at 243; *see also* Melissa B. Jacoby, Teresa A. Sullivan & Elizabeth Warren, *Medical Problems and Bankruptcy Filings*, WEST'S BANKR. NEWSL., May 31, 2000, at 2, 2 ("The public health care discussion currently overlooks a source of systematic, tangible evidence that individuals and families are struggling to pay their health care bills; hundreds of thousands of middle class families declare bankruptcy each year in the financial aftermath of an encounter with the American health care system."). *But see* Jones & Zywicki, *supra* note 30, at 244 (noting the lack of empirical support for the assertion that large medical bills explain upward trends in bankruptcy filing rates).

114. Jones & Zywicki, *supra* note 30, at 243.

115. *See* Steven H. Kropp, *The Safety Valve Status of Consumer Bankruptcy Law: The Decline of Unions as a Partial Explanation for the Dramatic Increase in Consumer Bankruptcies*, 7 VA. J. SOC. POL'Y & L. 1, 2-3 (1999).

session.¹¹⁶ President Clinton said he was doing so because it did not provide for the non-dischargeability of civil judgments for denial of access to abortion clinics.¹¹⁷

The link between bankruptcy and a larger social policy agenda is evidenced not only by what is included on the list of “important” related issues addressed in *The Fragile Middle Class*, such as a weak safety net and lack of universal healthcare, but also by what is excluded. For instance, the American tax burden stands at a peacetime high as a percentage of national income.¹¹⁸ Plunging personal savings rates are likely a result of these high tax burdens, as higher taxes erode families’ take home income.¹¹⁹ In surveys of bankruptcy filers, tax obligations are consistently listed as a leading reason for filing bankruptcy.¹²⁰ Given the traditional prominence of taxes as a cause of bankruptcy, it is somewhat astonishing that tax obligations fail to merit but passing mention in works such as *The Fragile Middle Class*, which purports to document the causes of rising consumer bankruptcy.¹²¹ A reduction in tax burdens or the punitiveness of the Internal Revenue Service’s powers to seize property and assess penalties would almost certainly reduce bankruptcy filings. And while critics of reform point to unsubstantiated myths of corporate downsizing as a cause of unemployment-induced bankruptcies, they fail to consider the impact of policies, such as the minimum wage, which are known to induce job loss and loss of valuable benefits (such as health insurance and termination benefits), especially among the most vulnerable

116. Kevin Diaz, *Wellstone Praises Clinton Veto of Bipartisan Bankruptcy Bill*, STAR TRIB. (Minneapolis, Minn.), Dec. 20, 2000, at 22A.

117. *Id.* Needless to say, it is somewhat odd to include an abortion provision in a bankruptcy bill. Still more odd, however, was the claim that vetoing the bankruptcy bill was a sensible response to the absence of such a provision. Vetoing the bill, of course, preserves the status quo where there is no special nondischargeability provision for abortion judgments. Vetoing the bill, therefore, did nothing to address the President’s concerns.

118. See Jones & Zywicki, *supra* note 30, at 245-46 & n.283 (noting that “personal federal tax payments as a share of wage and salary income are almost 27%” and that the burden is “close to the tax burden at the height of World War II”).

119. See *id.* at 246. It should be noted, however, that the reported savings rate dramatically understates the overall savings rate because it fails to account for capital gains.

120. See *id.* at 245-46.

121. See, e.g., SULLIVAN ET AL., *supra* note 76, at 243 (listing five factors purportedly explaining the upward trends in consumer bankruptcies).

workers in the economy.¹²² In short, the issues omitted from the list of social factors that cause bankruptcy filings illustrate the way in which bankruptcy is thought to be part of a larger social agenda.

