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BANKRUPTCY'S HOME ECONOMICS

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INTRODUCTION

There's a wonderful passage in the New Testament where Jesus finds his disciples debating which one of them would be the greatest in the kingdom of heaven. "What were you discussing on the way?," Jesus asks, as Saint Mark records the incident. "But they kept silent, for on the way they had argued with one another about who was the greatest. And he sat down and called the twelve And he took a child and put him in the midst of them, and taking him in his arms, he said to them, 'Whoever receives one such child in my name receives me, and whoever receives me, receives not me but him who sent me.'"¹

I love the passage for many reasons, but one reason is the timeless psychological truth: It's so hard to resist the temptation to debate our relative importance. The conference for which the articles in this symposium were prepared was, in fact, almost tailor-made for a spirited game of one-upmanship. Nearly all of the finest bankruptcy scholars in the country, as well as several leading lawyers and bankruptcy judges, gathered in a single law school classroom to discuss and debate the legacy of the reforms that ushered in a new era in American bankruptcy law twenty-five years ago. I am pleased to report there was very little discussion—none, indeed, that I was aware of—of who is the best or the most important bankruptcy scholar of this generation during the course of the conference.

But if we let down our guards and did have such a conversation, when it comes to personal bankruptcy, I think there would be something like unanimous agreement that Elizabeth Warren has been the nation's leading consumer bankruptcy scholar over the last ten or twenty years. By whatever yardstick we might choose—scholarly productivity, institutional leadership, prominence in the media—Professor Warren stands alone at the top of the list.²

* Professor of Law, University of Pennsylvania. These comments are substantially as delivered at the American Bankruptcy Institute's 25th Anniversary Symposium of the Bankruptcy Code on October 10, 2003. I have revised the remarks somewhat, but have preserved the structure and tone of the original comments. I am grateful to Ray Warner for inviting me to participate in the symposium, to Ronald Mann, Bruce Markell, Bob Rasmussen, Elizabeth Warren, and Amy Wax for very helpful comments and suggestions, and to Sam Gerdano and the American Bankruptcy Institute for making the symposium possible.

¹ *Mark* 9:33-37 (English Standard Version). The incident is also recounted in *Matthew* 18:1-5 and *Luke* 9:46-48.

² I have discussed Professor Warren's prominence in the scholarly literature in detail elsewhere. [David A. Skeel, Jr., *Vern Countryman and the Path of Progressive \(and Populist\) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1078 \(2000\)](#) (characterizing Warren as the principal successor to William Douglas and Vern Countryman). Warren was also the chief advisor to the 1994 Bankruptcy Review Commission, the last major study of America's bankruptcy laws. In the extensive press coverage of the major package of proposed bankruptcy reforms that has been debated in Congress for the past seven years, Warren has figured far more prominently than any other legal academic. See, e.g., Melissa B. Jacoby, *The Press and Complex Legislation: A Bankruptcy Reform Case Study* (2003) (unpublished manuscript, on file with author).

So it was a particular honor for me to be invited to comment on *The New Economics of the American Family*, which, as Professor Warren notes, is drawn in many respects from her recent co-authored book, *The Two Income Trap*.³ In the comments that follow, I will refer to both, though I will put particular emphasis on the article. I'll start by briefly describing the basic thesis of the article—that today's two-income families are actually worse off financially than their single-income counterparts of a generation ago—and by assessing both its power and its potential limits. I'll then turn to Professor Warren's proposals for responding to the most obvious causes of the financial predicament that so many American families find themselves in. I'll conclude by exploring several of the myths and morals of bankruptcy, and by outlining several of my own candidates for reform.

I. CAUGHT IN THE TWO-INCOME TRAP

When large numbers of women started entering the workforce in the 1970s, it was widely assumed that the new two income families would have it made. And this in many respects has remained the conventional wisdom. "They may be stressed," as Warren puts it, "they may feel guilty about sending their kids to day care, and they may have too little time for each other, but the one piece of good news the family can count on is that they are more financially secure."⁴

In *The New Economics of the American Family*, Warren shows that, for many families, this assumption of enhanced financial security is an illusion. Based on a simple hypothetical comparison between a single income family from 1973 and their 2000 two income counterpart, both of whom have two children, Warren demonstrates that the two income family is actually worse off financially.⁵ True, the two-income family earns substantially more—75% more than the old one income family (\$67,800 vs. \$39,000, when both figures are reported in 2000 dollars). But the cost of housing, daycare (which single-income families didn't need but dual wage earners do), and healthcare has increased so much in the past thirty years that it wipes out the increased earnings and then some. An average 1973 family spent \$5,310 a year in mortgage payments; \$1,030 for health insurance; \$5,140 for the payments, insurance and upkeep on one car; and roughly 24% of their income for taxes. Add all of this up, and the 1973 couple had \$17,834 left over for everything else they needed.

A 2000 couple who starts off with \$67,000 in income can expect to pay nearly \$9,000 in mortgage payments; \$1,650 for health insurance; and slightly over \$8,000

³ Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1 (2004) [hereinafter *The New Economics*]; ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE* (Basic Books 2003) [hereinafter *TI-TRAP*].

⁴ *The New Economics*, *supra* note 3, at 3.

