

# Conservative Economics and Optimal Consumer Bankruptcy Policy

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*In this paper, Professor Wiggins explores the relationship between conservative economic theories and major bankruptcy reforms recently enacted by the United States Congress. First, she describes three key components of conservative economic theory as advanced by the Bush Administration and conservative scholars. These include: (1) a strong preference for private ordering over public ordering, (2) the promotion of private property as a means to expand personal freedom and liberty, and (3) the encouragement of individual risk internalization. Next, she describes two theoretical components of the new bankruptcy reforms. These include: (1) a preference for creditor collection over debt relief and (2) the promotion of individual risk internalization. Then Professor Wiggins examines two questions: First, is there meaningful theoretical symmetry between conservative economics and the new bankruptcy law? Second, is there significant operational symmetry between the two? The paper suggests theoretical convergence for two reasons: First, both conservative economics and the new bankruptcy law aim to promote private bargains over administratively adjusted ones. Second, both seek to force individuals to absorb more of the risks of financial decision-making. The paper suggests, however, that at the operational level there exists significant divergence between*

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*the aims of conservative economics and the predicted consequences of the new law. Professor Wiggins concludes, among other things, that economic conservatives should pay more rigorous attention to personal bankruptcy policy because operational asymmetry between their theories and the new legislation could blunt their ambitious economic agenda for American consumers.*

Didn't need no Welfare State. Everybody pulled his weight.  
Gee our old LaSalle ran great. Those were the days.<sup>1</sup>

## INTRODUCTION

In the wake of the re-election of President George W. Bush and Republican control of Congress, conservative economic ideas and rhetoric are undergoing a fierce revival in some quarters. Free-market principles and ideologies that emphasize, among other things, the elimination of excessive government regulation carry considerable influence in political and policy circles.<sup>2</sup> These principles also translate into concrete policies. For example, President Bush's central initiative on domestic economic policy, termed "The Ownership Society,"<sup>3</sup> is rooted in conservative economic principles. While it remains unclear whether there has been a pronounced shift to economic conservatism among the general public,<sup>4</sup> conservative economic ideas and principles seem to have attracted renewed interest in and attention from opinion-makers and policy-analysts. At the same time, the United States Congress has recently enacted a major reform of consumer bankruptcy laws.<sup>5</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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1 Theme Song from *All in the Family*, a television program popular in the United States in the 1970s. Strouse & Adams, *Those Were the Days*.

2 Warren Vieth, *Bush Says Private Accounts Are a Part of the Solution*, L.A. Times, Feb. 5, 2005, at A1.

3 Albert B. Crenshaw, *The Economics of Creating an Ownership Society*, Wash. Post, Jan. 20, 2005, at A12.

4 Compare John Mickelwait, *The Right Nation: The Conservative Power in America* 381-82 (2004) (arguing that conservatism is now the prevailing ideology), with Robert Reich, *A Program for a New Majority*, in *Taking Back America and Taking Down the Radical Right*, at xiii, 56-57 (Katrina VandenHeuvel & Robert Borsage eds., 2004) (arguing that Americans are not consistent in their views because they want both lower taxes and more government benefits).

5 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

("The Act") represents the largest reform of bankruptcy law in a generation.<sup>6</sup> The credit card industry, believing that passage of the bill would enable it to minimize its bankruptcy losses, pushed hard for the legislation. For example, the industry gave generous contributions to the campaign coffers of influential legislators.<sup>7</sup> The industry consistently stressed to legislators that the rising number of bankruptcy filings was attributable to widespread fraud and abuse of the bankruptcy system.<sup>8</sup>

Many influential professionals in the bankruptcy bench and bar (and others) vigorously opposed the bill. They argued that it was not necessary, that it was not compassionate, and that it would have many negative consequences that would likely outweigh any expected gains.<sup>9</sup>

The terms of the bankruptcy reform debate have been remarkably stable over the last several years. The debate has revolved chiefly (although not entirely) around a split between those who viewed the prior bankruptcy law as much too lax, and thus very unsound, and those who viewed it as appropriately compassionate and thus basically sound. Framing the debate in this way has obscured many interesting and difficult questions. One of those questions is the subject of this paper: little has been said about the relationship between conservative economic principles, advanced more generally by the Bush Administration and other economic conservatives, and optimal consumer bankruptcy policy.<sup>10</sup> The objective of this paper is to consider that relationship and its implications for normative debates on consumer bankruptcy law and policy.