Bankruptcy law thus fits comfortably within the larger agenda of wealth redistribution and the advancement of a particular social and economic agenda. Bankruptcy holds out the promise of a vast system of wealth redistribution to the poor and downtrodden in society from banks and other easily-demagogued parties. Moreover, much of this redistribution goes on under the radar of public consciousness. Although every consumer pays for a runaway bankruptcy system, the costs are not usually large enough to overcome problems of collective action in effectuating appropriate reforms. Thus, the bankruptcy system has increasingly taken on the role of a wealth redistribution mechanism, advancing causes that would be politically unfeasible if advanced directly. As of late, however, the bankruptcy system has perhaps become a victim of its success (in the social agenda context) as Congress has taken notice and is seriously considering seizing the opportunity to enact various bankruptcy reforms that will help rein in the system.¹²³

V. THE NEED FOR REFORM

Bankruptcy law is social legislation as much as it is economic legislation. When an individual decides to file bankruptcy and repudiate his debts, this is a moral decision as much as an economic decision. By filing bankruptcy, the debtor rejects his promises and repudiates the moral bonds of reciprocity created when creditors extend goods, services, and credit to her. Because of a moral condemnation of bankruptcy (as well as the negative economic consequences of widespread bankruptcy), almost all legal systems in human history have provided bankruptcy rules that strongly deter bankruptcy filings. Indeed,

122. See Jones & Zywicki, *supra* note 30, at 243-45. Despite heavily-publicized anecdotes regarding downsizing, the ratio of middle-management employees to the overall workforce actually *rose* during the period supposedly marked by downsizing. See DAVID M. GORDON, *FAT AND MEAN: THE CORPORATE SQUEEZE OF WORKING AMERICANS AND THE MYTH OF MANAGERIAL "DOWNSIZING"* 51-60 (1996). "For all the talk of 'downsizing,'" Gordon observes, "there were more managers in 1994 than there were in 1989 before the 'downsizing' began." *Id.* at 53.

123. *E.g.*, Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001); Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001).

in many societies bankruptcy was punishable by death, dismemberment, or imprisonment.¹²⁴ The severity of these legal sanctions indicates the degree of moral outrage that permeate these legal systems.

Surprisingly, however, for over twenty years America has lived under a bankruptcy system that mocks the principle of personal responsibility and undermines the ethic of promise-keeping by providing astonishingly large incentives for individuals to file for bankruptcy. One study estimates that fifteen percent of the population could gain financially by filing bankruptcy—a much higher proportion would benefit if they filed after some modest and easily accomplished pre-bankruptcy financial planning.¹²⁵ Because of the structure of exemption laws and the type of property that a debtor can protect in bankruptcy, the financial benefits of bankruptcy, relative to one's income and assets, generally rise as a debtor's income and wealth rise.¹²⁶ Exemption laws identify the property that a debtor is allowed to retain after filing bankruptcy. Most exemptions in bankruptcy are tied to specific types of property, such as a house or car.¹²⁷ Almost by definition, wealthier individuals are likely to have more (and more valuable) of the types of property protected by exemptions. In a state such as Texas or Florida, for instance, a debtor is permitted to retain his entire homestead.¹²⁸ This has

124. For instance, in ancient Athens, defaulting on a debt was considered a capital crime. White, *supra* note 3, at 281. The Roman law of the Twelve Tables pledged the borrower as collateral and empowered creditors to either take the debtor into slavery or "divide the debtor's body into proportionate shares." *Id.*

125. See Michelle J. White, *Why Don't More Households File for Bankruptcy?*, 14 J.L. ECON. & ORG. 205, 213-15 (1998).

126. *Id.* at 227-29; see also White, *supra* note 3, at 284 ("Without discharge—with the knowledge that he must eventually repay his debts—the debtor would gain no advantage in switching his wealth about. It is the knowledge that he will not be held any longer liable for any part of his debts that prompts the prospective bankrupt to consume, or to hide, or to convert to exempt form his non-exempt wealth.").

127. E.g., TEX. PROP. CODE ANN. § 42.001 (Vernon 2000) (exempting personal property from garnishment, attachment, execution or other seizure); *id.* § 42.002 (listing exempted items, including jewelry, firearms, athletic equipment, vehicles, horses and other livestock, to name a few).