⁵ The details described in this paragraph and the next can be found in *The New Economics*, *supra* note 3, at 16–18. In the book, the 1973 couple is referred to as Tom and Susan, and the 2000 couple as Justin and Kimberly. *TI-TRAP*, *supra* note 3, at 50–52.

for the two cars they now need. The 2000 couple also needs more help with childcare, which adds \$4,350 for after school and summer day care for their older child and \$5,320 for their younger child's preschool; and they can expect to fork over 33% of their income to the government in taxes. Once all of these obligations are deducted, the 2000 couple isn't rolling in the dough at all. They have only \$17,045 left over for food, clothing and other expenses—\$800 less than their single-income counterparts of the early 1970s.

Ironically, the increasing number of two income families has contributed to the very financial problems that it was expected to solve. As two income families search for homes in safe neighborhoods with good schools for their kids, they bring their extra income to the table, which has helped to bid up housing costs in the most desirable neighborhoods.⁶

The data are depressing, but it gets even worse. In the most important insight of the article (and book), Warren points out that today's two-income families are actually more vulnerable—not just equally vulnerable but *more* vulnerable—to financial failure than their 1970s one income counterparts. In the one income family, the wife served as a back-up wage earner. If the husband lost his job or was side-lined by injury or illness, the wife could temporarily enter the workforce.⁷ The jobs that were available weren't glamorous, but they could often replace enough of the husband's income (roughly 25%, on average) to help the family make ends meet until the husband returned to the workforce. Two-income families don't have this insurance policy. And with two jobs that can be lost, rather than just one, they face almost twice the risk of a job loss that could lead to financial ruin.⁸ If the couple divorces—as nearly half do—the picture is bleaker still. Divorce ratchets up expenses (starting with the cost of the apartment or house the departing spouse moves into) but doesn't add anything to the family income.⁹

This is a powerful story, and it resonates deeply with many Americans. When I showed a draft of my comments to a friend, his reaction was—like Charlie Brown in the famous Christmas special, who finally recognizes his phobia after Lucy runs through a long list—"That's it!" His wife is a doctor and he's a medical resident, yet they and their two young children barely scrape by each month. The "two-income" trap provides an explanation for the struggles that they like numerous other families encounter in their daily financial lives.¹⁰

⁶ Economists refer to this pattern of working even harder, yet not seeming to get ahead, because others are competing for the same goods, as an "arms race" or "rat race." See, e.g., ROBERT H. FRANK, LUXURY FEVER: MONEY AND HAPPINESS IN AN ERA OF EXCESS (Princeton University Press 1999).

⁷ *The New Economics*, *supra* note 3, at 4 (describing wife's role as the "ultimate insurance against unemployment or disability" by providing additional source of income in event of emergency); TI-TRAP, *supra* note 3, at 59–60.

⁸ *The New Economics*, *supra* note 3, at 21 (discussing internal risks associated with two-income households).

⁹ *Id.* at 27 (stating high divorce, cancer, heart attack rates are surpassed by higher bankruptcy rates).

¹⁰ So deeply does the analysis resonate that it made its way into the speeches of several of the candidates for the Democratic presidential nomination. In an op-ed in the *Wall Street Journal* in late 2003, for instance, Howard Dean worried that the "average American family is in trouble," and cited THE TWO-INCOME TRAP's

The same era as the run-up in major living expenses chronicled by Warren has also seen an astonishing increase in bankruptcy filings, from slightly under 200,000 in 1979, the year the Bankruptcy Code became effective, to 1.1 million in 1996.¹¹ This past year set yet another record, with over 1.6 million new bankruptcy petitions. There obviously is some connection between the financial straits many two-income families find themselves in and the surge of activity in the bankruptcy courts. The question I would like to ask, as a way to put Professor Warren's analysis of the new economics of the American family into perspective, is this: How much of the bankruptcy wave can be attributed to the two-income trap?

One difficulty we encounter if we try to figure out how many Justin and Kimberlies are out there is definitional. Warren distinguishes between two kinds of families, those with two-incomes and those with a single breadwinner. One thing the data do not tell us is how many of the two-income families have two truly full-time incomes, as opposed to one full-time income and one supplemental or occasional salary. A family with one full-time salary, and a spouse who works two days a week in a dentist's office or as a retail sales clerk is quite different from the family with two full-time jobs.

It also would be useful to break down the category of unmarried women with children into those who were married but subsequently divorced, on the one hand, and those who never tied the knot in the first instance. If the children's mother and father both have jobs, their sundered families would qualify as two-income families in each instance, but they raise very different issues. The financial track record of never married mothers and their children has always been dreary, both before and after the financial changes that have taken place over the past generation.¹² It is the once-married mothers whose travails are most accurately attributed to the two-income squeeze. To be sure, these categories are blurrier than they once were: Marriage is a less accurate proxy for an initially intact family than it was in the past.¹³ But there still are broad differences between these two categories of families.¹⁴

finding that "today's two-income families earn 75% more money than their single-income counterparts did a generation ago, but they actually have less money to spend." Howard Dean, *We Can Do Better*, WALL ST. J., Aug. 22, 2003, at A8.

¹¹ For a table of the non-business filings from 1978-1998, see DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 188 (Princeton University Press 2001) [hereinafter *DEBT'S DOMINION*].