The paper proceeds in three parts. Part I describes three key theoretical components of prevalent conservative economic ideas and rhetoric, as advanced by the Bush Administration and others. Part II details the theory

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6 Mary Jo Wiggins, *New Bankruptcy Law: Winners and Losers*, S.D. Union-Trib., Apr. 21, 2005, at B3.

7 Stephen Labaton, *Bankruptcy Bill Set for Passage*, N.Y. Times, Mar. 9, 2005, at C5 (noting that major credit card companies have spent over \$40 million in political fund raising efforts since 1989).

8 Peter Gosselin, *Judges Say Overhaul Would Weaken Bankruptcy System*, L.A. Times, Mar. 29, 2005, at A1.

9 Law Professors' Letter on S. 256 (on file with author). See also Gosselin, *supra* note 8, at A18.

10 Some conservative commentators have used conservative principles to justify reforming bankruptcy laws, but those principles are usually based on a morality of personal responsibility. See, for example, the comments of Republican Senator Orrin Hatch: "[O]nce people borrow money, they need to take personal responsibility to pay it back. Personal responsibility is a core American value." Leslie Eaton, *Bankruptcy, the American Morality Tale*, N.Y. Times, Mar. 13, 2005, at C1.

and rhetoric of the Act. Part III examines two questions: First, is there meaningful theoretical symmetry between conservative economics and the Act? Second, will there likely be significant operational symmetry between the two? This analysis reveals significant theoretical alignment. First, both conservative economics and the Act aim to promote private bargains over administratively adjusted ones. Second, both seek to force individuals to absorb more of the risks of their financial decisions. However, this analysis also reveals potential divergence between the aims of conservative economics and the predicted consequences of the Act. For one, the Act will likely make it more difficult for middle-class consumers to acquire and retain private property. Additionally, the Act will probably require significantly more governmental involvement in the debt collection process. The paper concludes, among other things, that adherents to economic conservatism should pay more rigorous attention to bankruptcy policy because operational asymmetries between their theories and the Act could blunt their ambitious economic agenda for American consumers.

## I. THE THEORY AND RHETORIC OF CONSERVATIVE ECONOMICS

### A. Private Ordering over Public Ordering

Conservative economic policies are heavily rooted in the notion that society will be better off if more resources are privately-owned and operated rather than publicly-owned and operated.<sup>11</sup> Society will benefit from an economic standpoint for three reasons: First, private ownership, according to this theory, helps to internalize externalities and also lowers transaction costs. Private ownership will thus lead to more efficient choices about how entitlements are used. Second, private ownership will better promote incentives to maintain and improve property. Third, private property rights facilitate the optimal operation of market exchanges. All of this, the thinking goes, will lead to greater societal wealth maximization compared to a regime in which most of the important resources remain in public hands.<sup>12</sup>

A preference for private ownership over public ownership pervades Bush

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11 The Economic Report of the President 117-21 (Feb. 2005), *available at* [http://a257.g.akamaitech.net/7/257/2422/17feb20051700/www.gpoaccess.gov/eop/2005/2005\\_erp.pdf](http://a257.g.akamaitech.net/7/257/2422/17feb20051700/www.gpoaccess.gov/eop/2005/2005_erp.pdf). In using the term "publicly-owned," I am referring to forms of communal ownership by several individuals (i.e., joint tenancies, tenancies in common, etc.) and also to state ownership.

12 *Id.* at 121 ("Evidence suggests that societies that have protected property rights over time are more prosperous.").

Administration policy on many issues. Environmental policy is one example. The Bush Administration has consistently supported the privatization of land in environmental disputes between landowners and conservationists.<sup>13</sup> It also supports Individual Transferable Quotas (ITQs) as a means to regulate over-fishing and tradeable air pollution permits to control air pollution.<sup>14</sup> The Bush Administration has also tended to support private education as a meritorious alternative to public schools.<sup>15</sup> It argues that voucher programs, under which eligible families receive money from their state or school districts to pay for education at private schools, increase efficiency by forcing all schools to compete for students. Another example of the Administration's preference for private ownership is the President's advocacy of social security reforms. President Bush argues that the social security system will operate more efficiently and effectively if individuals are allowed to manage their own private retirement accounts.<sup>16</sup>