128. *Id.* § 41.002 (exempting an urban homestead up to 10 acres and rural homesteads up to 200 acres, regardless of value); FLA. STAT. ANN. § 222.02 (West 1998) (providing for sale under levy of any property not designated as homestead); see also Christine Dugas, *Should Debtors be Able to Keep Homes? Critics Say Bankruptcy Loophole Aids the Rich*, USA TODAY, June 26, 2000, at 10B (comparing homestead exemptions in several states, including Texas and Florida).

The Texas Property Code provides that it overrides federal law regarding homesteads in the event that federal law attempts to impose a monetary limit on homestead exemptions. See TEX. PROP. CODE ANN. § 41.008 (Vernon 2000).

given rise to such notorious bankruptcies as former Texas Governor John Connally protecting a gigantic cattle ranch in Texas and former baseball commissioner Bowie Kuhn exempting a multimillion-dollar home in Florida.¹²⁹ These are extreme examples, of course. Nonetheless, they illustrate a point—as one’s income and wealth rise, it becomes increasingly profitable to file for bankruptcy because one can usually exempt more property from one’s creditors than a poorer individual who rents an apartment and uses public transportation.

Current law also provides few limitations on opportunistic use of the bankruptcy system by high-income individuals who use bankruptcy to evade debts that they can repay. As enacted in 1978, in fact, the Bankruptcy Code contained no limitations on abusive use of bankruptcy by debtors who could repay some or all their debts but chose not to do so.¹³⁰ Concerned about a rising tide of debtors abusing the bankruptcy system to reject debts that they could actually repay, Congress amended the Code in 1984 to add Section 707(b), which empowered the bankruptcy court to dismiss a debtor’s case if granting relief would be a “substantial abuse” of the bankruptcy system.¹³¹ In making this determination, a bankruptcy court may particularly examine the question of whether the debtor could repay some of his debts under Chapter 13.¹³²

Despite Congress’s intention to reduce abusive bankruptcy filings, the advent of Section 707(b) has proven itself ill equipped to stem the rising tide of bankruptcy filings. As one commentator has observed, “many, including many in Congress,

129. *Id.*

130. 11 U.S.C. § 707 (Supp. V 1999); *see also* S. REP. NO. 95-989, at 94 (1978) (noting that the ability of the debtor to pay does not constitute cause for dismissal of a liquidation case).

131. 11 U.S.C. § 707(b) (Supp. V 1999).

132. *See* David B. Harrison, Annotation, *Bankruptcy: When Does Filing of Chapter 7 Petition Constitute “Substantial Abuse” Authorizing Dismissal of Petition Under 11 USCS § 707(b)*, 122 A.L.R. FED. 141 (1994). The term “substantial abuse” is not defined in the Bankruptcy Code, but some courts have implemented a “totality of the circumstances” test for determining whether there has been “substantial abuse.” *E.g.*, *In re Green*, 934 F.2d 568, 572 (4th Cir. 1991). Other courts have adopted a per se rule that “a finding that a debtor is able to pay his debts, standing alone, supports a conclusion of substantial abuse.” *In re Kelly*, 841 F.2d 908, 914 (9th Cir. 1988); *see also* *United States Trustee v. Harris*, 960 F.2d 74, 75 (8th Cir. 1992) (holding that the “debtor’s ability to pay a substantial portion of his unsecured debts” is “the primary consideration under § 707(b)”); *In re Jarrell*, 189 B.R. 374 (Bankr. M.D.N.C. 1995) (noting the per se rule adopted by some courts).