¹² E.g., Peter M. Cicchino, *The Problem Child: An Empirical Survey and Rhetorical Analysis of Child Poverty in the United States*, 5 J.L. & POL'Y 5, 38 (1996) (estimating "almost nine out of ten children who live with unmarried single mothers live in poverty."); Deborah L. Rhode, *Politics and Pregnancy: Adolescent Mothers and Public Policy*, 1 S. CAL. REV. L. & WOMEN'S STUD. 99, 116-17 (1992) (finding adolescent single mothers suffer severe financial hardships).

¹³ For a criticism of the emphasis on the family as the natural social unit, see, for example, Martha L.A. Fineman, *Masking Dependency: The Political Role of Family Rhetoric*, 81 VA. L. REV. 2181 (1995).

¹⁴ Rather than the blended rate of the 21.3 bankruptcy filings per 1,000 unmarried women with children (as compared to 14.7 for couples with children and 7.3 for couples without children), *The New Economics*, *supra* note 3, 26 n.78, for instance, it would be useful to see separate filing rates for once married and never married women with children.

Now, developing data for each of these categories of families would no doubt prove quite difficult and possibly unrealistic.¹⁵ But my guess is that the number of families in bankruptcy that fit squarely within the two-income paradigm would be substantially smaller than first meets the eye.

The housing data raise somewhat similar questions. Central to the two-income trap story is the plight of middle class families who extend themselves so that they can live in the right zip code, the zip code with safe neighborhoods and good schools for their kids. "With extra income from Mom's paycheck and extra mortgage money from the bank," as Warren puts it, "the usual supply and demand in the market for homes in desirable areas exploded into an all-out bidding war."¹⁶ Although mortgage costs clearly are a major issue for many families, Warren's data suggest that the proportion of bankruptcy debtors who have houses is roughly half. For the half who does not own houses, this aspect of the two-income trap isn't as obvious a piece of the puzzle.

The explosion of bankruptcy filings has been the subject of endless debate ever since it began, which is a sure sign that there's no simple explanation for the trend.¹⁷ My own view is that changes in the structure of the consumer credit market have played an enormous role in the increase even apart from dynamics of the two-income trap. Although credit cards date back fifty years (starting with a card that was limited to 27 New York restaurants), the now-ubiquitous black magnetic strip didn't appear until the early 1970s.¹⁸ The magnetic strip was one indication of the dramatic technological change afoot, as computers made it easier than ever before to track consumers' finances and to process transactions. Credit card companies also got a helping hand from a 1978 Supreme Court decision—*Marquette National Bank v. First of Omaha Service Corp.*¹⁹—which essentially deregulated interest rates by holding that any restrictions would be determined by the state of domicile of the credit card company, rather than the location of the consumer. To escape the tough interest ceilings in place in some states, all the credit card companies had to do is set up shop in a state—such as Delaware or South Dakota—that went easy on the restrictions.

In the past two decades, the entire consumer credit relationship has changed. Credit card companies have become increasingly promiscuous in their lending, often conducting only a cursory credit check of the consumers who respond to their pre-approved credit card solicitations. Consumers, for their part, don't look at their obligations in quite the same way as they did when obtaining credit meant a face-to-

¹⁵ The principal source of data outside of bankruptcy is the U.S. census, for instance, and census data do not provide these more fine-grained categories.

¹⁶ TI-TRAP, *supra* note 3, at 32.

¹⁷ Nor is the controversy new. There is a long history of hand-wringing over increases in bankruptcy filings. See, e.g., DEBT'S DOMINION, *supra* note 11, at 136 (describing similar concern about bankruptcy increase in early 1960s).

¹⁸ For good histories of credit cards, see generally DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING (The MIT Press 1999) and LEWIS MANDELL, THE CREDIT CARD INDUSTRY: A HISTORY (Twayne Publishers 1990).

¹⁹ [439 U.S. 299 \(1978\)](#).

face meeting with a bank or credit union loan officer. There's more credit than ever before—much of it extended to consumers who would never have qualified for a bank loan in the past—and the creditor is a voice mail system and an address on an envelope, rather than a real human being.²⁰

My point is simply that it is important to keep the significance of the squeeze on two-income families in perspective. As Warren's analysis makes clear,²¹ the two-income trap is only part—a startling and important part, but only a part—of a much larger story.

II. REINING IN A MARKETPLACE GONE AMOK

Although I've argued that the two-income trap is only part of the reason for the explosion of bankruptcy filings, it clearly is a major concern for many American families. What can be done to address the problem?

In the article, Warren offers (or hints at) three major proposals for reform. Her first proposal is to remove the special treatment that home mortgages are given in bankruptcy. Second, and related, is a proposal that Congress overturn the *Marquette* decision, so that it or the states could reintroduce meaningful usury regulation. Third, Warren suggests that Congress should consider providing much greater insurance against disability than currently is the case. As I have listed them, the proposals move from most to least directly related to bankruptcy, and from most to least politically plausible. In addition to these three, I'll also briefly consider a proposal for universal school vouchers that Warren makes in the book.

A. *Reversing the Special Treatment for Home Mortgages*

Under the 1978 Code, home mortgages are given something close to untouchable status. Although a home mortgage can be cured and reinstated if a debtor files for chapter 13, the mortgage can't be stripped down to the value of the house that secures it.²² The lender must be paid in full. Mortgages are similarly sacrosanct if the debtor files for chapter 7.²³

"At the time the 1978 Code was adopted," Warren writes, "such deference may have been entirely appropriate. After all, mortgage lending was stable, long-term

²⁰ For discussion of the extent to which credit card lending has moved down the economic ladder, see, for example, David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 332–46 (1999).