Conservative law professors Richard Epstein and Randy Barnett have advanced similar arguments, although each scholar approaches these questions from a different perspective. Professor Epstein dislikes communal ownership because he believes that communal property carries with it the danger of overexploitation by each member of the community.<sup>17</sup> This danger can be traced to the uneven benefits and burdens that result from the extraction from the resource. The problem is that someone might remove something from the property to the detriment of others. Ultimately, the resource might be destroyed and this will, Professor Epstein has argued, leave everyone worse off than if the group had collectively imposed restrictions on individual extractions.<sup>18</sup>

As for the merits of private property, Epstein argues that private property is beneficial because it allows parties to bargain for optimal arrangements

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13 Todd Wilkinson, *Drilling Where Antelope Play*, Christian Sci. Monitor, Apr. 13, 2005, at A1 (noting that the Bush administration plans to open up more public land to development); Seth Borenstein, *New Drilling Fight Looms*, Akron Beacon J., Feb. 17, 2005, at A10 (noting that the Bush administration is pushing to open up more public land to energy exploration by private companies).

14 The Economic Report of the President, *supra* note 11, at 122-25.

15 *Id.* at 127.

16 *Id.* at 127-29 ("By giving citizens greater control over their retirement assets, property rights can make an important contribution to improving the U.S. retirement system.").

17 See Richard Epstein, *Why Restrain Alienation?*, 85 Colum. L. Rev. 970, 978 (1985).

18 *Id.*; see also Harold Demsetz, *Toward a Theory of Property Rights*, 57 Am. Econ. Rev. 347, 347-57 (1967).

within the context of an ongoing relationship.<sup>19</sup> Moreover, Epstein suggests, the initial presumption regarding property rights should be that they are unrestricted — that we should be allowed all use of our private property — because the right to own one's land freely is more important than the right to veto one's neighbor's use of his land.

Professor Barnett, in his book *The Structure of Liberty*, is very critical of government ownership of public spaces. He argues that such ownership leads to what he calls a "dilemma of vulnerability."<sup>20</sup> This dilemma is caused by the ever-present potential for tyrannical government control of access to public property. Professor Barnett argues that the privileged status of government and the lack of economic constraints on government make public property particularly vulnerable to governmental control. The ultimate problem is that the need to protect society from the government will make citizens more vulnerable to crime because measures designed to restrain the government will give protection to criminals.<sup>21</sup>

### **B. The Acquisition and Retention of Private Property as a Way to Expand Personal Freedom and Liberty**

Conservatives consistently argue that acquisition of private property leads to greater personal freedom and political liberty. According to this theory, private property is beneficial because it separates the individual from the State and from dependence on the State.<sup>22</sup> Private property is also desirable

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19 See Richard Epstein, *Lucas v. South Carolina Coastal Council: A Tangled Web of Expectations*, 45 Stan. L. Rev. 1369, 1386 (1993).

20 Randy E. Barnett, *The Structure of Liberty* 220 (1998). Elsewhere in the book, Professor Barnett argues that

if all are thought to have an equal right to exploit the use of this property — then no person has the right to exclude others from using the resource. Without the right to exclude, it is unlikely that the benefits accruing to persons who privately invest in the care or improvement of a resource will exceed the costs of their efforts.

*Id.* at 217.

21 *Id.* ("The dilemma of vulnerability created by public property leads to an ever-present temptation to trade liberty for security—that is, to compensate for the inefficiency of government provided law enforcement by unjustly restricting individual rights . . .").

22 President George W. Bush, Second Inaugural Address (Jan. 20, 2005), available at <http://www.whitehouse.gov/inaugural/> [hereinafter Second Inaugural Address] ("By making every citizen an agent of his or her destiny, we will give our fellow Americans greater freedom from want and fear and make our society more prosperous and just and equal.").

because it tends to give individuals a stake in society and thus a reason to care about what happens in it.<sup>23</sup> The Bush Administration has, for example, recently sided with landowners in the high-profile constitutional litigation over the "Takings Clause" of the United States Constitution. In *Kelo v. City of New London*,<sup>24</sup> the Bush Administration argued that the doctrine of eminent domain is unconstitutional when it is used by a city to acquire private property in furtherance of an economic development plan. Social security again provides an example. President Bush thinks private accounts are a good idea, in part, because they will promote individual ownership and free individuals from the whims and control of government bureaucrats.<sup>25</sup>

A central theme of the Bush Administration's position on takings and on social security is the notion that private property, be it land or a retirement account, blunts government power and government control. It leads to greater political liberty and human freedom because the private property owner can use his interest in private property to tell government officials to leave him alone. Moreover, that stake in private property gives the owner an incentive to care about what happens to his investment. This, in turn, leads to greater interest in the actions and affairs of government. Private property thus provides a mechanism for scrutiny and examination of (and often opposition to) governmental actions.