[perceive Section 707(b)] as being a dismal failure.”¹³³ Similarly, lawyer and former law professor George Wallace has observed, “There are over 300 bankruptcy judges out there, and, in most of their courts, § 707(b) is simply a dead letter.”¹³⁴ As Wallace’s observation indicates, bankruptcy judges have shown little inclination to use Section 707(b) as a tool to weed-out abuse. Many cases turn not on questions of whether the debtor can repay his debts, but such things as judges’ subjective values¹³⁵ and “the extent to which the court . . . is able to find within itself the compassion needed to allow the debtor to proceed.”¹³⁶ Judicial indifference to preventing abuse is matched by equal apathy on the part of United States Trustees and Chapter 7 trustees.¹³⁷ Empirical studies suggest that approximately seven to ten percent of Chapter 7 bankruptcy filers could repay a substantial portion or all their debts if they pursued a repayment plan in Chapter 13 rather than walking away from their debts in Chapter 7.¹³⁸

Surveys indicate that bankruptcy debtors are routinely surprised, and pleased, to discover how easy it is to file bankruptcy and repudiate one’s debts. One survey found that sixty-six percent of bankruptcy filers discovered the bankruptcy process to be an easy one and that twenty-seven percent would consider filing again in the future.¹³⁹ In fact, bankruptcy attorneys report that one of their most difficult jobs is in persuading clients that there really is no “catch” to the deal offered by the bankruptcy system. As one lawyer told Professor Jean Braucher in her study of consumer bankruptcy practice, “[C]hapter 7 sometimes seems to debtors to be ‘too good to be

133. Jack F. Williams, *Distrust: The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REV. 105, 110 (1999).

134. *Resolved: The Time has Come for Means-Testing Consumer Bankruptcy*, 17-Apr. AM. BANKR. INST. J. 6, 45 (1998) (relating statement of George Wallace).

135. See *id.* at 46 (discussing the need for objective standards).

136. *In re Butts*, 148 B.R. 878, 880 (Bankr. N.D. Ind. 1992).

137. See Zywicki, *Screwtape*, *supra* note 5, at 620 n.41 (citing Williams, *supra* note 133, at 113).

138. This estimate is a composite of several studies discussed in Jones & Zywicki, *supra* note 30, at 186-200. A study conducted at the Georgetown School of Business found that, of those filing under Chapter 7, 5% could repay 100% of their debts within 5 years, 25% could repay at least 30% of their nonhousing debt over 5 years, and 10% could repay at least 78% of their nonhousing debt over 5 years. *Id.*

139. See McKinley, *supra* note 90, at 38.

true; they can't believe it."¹⁴⁰ Another lawyer added, "if Americans in general knew what you can do in bankruptcy, then we'd really be in trouble."¹⁴¹

Other bankruptcy lawyers believe that one of their primary responsibilities is to defeat the residual sense that debtors have of a moral obligation to repay their debts and live up to their financial obligations. Some attorneys advise their clients to simply evade their creditors by moving or changing telephone numbers.¹⁴² One attorney told Professor Braucher, "if [potential clients] have little debt and can't pay, I tell them to tell their creditors to go to hell."¹⁴³ Others deny the existence of any moral obligation to repay debts: "some people feel there is a moral issue; frankly I don't."¹⁴⁴ Another attorney adds, "I don't feel bad about it. . . . Some debtors say they feel bad about discharging debt, and I wonder if they do. Some are overly emotional, and I'm thinking, 'What's the big deal?' Especially with credit cards—it's not like a friend or a relative."¹⁴⁵ Many attorneys try to undermine the sense of moral obligation by contrasting these obligations with others that are generally regarded as having greater moral weight. Professor Braucher reports that a number of attorneys

said that they find themselves trying to talk debtors out of [the desire to repay their debts in] Chapter 13. They use such tactics as raising the question of their clients' moral obligations to their families, especially to their children, in order to diffuse clients' sense of moral obligation to repay creditors.¹⁴⁶

Even if bankruptcy judges and trustees were serious about trying to prevent bankruptcy abuse, current law makes it very difficult to do so. Approximately 1.3 million Americans troop through the bankruptcy system every year.¹⁴⁷ The vastness of this number simply overwhelms any efforts to seriously police abuse by even the most vigilant bankruptcy judges. Current law also

140. Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 554 (1993).

141. *Id.*

142. *Id.* at 524.