²¹ This is especially true in the book, which devotes a chapter to the explosion of credit card and mortgage debt. TI-TRAP, *supra* note 3, at 123–62.

²² Section 1322(b)(2) of the Bankruptcy Code prohibits a debtor's chapter 13 plan from impairing the rights of a mortgage that is "secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2) (2002).

²³ Cf. 11 U.S.C. § 722. That section of the Bankruptcy Code permits the debtor to redeem personal property by paying the current value of the property, but it does not apply to real estate.

lending, with interest rates pegged only modestly above anticipated inflation."²⁴ Mortgage lenders warned, moreover, that they would be forced to raise rates or cut off credit if homeowners who defaulted could use bankruptcy to strip down the amount of their repayment obligation to the value of the property. The world has changed since 1978, Warren argues. Mortgage obligations are now "a significant part of the middle class family's financial woes," due to the rising cost of housing;²⁵ and the advent of the subprime lending market has brought second and third mortgages, dubious fees and sky-high interest rates. For both of these reasons, Warren questions why home mortgages should be treated any differently from credit cards or other loans in bankruptcy.

Now, an obvious danger is that permitting debtors to strip down their mortgages and at the same time keep their houses would exacerbate the two-income trap rather than alleviating it. If lenders did indeed raise their interest rates, cut back on credit, or perhaps insist on higher downpayments, in response to the increased vulnerability of their mortgages, things could get even worse for some families.²⁶ Hardest hit would be lower or lower-middle class families, the ones who already have less access to mortgage credit.

My own view is that this is a risk worth taking. Reputable lenders that finance a family's initial home purchase are less likely to be affected than the lenders who peddle second and third mortgages, often with loan-to-value ratios that significantly exceed the actual value of the borrower's house. As Warren suggests, these loans are quite far afield of the home mortgages that Congress agreed to protect in 1978.²⁷ Some bankruptcy courts have in fact already started chipping away at the special mortgage protections as they apply to second mortgages. If the debtor's property is completely encumbered by a higher priority mortgage, a few courts have permitted the borrower to eliminate the second mortgage, based on the view that it's really no different than an unsecured claim.²⁸

The proposal to eliminate the special status for home mortgages would generate fierce opposition from mortgage lenders, who have shown themselves quite adept at bringing lawmakers around to their way of thinking. (I suggested at the outset that

²⁴ See *The New Economics*, *supra* note 3, at 32 (addressing special treatment of mortgage lenders under Bankruptcy Code).

²⁵ *Id.* at 33 (demonstrating mortgage debt severely affects middle-income families by subtracting funds away from everyday necessities).

²⁶ As discussed in the next section, the empirical data on interest rate restrictions suggest that intervention can have each of these effects. See *infra* note 31 and accompanying text. One might expect strip down, which decreases lenders' expected payout if they are undercollateralized, to prompt similar responses.

²⁷ See *The New Economics*, *supra* note 3, at 33 (suggesting that the protections for mortgagees predate and do not account for home mortgage lending's recent evolution). The Supreme Court could have sharply curtailed the mortgage protection in *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993), but it rejected the statutory interpretation that would have permitted the lender's mortgage to be stripped down.

²⁸ See, e.g., *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357, 1359–60 (11th Cir. 2000) (adopting majority position to "strip off" debtor's junior mortgage as 11 U.S.C. 1322(b)(2) protects "only undersecured, and not wholly unsecured, homestead lenders" and "[e]xtending section 1322(b)(2)'s protection to wholly unsecured junior mortgages would enlarge the rights afforded to those lenders when the mortgagors are forced to file a Chapter 13 petition . . .").

this is the most politically plausible of the proposals, but that certainly doesn't mean it would be an easy sell). If lawmakers wanted to defuse some of the opposition, there's an easy way to do it: Simply exclude first mortgages from the reform. If the existing protection were retained for first mortgages, and jettisoned only first second and third mortgages, prime mortgage lenders might call off their troops, leaving only the subprime lenders (and lenders who offer both prime and subprime mortgages) to battle the reform. But this more limited reform would leave a very large loophole: it wouldn't apply to mortgages that are repeatedly refinanced or have extremely high loan to value ratios—and thus smell like a second or third mortgage—but are the only mortgage on the property. A more nuanced strategy might be to protect only the mortgages of lenders who supply the purchase money for the debtor's house, together with mortgages that refinance the original mortgage and do not increase its balance by more than the costs of the refinancing.²⁹

In short, there would be a cost to eliminating the special status of home mortgages, but I personally am persuaded that the cost would be worth bearing.