The conservative economist most closely associated with this view of private property is Professor Milton Friedman. In his landmark 1962 book, *Capitalism and Freedom*, Friedman argued that free transferability of property is essential to political freedom. He wrote:

Economic arrangements play a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.<sup>26</sup>

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23 President George W. Bush, Remarks in New Port Richey, Florida (Oct. 19, 2004), available at <http://www.whitehouse.gov/news/releases/2004/10/20041019-6.html> ("I believe our country can, and must, be an ownership society. . . . When you own something, you care about it. When you own something, you have a vital stake in the future of your country.").

24 125 S.Ct. 27 (2004).

25 The President said, "We must allow younger workers to save some of their own payroll taxes in a personal savings account that earns better interest, a personal savings account they call their own and an account the government cannot take away." *Id.*

26 Milton Friedman, *Capitalism and Freedom* 8 (1962).

Professor Epstein also argues that liberty and private property are very closely connected. He claims, for example, that a system of private property rights should be protected because it protects people from others who might be more powerful or dominant.<sup>27</sup> In making this argument, Professor Epstein cites the work of John Locke and Adam Smith. Locke, in particular, argued that liberty of action included the ability to use one's mind and body as he sees fit, and also the ability to use his property.<sup>28</sup> Following on that argument, Epstein argues that there should be an initial presumption in favor of liberty of action, including the right to possess, use, and dispose of private property.

### C. Individual Internalization of Risk and Reward

Another theory that animates economic conservatism is the idea that individuals should have the opportunity to internalize the risks and rewards of their economic decisions. The ultimate aim is to decrease the burdens and responsibility currently assumed by the government.<sup>29</sup> This, in turn, will lead to lower tax demands on the government and ultimately to a reduction in the size of government. It will also incentivize individuals to take more responsibility for their economic futures since, if they don't, they will have to assume the risks involved instead of shifting those risks to the government and ultimately to other taxpayers.<sup>30</sup>

Again, the proposed reforms to social security provide an excellent example of how conservative economic theory can translate into practical policy. The idea to have social security funds in private accounts rests, in part, on the notion that if people have the responsibility of managing private accounts, this will lead to less reliance on the government.<sup>31</sup> It will

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<sup>27</sup> Richard Epstein, *Property and Privilege*, Nat'l Rev., Aug. 8, 2005, at 1.

<sup>28</sup> See Richard Epstein, *The Erratic Takings Jurisprudence of Justice Holmes*, 86 Geo. L.J. 875, 877 (1998). Professor Barnett's theory of "several property" also shares intellectual roots with Lockean theory. Barnett, *supra* note 20, at 65 ("The term 'several property' makes it clearer that jurisdiction to use resources is dispersed among the several . . . persons and associations that comprise a society, rather than being reposed in a monolithic centralized institution.").

<sup>29</sup> See Crenshaw, *supra* note 3, at A12.

<sup>30</sup> James Surowiecki, *The Risk Society*, New Yorker, Nov. 12, 2004, at 40.

<sup>31</sup> One Bush Administration supporter says, "What we've seen is that government, at least in my opinion, over the years, has grown into an enabler that, in fact, includes more people than it really needs to. It tries to help more people than truly need help." Interview with Economist Brian Westbury, available at [http://www.pbs.org/newshour/bb/economy/july-dec04/ownership\\_12-15.html](http://www.pbs.org/newshour/bb/economy/july-dec04/ownership_12-15.html) (last visited Mar. 1, 2006).



also mean that if an individual faces financial difficulty in retirement due to portfolio fluctuations, that individual must rely on other sources of savings (ERISA accounts, 401Ks, or IRAs) or on family or friends.

Health Savings Accounts (HSAs) are another example. The Bush Administration proposes using such accounts as a way to help individuals pay for their health care expenses. Under these accounts, an individual would save money in personal accounts and he or she would own the account. The accounts would be transferable from job to job and would be tax-advantaged. As the Bush Administration sees it, these accounts have two major advantages, both consistent with risk internalization. First, they shift the cost of financing health care from the government and employers to individuals. Second, they force individuals to use health care more efficiently because they will have to make up the difference between the amount they prospectively allocate and the amount they actually use.<sup>32</sup>

Professor Epstein and other conservatives have long argued that individual action and the power of bargaining will increase social welfare.<sup>33</sup> Individual bargaining will, it is argued, create joint gains and will reduce externalities or detriments to third parties. To achieve these goals, legal rules should avoid bargains that are induced by force or fraud, or that contemplate the use or threat of coercion or fraud against third parties.