143. *Id.*

144. *Id.* at 564.

145. *Id.*

146. *Id.* at 509.

147. Henry, *supra* note 28, at A1.

presumes that all debtors are entitled to relief under Chapter 7, regardless of how high their income and regardless of how much of their debts they could repay in Chapter 13.¹⁴⁸ The burden is on the bankruptcy judge and trustee to demonstrate substantial abuse to dismiss the case.¹⁴⁹ This requires a fact-intensive, case-by-case inquiry to determine whether substantial abuse has occurred.¹⁵⁰ As noted above, obtaining dismissal will often be substantively difficult due to the lack of desire on the part of many judges to actually attack abuse. But more fundamentally, this expensive, fact-intensive, case-by-case inquiry is simply not a plausible way of dealing with abuse in a system of 1.3 million filers. Given the press of so many cases, most cases of abuse are probably not even noticed, much less contested.¹⁵¹ The system is simply overwhelmed. Moreover, obtaining dismissal in any single case is likely to prove expensive and time-consuming, thereby distracting trustees and judges from their other responsibilities. Thus, even the grossest case of abuse can prove difficult and expensive to prevent.

Consider the case of Doctor Robert Kornfield, a successful physician in Rochester, New York.¹⁵² It appears that he earned approximately \$472,000 in 1994 and \$404,000 in 1995, but his income “plunged” to a mere \$318,000 a year in 1996.¹⁵³ Dr. Kornfield’s newfound poverty made it difficult for him to make the payments on the “extravag[ant] . . . multi-million dollar home”¹⁵⁴ that he was building, as well as the lease payments on

148. See *supra* notes 130-38 and accompanying text.

149. 11 U.S.C. § 707(b) (Supp. V. 1999) (“[T]he court, on its own motion or on a motion by the United States trustee . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter.”).

150. *In re Green*, 934 F.2d 568, 572 (4th Cir. 1991) (“The consensus among these courts is that the substantial abuse determination must be made on a case-by-case basis, in light of the totality of the circumstances.”); see also *United States Trustee v. Harris*, 960 F.2d 74, 75 (8th Cir. 1992).

151. See, e.g., LoPucki, *supra* note 64, at 461 (noting the number of “dishonest debtors, in proportions much higher than those acknowledged by judges and empirical researchers”).

152. *In re Kornfield*, 211 B.R. 468 (Bankr. W.D.N.Y. 1997).

153. *Id.* at 472-73. It is difficult to determine his income for sure because of apparent errors and misstatements on his bankruptcy schedules. The bankruptcy court reported that Dr. Kornfield “had \$472,445.00 in self-employment income (net before taxes) in 1994, \$311,654.00 in self-employment income (net before taxes) and \$92,939.00 in employment income in 1995,” *id.* at 472, while the Second Circuit later reported “a gross income of \$404,593 in 1995 and \$472,445 in 1994.” *In re Kornfield*, 164 F.3d 778, 780 (2d Cir. 1999).

154. *Kornfield*, 211 B.R. at 483.

his Land Rover Range Rover and the \$53,000 in tuition he was paying for private school for his children.¹⁵⁵ Despite this income reduction, the bankruptcy judge observed that the Kornfields were “unwilling to make any effort to reduce their . . . voluntary and excessive[] living expenses to enable them to pay something to their creditors.”¹⁵⁶ Nonetheless, Kornfield appealed his case all the way to the Second Circuit Court of Appeals before his case was finally dismissed.¹⁵⁷ Given the difficulty and expense of preventing abuse in even outrageous cases of abuse such as Kornfield’s, it is likely that bankruptcy judges and trustees will think twice before bringing future actions to dismiss cases for abuse. When relief is granted, it is granted only if the bankruptcy judge subjectively believes the filing to be abusive, undermining predictability and the rule of law.