B. Reintroducing Usury Regulation

Next up is Warren's proposal to reintroduce meaningful usury regulation. "Federal law could be amended to close the loopholes that let one state override the lending rules of another," she argues—that is, to reverse the effect of the *Marquette* decision. "Alternatively, Congress could impose a uniform rate to apply across the country."³⁰

Stiffer usury regulation raises somewhat similar questions as the ones we have just seen, as well as several additional concerns. As with eliminating special treatment for mortgages, the most obvious concern with usury restrictions is that it's not clear whether they would make consumers better or worse off.³¹ To answer this question, I think it would be helpful for Warren to develop a more precise explanation for why the restrictions are necessary. At some points, she seems to suggest that the problem is fraudulent behavior by lenders, as when Citibank's subprime lending subsidiary was accused of deceptively "steer[ing] families to higher-cost loans whenever they thought they could get away with it."³² Elsewhere, Warren worries that lenders are making loans to marginal customers who aren't

²⁹ My thanks to Ronald Mann for suggesting this approach.

³⁰ *The New Economics*, *supra* note 3, at 38 (noting "[s]uch a provision would enable the states or the federal government to reimpose meaningful limits on interest rates.").

³¹ Surveying existing evidence on interest rate restrictions, a recent article concludes that "usury limits disproportionately hurt the poor" because when "usury limits become binding, lenders ration credit by requiring higher down payments, increasing loan fees, shortening loan maturities, and restricting the size of loans." Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1313 (2002).

³² *The New Economics*, *supra* note 3, at 36 (recounting Citibank subsidiary's 2002 scandal concerning deceptive subprime lending, which led to prosecution and \$240 million settlement).

likely to be able to repay even a properly priced loan.³³ If the problem is fraud, targeting it directly might make more sense than an across-the-board solution like usury restrictions, since usury laws can reduce access to credit even for consumers who aren't likely to be duped.

Building on the work of a variety of other scholars, including Warren herself, Oren Bar-Gill has recently suggested yet another diagnosis.³⁴ Bar-Gill argues that the high cost of credit cards don't stem from fraud but aren't simply risk-appropriate interest rates either. Drawing on the economic notion of "hyperbolic discounting," Bar-Gill argues that many consumers focus much more on the short-term costs and benefits of credit cards than on their long-term costs. As a result, consumers are very sensitive to the initial interest rate; but they blithely ignore the late fees and high interest rate they will incur for carrying a balance.³⁵ According to Bar-Gill, this behavioral tendency gives credit card companies an incentive to offer extremely low initial rates, and punitively high subsequent rates. The pricing disparity will persist even if credit card companies compete vigorously with one another. Indeed, if a credit card company bucked the trend by increasing its initial rates and reducing the costs for those who carry a balance, it would quickly lose out to companies that offered low initial rates.³⁶

There are some difficulties with Bar-Gill's account,³⁷ but it has a great deal of intuitive appeal—it makes sense, for instance, of the odd structure of credit card (and subprime mortgage) pricing. Like the concern that high risk borrowers can't handle the high rates, and that this is what's landing many of them in bankruptcy, the underestimation problem can't be solved by anti-fraud measures, since it doesn't involve fraud. If either of these concerns is the real problem, it can be seen as justifying ceilings on permissible interest rates.

But we need to be careful to count the potential costs of these kinds of restrictions. If the usury ceiling is set too low—or becomes too low due to inflation—many marginally risky consumers will simply be cut off from standard forms of credit. Like other advocates of interest rate ceilings, Warren corrects for this risk to some extent by proposing that the interest rate ceiling be tied to a measure such as the treasury bill rate that moves up and down with inflation.³⁸

³³ See, e.g., *id.* at 39 (arguing that if usury restrictions were imposed, lenders "would no longer be allowed to charge exorbitant interest rates to families with marginal credit records, it would become unprofitable for lenders to pursue families in financial trouble").

³⁴ Oren Bar-Gill, *Seduction by Plastic* (2003) (unpublished manuscript, on file with author).

³⁵ See, e.g., *id.* at 37 ("The hyperbolic discounting phenomenon, which accounts for the underestimation of future borrowing, also explains consumers' underestimation of the repayment period.").

³⁶ *Id.* at 4 ("[I]f the credit card market is indeed as competitive as it appears to be, issuers *have to* exploit consumers' imperfect rationality in order to survive in this market.").

³⁷ The analysis doesn't explain, for instance, why consumers don't stop borrowing after the first month that they are able to pay their credit card bill in full. It also doesn't fully address the intuition that borrowers focus more on features other than the long-term interest rate because these features are of particular concern to consumers.

³⁸ See *The New Economics*, *supra* note 3, at 39 (indicating tying interest rate to inflation rate or treasury rate will protect consumers regardless of inflation rate). For a detailed analysis of the floating rate approach, see, [Vincent D. Rougeau, *Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest*](#)

Using a float rate solves one problem—the risk of changing interest rate conditions—but there still remains the very serious risk that a low baseline rate will jeopardize many consumers' access to credit.

Access to legitimate credit, at least. Consumers who are cut off from legitimate credit may seek out alternative forms of credit. The most likely alternative for those who are unable to obtain a credit card or other credit is pawn shops—some of which are legitimate, but others of which are more nefarious. Other consumers may turn to more dubious sources of credit, such as loan sharks.³⁹ Not only are these alternative forms of credit likely to have a much higher effective interest rate than credit card debt, but these aren't the kinds of obligations that can easily be discharged by filing for bankruptcy if the consumer gets in over her head.