Concomitantly, the State should have a decreased role. Cutting down on State activity, these conservatives contend, reduces the need for taxation while simultaneously increasing collective prosperity.<sup>34</sup> Greater levels of societal wealth should, in theory, reduce the need for the redistribution of wealth by government. This will reduce the need for the welfare state.<sup>35</sup>

## II. THE THEORY AND RHETORIC OF THE BANKRUPTCY REFORM ACT

### A. Repayment over Relief

A chief goal of the recent revisions to the Bankruptcy Code is to force more debtors to repay their debts in a Chapter 13 repayment plan rather than have them discharged in a Chapter 7 liquidation. There are several Code

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<sup>32</sup> The Economic Report of the President, *supra* note 11, at 130.

<sup>33</sup> See Richard Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 Harv. L. Rev. 4 (1988).

<sup>34</sup> See Richard Epstein, *The Limits of Liberty*, in *Coercion vs. Consent: A Reason Debate On How to Think About Liberty*, Reason, Mar. 2004.

<sup>35</sup> *Id.*

sections that are designed to achieve this goal. For example, Section 707(b) has been revised to implement what is called "means testing." Under the revision, if an individual's income exceeds the median income under IRS guidelines and if that individual meets certain other criteria, he or she must file a Chapter 13 plan under which the debtor must pay a significant portion of his or her debt over at least five years.<sup>36</sup>

In addition, the Act will force debtors to commit more of their post-petition income to repaying old debts rather than using it for current expenses. For example, Section 707(b) will contain more uniform and precise guidelines for allowable expenses in Chapter 13 bankruptcies.<sup>37</sup> This means that debtors will not be able to confirm plans that contain individualized (and sometimes controversial) allocations for education, child care, and groceries. Additionally, Section 1325 has been amended to limit the ability of individual debtors in Chapter 13 to modify secured claims on certain secured loans.<sup>38</sup> Finally, and perhaps most important, the so-called "superdischarge" has been eliminated.<sup>39</sup> Chapter 13 discharge will now look more like that of Chapter 7, as more types of debts are categorically non-dischargeable.<sup>40</sup> As one economic historian noted, "Until now, the principle in this country has been that people's future human capital is their own. . . . [That] would change with this bill."<sup>41</sup>

## B. Individual Risk and Cost Internalization

The Act is also designed to force bankrupt individuals to bear more of the risks and costs associated with default. The Act makes it easier for creditors

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<sup>36</sup> 11 U.S.C. § 707(b) (1978).

<sup>37</sup> § 707(b).

<sup>38</sup> § 1325(a).

<sup>39</sup> §§ 1325(a), 523(a)(1)(B).

<sup>40</sup> If it was Congress's intent to incentivize debtors to use Chapter 13, then this is an odd provision indeed. It means that Chapter 13 has now been dramatically altered to make even its voluntary use a very unattractive financial move. One suspects, however, that Congress was not thinking about incentives when it drafted this bill. It was merely trying to force people to do what it thinks they should do (from a moral perspective) regardless of what is economically rational. It will be interesting to see what happens to voluntary Chapter 13 filing rates as a result of this bill. One suspects they will go down. It will also be interesting to see what happens to plan completion rates under this new law. Since many of the debtors are going to be forced into Chapter 13, motivation to complete plans might drop significantly. The result will likely be a lot of people going into Chapter 13, but not a lot of completed plans. This would also seem not to be consistent with what Congress intended.