In Dr. Kornfield’s case, at least, the case eventually was dismissed. Consider, by contrast, the bankruptcy of Willie Jackson, professional football player for the New Orleans Saints.¹⁵⁸ Jackson, a talented wide receiver, earns about \$800,000 in salary from the Saints.¹⁵⁹ Nonetheless, after a business deal went sour, Jackson decided to file bankruptcy last year.¹⁶⁰ One of Jackson’s creditors objected to Jackson filing bankruptcy under Chapter 7 since he could repay all or most of his debts out of his future income.¹⁶¹ The creditor’s objection was denied.¹⁶² The bankruptcy court explained that under both the substantive and procedural standards of current law, the creditor could not ask to have Jackson’s case dismissed. As the court explained to the mystified creditor, “[A] debtor’s case [should not] be dismissed solely because a debtor may be able to pay creditor’s claims in full.”¹⁶³ The court also informed the creditor that it had no standing under the law to object to Jackson’s case, because law limits that power to the United States Trustee. The court patiently explained the bizarre state of current bankruptcy law

155. *Id.* at 472-73.

156. *Id.* at 482.

157. *Kornfield*, 164 F.3d 778.

158. *In re Jackson*, 258 B.R. 272 (Bankr. M.D. Fla. 2000).

159. *Id.* at 276.

160. *Id.* at 274-75.

161. *Id.* at 277.

162. *Id.*

163. *Id.* at 276.

to the creditor, "The Court recognizes that [the creditor] is frustrated. However, [the creditor] must recognize that it is not the first frustrated creditor in the history of the Bankruptcy Code, nor will it be the last."¹⁶⁴ Given the procedural hurdles that frustrate the ability to prevent abuse in cases even as egregious as Willie Jackson's, it is difficult to believe that current law prevents more than a fraction of the abuse present in the system.

The current American bankruptcy system is thus unique in the legal systems of the world—it provides powerful economic incentives to file bankruptcy and places few limitations on opportunistic use of bankruptcy. In so doing, it mocks the traditions of personal responsibility and performance of obligations that provide the bedrock for a free market, stable democracy, and healthy civil society. Because of the structure of the exemption laws, these incentives rise as one moves up the income ladder. Thus, restraints on opportunism, such as social stigma and individual morality, become increasingly important as income rises.¹⁶⁵ As temptation rises, it places greater stress on individual conscience and social morality. We know many people who would return a wallet with \$20 in cash that they found on the street. We know fewer people would return a wallet with \$2,000 in cash and still fewer who would return a wallet with \$20,000 in cash in it. As the economic rewards of acting improperly rise, it becomes increasingly likely that people's morality may yield to economic calculation. Similarly, as the economic benefits of filing bankruptcy rise, one might expect increasing numbers of people to yield to the temptation to break their promises by filing bankruptcy.

In part to restore notions of personal responsibility to the bankruptcy system, Congress has sought to enact the Bankruptcy Reform Act of 2001 (the "Act").¹⁶⁶ Among its provisions, the Act provides a "means test" for eligibility for Chapter 7.¹⁶⁷ The means test would require high-income debtors with the ability to repay a substantial portion of their debts without significant hardship

164. *Id.* at 278.

165. *Cf. Jones & Zywicki, supra* note 30, at 220 ("As shame and stigma decline, therefore, the marginal impact will be felt most heavily with respect to upper-income debtors.").

166. Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001); *see also* Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001).

167. S. 420, § 102.

to do so by filing Chapter 13, rather than Chapter 7.¹⁶⁸ The means test would create a rebuttable presumption that high-income debtors who can repay some or all their debts in Chapter 13 should be required to do so unless they can demonstrate why they should not be so required.¹⁶⁹ This provision reverses the presumption of current law, which even allows a high-income debtor such as Robert Kornfield to be entitled to a presumption that he could file in Chapter 7. The provision would not prohibit anyone from filing for bankruptcy; it would simply make compliance with a Chapter 13 repayment plan a condition on the debtor receiving his discharge in bankruptcy.