This leaves us with two questions. The first is whether the need to take arms against the excesses of the current credit market is strong enough to justify taking the risk that usury restrictions would backfire. The second is whether there might be a less intrusive solution than stringent usury restrictions. It may be that aggressive disclosure obligations like the warnings that cigarette and liquor advertisements are subject to would alert consumers' to the real costs of their credit. One can imagine other new disclosure strategies as well. If disclosure were required not only in the consumer's monthly bill, but also at the point of sale, consumers would be less likely to incur penalties for accidentally exceeding their credit limits.⁴⁰ But disclosure may not be enough. My own view is that reversing *Marquette* in order to let each state regulate interest rates on consumer credit for its consumers might make sense, but that the significant risk that usury regulation will backfire counsels against a federal usury regulation. Whatever one ultimately concludes, it is important to identify the problem as precisely as possible; to tailor any intervention to that particular problem; and to recognize the potential downsides of credit regulation.

C. Disability Insurance and Universal School Vouchers

[*Rates*, 67 U. COLO. L. REV. 1, 41–42 \(1996\)](#) (noting difficulties of selecting best spread between benchmark rate and usury ceiling and concluding "a floating cap on interest rates is probably the best way to set a maximum rate.").

³⁹ A prominent historian of consumer finance notes that "pressure from loan sharks to preserve the status quo" was one reason that strict usury laws lasted so much longer in the U.S. than in most European countries and "illegal lenders resisted reform of the usury laws...because they rightly recognized that no state was willing to sanction the rates they needed to stay in business." LENDOL CALDER, *FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT* (Princeton University Press 1999). For a fascinating account of current fringe banking operations, see JOHN P. CASKEY, *FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR* (Russell Sage Foundation 1994). For evidence that lack of access to legitimate credit leads to use of costly, illegal and dangerous forms of credit in Japan, see [Ronald J. Mann, *Credit Cards and Debit Cards in the United States and Japan*, 55 VAND. L. REV. 1055 \(2002\)](#).

⁴⁰ Ronald Mann argues for point-of-sale disclosure in an extensive new study of credit cards. Ronald J. Mann, *Credit Card Policy in a Globalized World* 57–60 (2004) (unpublished manuscript, on file with author).

The final two proposals are for disability insurance and universal school vouchers. "Each year," Warren argues, "as many as 300,000 families are driven into bankruptcy when they lose time from work because of a medical problem."⁴¹ The existing disability system offers inadequate protection, she argues, because it is aimed at those who will be out of work for at least a year. Given the link between health care problems and financial failure, "the expansion of disability insurance to aid *all* workers who are struck with a serious disease should be on the national agenda."⁴²

Warren's argument strikes me as compelling, at least in the abstract, and she has elaborated on the connection between healthcare problems and bankruptcy elsewhere. (Most strikingly, she and two co-authors show that a large percentage of the consumers who cite health-related expenses as a reason they filed for bankruptcy actually have healthcare insurance—it's just that the insurance often doesn't cover problems like the job disruption caused by an injury or illness).⁴³ The principal obstacle is cost. The cost of financing disability benefits with public money would be staggeringly high.⁴⁴ In the current political environment, in the wake of the contentious recent battle over Medicare drug benefits and the earlier failure of the Clinton administration's national healthcare proposal, it is hard to imagine a proposal for disability benefits getting off the ground in Washington.

The last proposal calls for universal school vouchers.⁴⁵ If the voucher proposal were adopted, every student would be given a full voucher that could be used at any "public school in a locale, with no presumptive assignment based on neighborhood."⁴⁶ Under this approach, "parents not bureaucrats, would have the power to pick schools for their children—and to choose which schools would get their children's vouchers."⁴⁷ The idea is that, if the link between a student's address and the public school she attends were severed, parents wouldn't need to compete to buy houses in the best school districts. Zip code would no longer be destiny, housing prices would cool off, and many families' mortgage bills would be lowered.

This is a wonderfully clever and intriguing proposal, but it would face the same obstacles as disability insurance: money and politics. In theory, universal vouchers needn't increase the cost of public school funding, since the vouchers would simply replace the existing financing structure. In reality, however, if the vouchers were

⁴¹ *The New Economics*, *supra* note 3, at 38.

⁴² *Id.* (emphasis added).

⁴³ See Melissa B. Jacoby et al., *Rethinking the Debates Over Health Care Financing: Evidence From the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375, 377 (2001) (noting that basic health insurance is inadequate to shield those suffering serious medical problems from financial devastation).

⁴⁴ Cost is also a significant obstacle to employers' willingness or ability to provide disability insurance along with basic health insurance, and it also prevents most families from paying for disability insurance themselves.

⁴⁵ Warren proposes universal school vouchers in the book but not the article. TI-TRAP, *supra* note 3, at 35–37. I raise it here because it underscores some of the difficulties of addressing the two-income trap. Warren also makes a variety of other proposals (such as publicly funded pre-school) in the book.

⁴⁶ TI-TRAP, *supra* note 3, at 35.

⁴⁷ *Id.*

designed to give every student enough money to go to a top-notch public school, the program would require substantially more funding than public schools currently provide.⁴⁸ Even more daunting are the political obstacles. Universal vouchers would transform the public school system, and the public school bureaucracy would fight it with every weapon in their formidable arsenal. Indeed, one can imagine opposition both from conservatives (who would recoil at the prospect of higher spending on public schools) and liberals (who might resist the more market-oriented approach to public education).