<sup>41</sup> Peter Gosselin, *Credit Card Firms Won As Users Lost*, L.A. Times, Mar. 4, 2005, at A1 (quoting Harvard economic historian David Moss).

to lift the automatic stay in order to foreclose on collateral that is subject to a lien.<sup>42</sup> The Act also imposes significant restrictions on the availability of bankruptcy discharge. For example, it restricts the availability of Chapter 7 discharge to once every eight years.<sup>43</sup> The Act also expands restrictions on the discharge of student loans, credit card debt, and other obligations.<sup>44</sup> Under certain circumstances, the Act also restricts the ability of debtors to claim large homestead exemptions.<sup>45</sup>

If the Act works as intended, debtors will also have to absorb more of the administrative costs of bankruptcy filings. For example, debtors will have to routinely produce more documents in bankruptcy cases than before. They will have to produce tax returns at their own expense.<sup>46</sup> They will have to pay increased filing fees.<sup>47</sup> They will have to pay for mandatory debtor education.<sup>48</sup> The Act also imposes new notice procedures on debtors and essentially makes the debtor the legal guarantor of proper notice under the Code.<sup>49</sup> There exists much evidence that Congress's intent in passing these laws was to shift the administrative costs of bankruptcy from creditors to individual filers.<sup>50</sup>

### III. CONSERVATIVE ECONOMICS AND THE BANKRUPTCY REFORM ACT

#### A. Intellectual Symmetry

##### 1. *Laissez Faire Economics*

Conservative economics and the Bankruptcy Reform Act share a philosophical commitment to *laissez faire* economics, the doctrine that opposes governmental interference in private commerce beyond the minimum necessary for efficient operation. In this context, the core idea is that, absent fraud or abuse, governmental actors (judges, legislators, etc.) should not routinely adjust private bargains. Government regulation of markets should be minimal because such regulation tends to result in unfairness and inefficiency.<sup>51</sup> According to this view, excessive governmental

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42 § 362(b), (h).

43 § 727(a)(8).

44 § 523(a)(8), (a)(2)(c).

45 § 522(o)-(q).

46 § 521.

47 § 325.

48 § 106(a).

49 § 342(c).

50 See Elizabeth Warren, *The Phantom \$400*, 13 J. Bankr. L. & Pract. 77, 84 nn.46-48 (2004).

51 See Interview with Economist Brian Westbury, *supra* note 31 (arguing that too many

regulation is unfair because it undermines legitimate reliance interests on the part of relevant actors. It is inefficient because it circumvents the judgments the parties themselves have made about the relative costs and benefits of the bargain; the regulator (usually a judge or government administrator) substitutes her own judgment for that of the parties. Allowing anyone other than the parties themselves to calculate the costs and benefits of the contract will usually produce inefficient results.

Conservative support for laissez faire economics is evident in the Bush Administration's approach to tax and regulatory issues, as well as in its approach to legal reforms. In both areas, the Bush Administration supports legislation to lower taxes, streamline regulation, and restrain the use of courts to reform business practices.<sup>52</sup>

A basic theme of the bankruptcy reform provisions is that private credit contracts between lenders and debtors should not be impaired unless absolutely necessary. Thus, as explained earlier, the Act tries to make it more difficult to seek discharge in the first place.<sup>53</sup> Even more important for purposes of the commitment to laissez faire economics, the Act tries to make it much more difficult for those who successfully seek relief to adjust pre-bankruptcy bargains.<sup>54</sup> The intellectual justification for these provisions parallels laissez faire thinking. First, proponents of the Act argue that it is morally unfair to creditors to allow debtors to seek relief when they can legitimately pay back some of their debt.<sup>55</sup> Second, they argue that it is inefficient to place the authority in the hands of a bankruptcy judge or trustee to assess whether or not someone should honor their freely negotiated bargain. Instead, the parties to the contract should determine what is best for them, at the outset, in the negotiating process. If a debtor or a creditor makes a bad decision, he or she must live with the consequences.<sup>56</sup>

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risks to business in the United States come from the legal sector and that taxes punish successful people).

52 President George W. Bush, Speech at the White House Conference on the Economy at the Ronald Reagan Building, Washington, D.C. (Dec. 16, 2004), *available at* <http://www.whitehouse.gov/infocus/economy/index.htm>.

53 *See Supra* Section II.A.

54 *See id.*

55 *See Gosselin, supra* note 8, at A18 (quoting law professor Todd Zywicki).

56 *Id.* at A18 (quoting Federal Appellate Court Judge Edith Jones). There is an emerging scholarly literature on the limits of rational decision-making in contracting. This literature draws on the insights of behavioral economics to show that individuals are often over-optimistic when making decisions about the future. *See, e.g.*, Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Card Advertising*, 7 *Theoretical Inquiries L.* 431 (2006).