Much of the debate over the usefulness of means testing has revolved around economic questions as to the number of filers who would be affected and how much they could repay.¹⁷⁰ But means testing sends a powerful moral statement as well. Unlike current law, means testing makes the powerful statement that if a debtor can repay some or all his debts he should be required to do so. Means testing thus strongly vindicates the principle of personal responsibility by requiring debtors to live up to their obligations to creditors to the extent that they can. Even critics of the Act, such as Hillary Clinton, acknowledge that “[d]ebtors who have the genuine capacity to repay their debts should be required to do so.”¹⁷¹

Proponents of the Act have identified the important moral and social reasons for bankruptcy reform. During the debates on the Act, Congressman Sensenbrenner remarked, “The purpose of the bill is to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system, and to ensure that the system is fair to both debtors and

168. *Id.*

169. *Id.*

170. It has been contended that an “underlying assumption” of the proponents of means-testing is that many debtors “have the income to repay a significant portion of their debts.” Williams, *supra* note 133, at 122-23. Studies conducted by participants in the current bankruptcy system and proponents of reform are in conflict. Some studies suggest that a “substantial” number of debtors could pay a significant portion of their debt through a Chapter 13 plan, rather than a chapter 7 plan; however, other studies disagree. *Id.* at 123-25.

171. First Lady Hillary Rodham Clinton, Remarks on Consumer Protection, Washington, D.C. (May 4, 1999) (transcript available from the Federal Document Clearing House).

creditors.”¹⁷² House Majority Leader Richard Armey was even more outspoken in identifying the moral basis of bankruptcy reform:

I believe that the law of this land should always be a complement to and encouragement for those lessons in life that we as parents invest most heartfelt in the instruction of our children.

....

One of the things that we have already worked so hard with our children is to be so, so careful how we accept obligations in our lives and be judicious in that manner, but once we accept an obligation to understand the need as a matter of personal pride and honor to fulfill that obligation, the law of the land should complement that lesson on behalf of every child in America and on behalf of every parent that passes that lesson down to yet another generation.

Bankruptcy laws in America have not done that. Bankruptcy laws in America have put a lie to one of the most important lessons we teach our children. Bankruptcy laws in America have said to our children, you are a fool if you do not file. That is not right. Yes, this [passage of the Act] is a right step for us to take, a good step for us to take. It is not about the money. Anybody who thinks this bill is about who gets the money is missing the point, Mr. Chairman.

This bill is about the character of a Nation and will the Nation's laws have a character of the Nation's people.¹⁷³

Armey's statements are quoted at length because they illustrate the point that has been advanced in this article. Bankruptcy law is social and moral legislation as much as it is economic legislation. For twenty years, we have suffered under a bankruptcy system that mocks the principles of personal responsibility and financial obligation. An express intent of the Bankruptcy Reform Act of 2001 is to try to rein in the excesses of the prior bankruptcy law and to vindicate these principles. At the same time that bankruptcy reform vindicates the principles of justice and promise keeping, it preserves the principle of charity and forgiveness for those who need it.

172. 147 CONG. REC. H517 (daily ed. Mar. 1, 2001) (statement of Rep. Sensenbrenner).

173. 147 CONG. REC. H518 (daily ed. Mar. 1, 2001) (statement of Rep. Armey).

VI. THE OPPORTUNITY FOR REFORM

A primary impetus for bankruptcy reform is thus to rein in the excesses of the bankruptcy system that were created in the 1970s and to bring the bankruptcy laws back into line with traditional, universal notions of morality and personal responsibility. As such, it is consistent with other legislative initiatives, such as welfare reform, which similarly attempt to reinstate the traditional moral foundations of our social legislation. It is not surprising that the critics of bankruptcy reform are many of the same people who opposed welfare reform.¹⁷⁴ In fact, bankruptcy reform opponents make many of the same arguments as did the critics of welfare reform.¹⁷⁵ The triumph of traditional morality in the bankruptcy reform debate, however, is also consistent with larger trends indicating a restoration of traditional morality after a period of straying from it. Francis Fukuyama, professor of public policy at George Mason University, calls this interregnum the "Great Disruption."¹⁷⁶ Fukuyama argues that there are