Unlike with disability insurance, there also is a question whether universal vouchers would work. People like to live near other people like themselves, and there is a very good chance that they would continue to compete for houses in safe neighborhoods even if their children's schools were determined by voucher rather than zip code. The vouchers might not cool off housing prices nearly as much as we might like. It may even be that putting more money into the goal of making neighborhoods safe would be a more effective investment of public funds to respond to the competition for houses in the most favored neighborhoods.

To conclude my comments on Professor Warren's proposed reforms, let me make a somewhat different observation about their significance. Suppose Congress enacted a national healthcare reform that provided disability insurance and perhaps threw in universal school vouchers to boot. If these reforms were enacted and proved effective, it would be much less necessary to provide generous bankruptcy protection as well. Our generous bankruptcy discharge can be seen as a substitute for the extensive middle class social welfare protections one sees in Europe. If we provided a broad middle class safety net, the middle class wouldn't be nearly so fragile, and the universal discharge wouldn't be nearly so essential. This is one more consideration we need to keep in mind as we debate different responses to the squeeze that so many families find themselves in.

⁴⁸ This is of course a damning statement about current educational funding, which remains wildly inconsistent even after decades of school litigation challenging the disparities between wealthy school districts and poorer ones.

III. THE MYTHS AND MORALS OF BANKRUPTCY

Let me conclude by turning to the families themselves. What responsibility, if any, should they bear for the difficult straits many find themselves in?

Professor Warren makes a powerful case in *The New Economics of the American Family*—and in even more detail in *The Two-Income Trap*—that the myths of lavish debtors who run up credit to live the high life, and of immoral debtors who have no qualms whatsoever about filing for bankruptcy, are significantly overstated. Warren notes, in response to a *Newsweek* article that identified "[f]rivolous shopping"—our preoccupation with "Tommy, Ralph, Gucci, and Prada"—as a major source of Americans' financial woes—that the "average family of four today spends 21 percent *less* (inflation adjusted) on clothing than a similar family did in the early 1970s."⁴⁹ Americans do eat out a lot more than their Brady Bunch era counterparts, but they also spend much less at the grocery store. As a result, the average family's total food bill is actually 22% percent less than it was thirty years ago.⁵⁰

Professor Warren also takes aim at the "myth of the immoral debtor"—the common view that consumers file for bankruptcy at the first sign of trouble, and that the stigma of bankruptcy has disappeared.⁵¹ Today's bankrupts, she argues, are in substantially more financial trouble than the bankrupts of thirty years ago. Nor is there any evidence that the bankruptcy courts are full of fraudulent debtors who are hiding their assets from creditors, as critics sometime suggest.⁵² The debtors we meet are far more likely to have been derailed by a layoff or job interruption, a divorce, a healthcare crisis, or a combination of these factors.

What we don't hear as much about, however, are the debtors who muddle through, who encounter financial distress and somehow manage to pay all of their creditors and get back on their feet. Long before he took his "show-me" state attitude to the White House and posted a placard announcing that "the buck stops here" on his desk, Harry Truman watched an initially successful haberdashery store sink into financial failure. Although Truman was saddled with substantial debts, he refused to file for bankruptcy. He insisted on repaying all of his and the stores' creditors. Eventually he did.⁵³

⁴⁹ TI-TRAP, *supra* note 3, at 17.

⁵⁰ *Id.* at 18.

⁵¹ *Id.* at 77. Todd Zywicki has written in most detail about these concerns. Todd J. Zywicki, *Why So Many Bankruptcies and What to Do About It: An Institutional and Transaction Cost Analysis of Bankruptcy Law and Bankruptcy Reform* (2003) (unpublished manuscript, on file with author). As suggested earlier, I am more persuaded than Professor Warren that declining bankruptcy stigma, due in no small part to the changed nature of the consumer credit relationship, is in fact one of the reasons for the stratospheric number of bankruptcy filings. See *supra* note 21 and accompanying text.

⁵² TI-TRAP, *supra* note 3, at 78–79.

⁵³ DAVID G. MCCULLOUGH, *TRUMAN* 151 (Simon & Schuster 1992). It appears that Truman himself may have had a bit more help than many of the rest of us do, in that creditors were precluded from garnishing his wages while he served as a county judge in Missouri.

A great deal has changed in the decades since Truman's era, of course, but it seems to me that we need to emphasize this kind of behavior, even in a world where credit comes in the mail rather than through a face to face meeting with another human being.

So, what might we do differently if we conclude that the bankruptcy system should provide a generous discharge for Americans who get caught in the financial squeeze that Warren so powerfully demonstrates, but that we should also be careful not to undermine the virtues of fiscal discipline and perseverance? In my view, there is a strong case for a bankruptcy law that requires debtors to repay some of what they owe if they can, and gives them a blanket discharge only if they can't. This doesn't mean that the consumer provisions of the much-debated recent bankruptcy reform proposals are a good thing. They aren't. Although the ostensible justification for the proposed reforms is quite similar to the argument I have just made, the proposed legislation is difficult to defend. Its principal effect would simply be to increase the cost of filing for bankruptcy, which would discourage many debtors who genuinely need a discharge from filing.⁵⁴