## 2. *Individual Risk Internalization*

Another theoretical similarity between conservative economics and the Act is the notion that individuals must internalize most of the risks of their own financial decisions. President Bush's policies in a wide variety of areas are profoundly shaped by the idea that individuals should be more self-reliant and should be held personally responsible for the consequences of their own decisions.<sup>57</sup> President Bush thinks this is a good moral stance because self-reliance is an important moral virtue. Moreover, President Bush opines that this will lead to stronger families and stronger communities and thus to less reliance on governmental spending.<sup>58</sup> As with laissez faire economics, the notion that social welfare will be enhanced through individual bargaining has long been a staple of conservative economic thinking.<sup>59</sup>

The bankruptcy law reforms passed by Congress also seek to force individuals to bear the costs of their own financial decisions. Through the provisions described earlier, Congress is trying to ensure that people are more careful about borrowing money, because it wants people to take moral responsibility for their actions.<sup>60</sup> Congress is also trying to decrease collection costs to creditors; this is expected to lead to increased liquidity because creditors can more accurately price the costs of extending credit.<sup>61</sup>

## B. **Operational Asymmetry**

### 1. *Private Property Acquisition and Retention*

It is clear that conservative economic policies and the Bankruptcy Reform Act share philosophical underpinnings. However, a close examination also reveals possible operational inconsistencies between the principles and the likely consequences of the Act. First, the new law could make it substantially more difficult for many middle-class filers to retain private property under certain circumstances. For example, the Act will likely make it harder for many middle-class filers to file for bankruptcy and still retain a home residence. These filers (who will probably fail the means-test) will likely have to go into Chapter 13, where they will have to contend with a tougher set of minimum requirements in order to confirm a plan.

Moreover, many middle-class Americans, banking on a continued rise in

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<sup>57</sup> Michael Schroeder & Suein Hwang, *Sweeping New Bankruptcy Law to Make Life Harder for Debtors*, Wall St. J., Apr. 6, 2005, at A1.

<sup>58</sup> Second Inaugural Address, *supra* note 22.

<sup>59</sup> See *supra* notes accompanying Section II.C.

<sup>60</sup> Schroeder & Hwang, *supra* note 57, at A1.

<sup>61</sup> *Id.*

real estate prices, are now using home equity loans to finance health care and education costs.<sup>62</sup> If prices become volatile, these individuals might be severely disadvantaged. Even if they qualify for Chapter 7, they might enter their Chapter 7 case with a home that is highly leveraged. Making matters worse, they will not be able to discharge any of that debt because the debt is secured by the home. Additionally, discharge restrictions in Chapter 7 have been substantially expanded.<sup>63</sup> This means that more debtors will likely leave bankruptcy with larger debts completely unaffected by the filing. Creditors whose debts are non-dischargeable can continue to pursue the debtor and his or her property once the bankruptcy case has concluded.

Many debtors will also likely find it more difficult to retain certain key property in Chapter 13 cases. For example, the Code now provides that certain personal-property-secured claims in vehicles will no longer be treated as secured claims only to the extent of the value of the collateral.<sup>64</sup> The practical effect of this provision is that debtors who want to retain vehicles in Chapter 13 must provide for payment of the entire claim as a secured claim. Moreover, the court must value that secured claim by using a replacement retail value standard, whereas in the past a wholesale value standard could have been used. In many cases, this change will make it more difficult for debtors to retain vehicles they use for transportation to and from work. This, in turn, could have a negative impact on the ability of these debtors to meaningfully participate in the economy.

The revisions to the Chapter 13 discharge provisions provide a final example. Prior to the Act, a Chapter 13 debtor who successfully completed a Chapter 13 plan received what was known as the "superdischarge." This meant that the Chapter 13 debtor received a discharge from many types of debts that Chapter 7 debtors could not get, including debts for willful and malicious injury. The Act restricts the scope of discharge in Chapter 13 cases.<sup>65</sup> This means that even in a Chapter 13 case, more of the debtor's post-petition income will necessarily need to go to paying off pre-bankruptcy obligations. Prior to the Act, that post-petition income could have gone toward investments in future acquisitions of property and/or investment in human capital.

Two important points merit mention at this juncture. First, this paper has discussed the *predicted* consequences of the Act. Empirical testing will need

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<sup>62</sup> *Id.*

<sup>63</sup> 11 U.S.C. §§ 523, 727 (1978).

<sup>64</sup> § 1325(a)(9).