174. For instance, the American Bar Association (ABA) has expressed opposition to welfare reform. See Byron York, *Disbarred!: Bush Throws the ABA Out*, NAT'L REV., Apr. 16, 2001, at 21, 22 (noting the ABA's opposition to welfare reform). It has also consistently expressed a reluctance to pass bankruptcy reform. See *Board Urges Congress to Go Slow on Bankruptcy Bills*, N.J. LAW., June 15, 1998, at 9 (noting the request of the ABA for more time to review proposed reforms); Kristin E. Cormier, *Bankruptcy Bill Passes In House*, May 10, 1999, NATION'S CITIES WKLY, at 1 (noting concerns of the ABA yet to be addressed).

President Clinton is sometimes given credit for the welfare reform that occurred during his administration, but he vetoed the first two welfare reform bills sent to him and signed the third during an election year. See *Hannity & Colmes* (Fox television broadcast, Oct. 31, 2000) (interviewing Governor Tommy Thompson regarding welfare reform). Clinton's opposition to welfare reform was matched by his opposition to bankruptcy reform. See Diaz, *supra* note 116, at 22A.

175. Proponents of bankruptcy reform argue that the rise in bankruptcy filings is due to increasingly "lax moral standards and a culture of tolerance." Williams, *supra* note 133, at 107. Opponents of such reforms as means-testing argue that these reforms are "mean spirited and ill-conceived." *Id.* Other critics similarly argue that bankruptcy reform "let[s] wealthy deadbeats off the hook . . . even though it was supposed to crack down on debtors who abuse bankruptcy laws." Dugas, *supra* note 128, at 10B. Opponents also argue that the bankruptcy reform profits wealthy credit card companies and hurts the poor. See *supra* notes 92-95 and accompanying text.

Similarly, the welfare debate was presented as a battle between the rich and the poor. Opponents of the reform contended that reform was being passed at the expense of the poor who needed help. See Benjamin Akande, *Let's Ask the Poor How to Solve Poverty*, DALLAS MORNING NEWS, July 23, 1995, at 6J (portraying the welfare reform package as legislation thrust on the poor due to their under-representation in the "corridors of power"). In contrast, proponents of the reform argued that it encouraged the development of individual responsibility. Jane Nelson, *Individual Responsibility Needed to Solve Problems*, DALLAS MORNING NEWS, July 13, 1996, at 7A.

176. See FRANCIS FUKUYAMA, *THE GREAT DISRUPTION: HUMAN NATURE AND THE RECONSTITUTION OF SOCIAL ORDER* 5-8 (1999).

patterns of behavior and morality that are rooted in human nature and thus universal to all successful societies.¹⁷⁷ Promiscuous bankruptcy laws are but one of many examples of the way in which societies can suffer from radical social experiments that are not grounded in the wisdom of the past. Fukuyama, however, notes that humans need not be passive in the face of the social consequences of the problems they sow. He observes that there is the possibility of self-correction when social order goes awry.¹⁷⁸ In particular, he observes that the "Great Disruption that took place from the 1960s to the 1990s is beginning to recede."¹⁷⁹ For example, since the 1980s, crime has fallen, illegitimacy rates have leveled off, and divorce rates have been falling.¹⁸⁰ Levels of trust in major institutions have risen in the 1990s and, as noted earlier, it appears that civil society appears to be rebounding.¹⁸¹ Bankruptcy reform presents an opportunity for the law to embrace this societal shift as we rediscover the moral, social, and economic benefits of personal responsibility and reciprocity and refuse to continue to permit bankruptcy laws to effectuate social legislation.

177. *Id.*

178. *Id.* at 6 ("[S]ocial order, once disrupted, tends to get remade once again, and there are many indications that this is happening today.").

179. *Id.* at 7.

180. *Id.* at 7-8.

181. *Id.* at 8.