There are a variety of ways one could combine a generous discharge with the expectation that debtors who are capable of repaying should be expected to do so. The most sensible solution would be to combine chapter 7 and chapter 13 into a single chapter that imposed a simple repayment obligation—say, 10% of the debtor's net income for the three years after bankruptcy.⁵⁵ Chapter 13 has never worked as expected—its use is determined more by local legal culture than by the debtor herself, and most chapter 13 plans fail. A combined consumer bankruptcy chapter would acknowledge that chapter 13 has been a sixty-five year experiment, and the experiment didn't work out as lawmakers hoped. Whether lawmakers could ever be persuaded to take this view is another issue, however, which suggests that a less dramatic scheme might prove more plausible. A repayment expectation might be added to chapter 7, for instance, without taking away the chapter 13 option.⁵⁶

One virtue of a mandatory repayment obligation for debtors who can realistically repay some of what they owe is that it would function like an insurance co-payment, assuring that bankruptcy debtors bore a portion of the costs of the

⁵⁴ For a more detailed discussion of the proposed reforms and the costs they would impose, see DEBT'S DOMINION, *supra* note 11, at 202–10.

⁵⁵ For a somewhat similar proposal, see generally Michelle J. White, *Why it Pays to File for Bankruptcy: A Critical Look at Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change*, 65 U. CHI. L. REV. 685 (1998). Interestingly, Warren herself argued for a single chapter approach when she served as reporter for the National Bankruptcy Review Commission, but the proposal was attacked both by consumer lenders and by lawyers for consumer debtors.

⁵⁶ Jean Braucher and Chuck Mooney have recently offered an intriguing proposal with these features. Jean Braucher & Charles W. Mooney, Jr., *Means Measurement Rather than Means Testing*, 22 AM. BANKR. INST. L.J. 6 (2003) (proposing chapter 7 debtors, with taxable incomes above set minimal levels, be required to make bankruptcy surcharge payments for three years immediately following discharge).

bankruptcy discharge.⁵⁷ The single chapter approach wouldn't undermine the fresh start for debtors who are truly unable to repay, but it would ensure that those with more significant income or income potential contributed some of the income to their existing creditors. There are countervailing concerns, of course, such as the effect that restrictions on the bankruptcy discharge might have on entrepreneurial activity, but the extent of the repayment obligation could be adjusted to take these considerations into account.⁵⁸

Let me briefly suggest two other ways that we could improve the framework bequeathed to us by the drafters of the 1978 Code. First, we should seriously rethink the exceptions to the discharge. The existing scheme, with its superdischarge for debtors who file for chapter 13, is essentially designed to bribe debtors to file for chapter 13. This strikes me as an extremely confused way to structure the choice between chapter 7 and chapter 13.⁵⁹ For many years, Vern Countryman argued that most or all of the exceptions to the discharge should simply be eliminated.⁶⁰ In my view, Countryman was right. If the exceptions to the discharge were eliminated, the bankruptcy court could still kick the debtor out of bankruptcy altogether in an egregious case. But in cases where the debtor's obligations genuinely exceeded her ability to pay, she would receive a full discharge.

Second, assuming that chapter 7 and chapter 13 are both with us to stay, it's always been a bit of a mystery why chapter 13 debtors do not get their discharge until after the rehabilitation plan has been completed. Unlike in chapter 11, where confirmation of a plan permanently alters the terms of the debtor's obligations, a debtor who fails to complete a chapter 13 plan goes back to square one.⁶¹ The original obligations are reinstated (less any payments made, of course), just as if the debtor never went through the chapter 13 process. There's no obvious reason why the terms of the chapter 13 plan—terms that the debtor proposes and the court approves—ought not be made permanent at the time the plan is confirmed.

These are my proposals, not Professor Warren's, however, so let me conclude by returning to *The New Economics of the American Family*. As I said at the outset,

⁵⁷ For a detailed analysis of the insurance effect of a bankruptcy discharge, see generally [Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283 \(1995\)](#).

⁵⁸ For evidence that the generosity of a state's exemptions is directly correlated with the amount of entrepreneurial activity in the state, see Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity* (Feb. 2001) (unpublished manuscript, available at <http://fic.wharton.upenn.edu/fic/papers/01/0111.pdf>).

⁵⁹ See, e.g., DEBT'S DOMINION, *supra* note 11, at 210–11 (criticizing "moral confusion" of choice between chapter 7 and chapter 13).

⁶⁰ See, e.g., *Hearings before the Subcommittee on Improvements in Judicial Machinery of the Committee on the Judiciary on S. 235 and S. 236*, 94th Cong., 1st Sess. 1038 (1975) (statement of Vern Countryman) (noting that he would "reject the basic notion that exceptions should be carved out of the bankruptcy discharge for the purpose of punishing disapproved conduct").

⁶¹ See, e.g., [11 U.S.C. § 1328\(a\) \(2002\)](#) (providing for discharge after all payments are made). Section 1328(b) provides for a "hardship" discharge for some debtors who fail to complete their chapter 13 plan, but only under limited circumstances. [11 U.S.C. § 1328\(b\)](#).

this is an extremely important article, and the book on which it is based is an extremely important book. The "two-income trap" is a brilliant term and diagnosis for the dilemma that millions of American families find themselves in. The term so effectively captures this crisis in American life that I have used it ten times in these brief comments alone. This is just the beginning. I suspect we'll be discussing, debating and worrying about the two-income trap a lot more in the years to come.