<sup>65</sup> § 1328.

to be undertaken before we can establish with certainty the gulf between the aspirations of "Bush style" conservative economics and the actual operation of the Act. However, the mere possibility that these predicted consequences might actually occur should prompt conservative economists (and others) to conduct empirical studies and, in the meantime, to consider whether, given their own theoretical aims, the Act constitutes sound public policy. Second, this paper does not make the point that a conservative economist should not endorse the Act. While conservatives undoubtedly love private property, they also tend to value other normative goals (i.e., keeping one's promises, being self-reliant, etc.). The point is that in endorsing the Act, an economic conservative might necessarily have to scale back a commitment to the acquisition of private property by middle-class Americans. This crucial (but largely hidden) policy choice has important implications for the rest of the conservative economic agenda.

## *2. Expansion of Governmental Power and Control*

The Act will probably require a significant increase in the governmental bureaucracy that administers bankruptcy cases. Even if the overall number of filings declines as a result of the Act, means-testing of all consumer debtors and educating those debtors in federally-mandated credit counseling programs will undoubtedly require a major commitment of money and personnel. The Act also requires debtors to file federal tax returns, and to provide evidence of employer payments, monthly net income projections, and anticipated income or expenditure increases. The government is going to have to collect, process, and secure substantially more personal financial data on all bankruptcy filers.

In addition, the Act contains a substantial expansion of what I call "policing rules" — rules that appear to be designed to control minute aspects of bankruptcy cases by aggressively regulating debtor and creditor interactions. These include extremely detailed and specific dictates on notice and disclosure.<sup>66</sup> The rules also contain laborious (and often unrealistic) deadlines for taking certain actions. Rules (as opposed to general standards) usually save costs to the extent that they reduce inefficiency. This seems to have been Congress's intent. However, a close review of the Act reveals a substantial increase in both the number and complexity of policing rules. This suggests a shift toward what I call "Congressional micro-management" of the debt collection process. Congressional micro-management will probably result in more contractual leverage for creditors and more systemic leverage

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<sup>66</sup> §§ 521, 524, 526, 527, 528.

for bankruptcy trustees. However, it is not clear that the startling expansion of policing rules will result in costs savings for any entities other than large, national creditors who have the advantage of economies of scale.<sup>67</sup>

The Act's expansion of the bankruptcy bureaucracy and its imposition of policing rules raises a potential policy tension that conservative economists might not be fully aware of. They tend to want less government, but this bill probably gives them more government. Of course, a conservative economist might be all in favor of more regulation if the result is lower collection costs for creditors and thus more liquidity in the credit system. But we don't know at this point if the Act will indeed produce more liquidity and thus a net increase in social wealth. Unless and until the empirical evidence points to such an effect, the conservative economist will have to entertain the possibility that the Act might force a difficult policy choice between expanded governmental regulation and more liberal bankruptcy relief.

### CONCLUSION

At a theoretical level, President Bush's signature on the Act is consistent with a theoretical preference for *laissez faire* economics and a philosophical commitment to individualism. As this article has shown, the work of leading conservative legal scholars also reflects these preferences and commitments. If the Act works as conservatives intend, bankruptcy law will make it more difficult to adjust pre-bankruptcy bargains. Moreover, it will encourage individuals to take more responsibility for their financial decisions even at the cost of significant pain and difficulty to them and to their families.

However, the preceding analysis highlights important but largely overlooked tensions within conservative economic theory on the issue of bankruptcy reform. Specifically, adherents to conservative economic principles might have to make trade-offs between their commitment to the retention of private property by middle-class Americans and their commitment to enhancing creditor collection. They might also have to make choices about which is the greater evil: allowing middle-class Americans to get bankruptcy relief or supporting a substantial increase in the size and reach of the federal bankruptcy system.

More broadly, the new bankruptcy law brings to the surface tensions within

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<sup>67</sup> It is likely that these policing rules — unprecedented in size and scope — will impose two significant types of costs on the bankruptcy system: enforcement costs and costs associated with interpreting ambiguous rules.



conservative thought over the question of social welfare policies. Social conservatives, interested as they are in inculcating moral virtue in citizens, probably like the portions of the bill that force repayment, thinking that this will reinforce the fundamental norm of personal responsibility. Economic conservatives, on the other hand, should have strong reservations about this legislation. President Bush has achieved political success on other issues by obscuring tensions between social and economic conservatism, and he seems to have done the same with bankruptcy reform by blending Burkean-style social conservatism with Reagan-style economic conservatism. For President Bush, this seems to have made good politics. Whether it will make good policy remains doubtful.

