DEFINING THE SOCIAL INSURANCE FUNCTION OF CONSUMER BANKRUPTCY

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Bankruptcy scholars generally agree that consumer bankruptcy functions, at least in part, as a form of social insurance.[1] For some, the claim is primarily formal and theoretical, based in large part on economic theories of insurance.[2] From this

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1 *See, e.g.*, Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis* 3 (George Mason Univ. Law & Econ., Research Paper Series, Research Paper No. 04-35, 2004) (noting that most bankruptcy scholars currently believe consumer bankruptcy is accurately described as a form of social insurance), *at* http://ssrn.com/abstract_id=587901 (Sept. 7, 2004). This description of bankruptcy "continues to have substantial explanatory power." *Id*. at 11.

2 *See, e.g.*, Barry Adler, Ben Polak & Alan Schwartz, *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 587 (2000) (proposing that "[c]onsumer bankruptcy is best justified as a form of partial wage insurance"); Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 ILL. L. REV. 301, 350–59 (2004) [hereinafter Hynes, *Non-Procrustean Bankruptcy*] (explaining debt relief as a form of social insurance and comparing bankruptcy to other social insurance programs); Richard M. Hynes, *Optimal Bankruptcy in a Non-optimal World*, 44 B.C. L. REV. 1, 2 (2002) [hereinafter Hynes, *Optimal Bankruptcy*]; Richard M. Hynes, *Why (Consumer) Bankruptcy?*, 56 ALA. L. REV. 121, 153 (2004) [hereinafter Hynes, *Why (Consumer) Bankruptcy?*] (stating that "the most plausible justification for the bankruptcy discharge is that it provides the consumer with a form of insurance"); 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, 307 (1995) ("[B]ankruptcy law is analogous to the welfare system: it is social insurance for the nonpoor."); Iain Ramsay, *Models of Consumer Bankruptcy: Implications for Research and Policy*, 20 J. CONSUMER POL'Y 269, 274–78 (1997) (discussing a "consumer protection" model of bankruptcy law that rests in part on a rationale of risk allocation); Hung-Jen Wang & Michelle White, *An Optimal Bankruptcy Procedure and Proposed Reforms*, 29 J. LEGAL STUD. 255, 258–59 (2000) (describing consumer bankruptcy as "partial wealth insurance"). For earlier works connecting consumer bankruptcy to economic theories of insurance, see, for example, KENNETH J. ARROW, ESSAYS IN THE THEORY OF RISK-BEARING 139–40 (1971), RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 293 (2d ed. 1977), Homer Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 485 (1968), and John C. Weistart, *The Costs of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 107, 119–22 (1977). The first fully-developed treatment of this concept is found in Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 97–109 (1986) (elaborating economic theorists' descriptions of existing bankruptcy law as a risk-allocation mechanism). *See also* Kartik Athreya & Nicole B. Simpson, *Personal Bankruptcy or Public Insurance?* 1 (Fed. Reserve Bank of Richmond, Working Paper No. 03-14, 2003) ("Borrowing with recourse to bankruptcy implicitly provides insurance."), *at* http://www.rich.frb.org/pubs/working_papers/pdfs/wp03-14.pdf (Nov. 24, 2003). *See generally* Jonathan D. Fisher, *The Effect of Transfer Programs on Personal Bankruptcy* (U.S. Bureau of Labor Statistics, Working Paper No. 346, 2001), *at* http://www.bls.gov/ore/abstract/ec/ec010140.htm (Oct. 2001). For summaries of alternative justifications for the bankruptcy discharge, see Hallinan, *supra*, at 50–52, Adam J. Hirsch, *Inheritance and Bankruptcy: The Meaning of the "Fresh Start"*, 45 HASTINGS L.J. 175, 202–10 (1994), and Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56 (1990).

perspective, bankruptcy relief, especially the discharge of debts, satisfies the basic economic definition of insurance. It transfers risk from a debtor (the insured) to his or her creditor (the insurer), for which the creditor seeks compensation in the form of an increased interest rate. The ability to discharge debt in bankruptcy is *social* insurance, as opposed to private insurance, because it is a compulsory, non-waivable aspect of the relationship between debtors and most unsecured creditors. For other scholars, the claim that bankruptcy is social insurance is more functional and less a matter of economic theory. To them, bankruptcy is effectively an "insurer of last resort," providing some measure of protection to individuals who fall through cracks in other private and public institutions and legal regimes designed to promote economic security.[3] These scholars have focused less on the risk-shifting function of bankruptcy and have tended to evaluate bankruptcy more as an indicator of broader social and economic problems. Despite their different orientations, both groups of scholars have relied on the basic description of consumer bankruptcy as social insurance as a basis for evaluating bankruptcy law and proposed reforms thereto.[4]

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[3] *See, e.g.*, TERESA A. SULLIVAN, ELIZABETH WARREN & JAY WESTBROOK, THE FRAGILE MIDDLECLASS: AMERICANS IN DEBT 3–5 (2000) (describing bankruptcy as part of a social safety net):

> The dynamics of capitalism, combined with a thin social safety net, guarantee that some families will always fail. Without universal health insurance to protect every family from the financial ravages of illness and without higher levels of unemployment compensation to cushion the effects of a layoff, each day, in good times and in bad, some families will fall over the financial edge [into bankruptcy].

Id. at 3; *see also* Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?* 44 SANTA CLARA L. REV. 1065, 1073 (2004) (arguing that the recent rise in consumer bankruptcy is due to an otherwise incomplete social safety net); Melissa B. Jacoby, *The Bankruptcy Code at Twenty-Five and the Next Generation of Lawmaking*, 78 AM. BANKR. L.J. 221, 231–32 (2004) ("[I]t is by human action and not inherent logic that consumer bankruptcy is legally separate from other programs for financial distressed families . . . ."); Melissa B. Jacoby, *The Debtor-Patient: In Search of Non-Debt-Based Alternatives*, 69 BROOK. L. REV. 453, 461–79 (2004) [hereinafter Jacoby, *The Debtor-Patient*] (discussing and criticizing bankruptcy as a form of heath care finance); Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, But Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U. L. REV. 229, 266–69 (2001) [hereinafter Jacoby, *Collecting Debts*]; 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) (considering "the extent to which middle-class families have used bankruptcy as a safety net, or as insurance of last resort, in the financial aftermath of medical problems"); Ramsay, *supra* note 2, at 278–82 (discussing a "social welfare" model of consumer bankruptcy that focuses on the role of bankruptcy as a social safety net); Jay Lawrence Westbrook, *Empirical Research in Consumer Bankruptcy*, 80 TEX. L. REV. 2123, 2125 (2002) (describing the Consumer Bankruptcy Project as a "pathology laboratory for data and insights about other social issues").

[4] A number of scholars who have focused on the economic theoretical dimension of bankruptcy as a form of insurance have, for example, explored how to optimize a bankruptcy system that serves an insurance function. *See, e.g.*, Adler et al., *supra* note 2, at 585–92 (exploring whether consumer bankruptcy "resemble[s] an optimal insurance contract against personal insolvency" and arguing that allowing debtors to choose *ex ante* whether to contract out of bankruptcy protection may be more efficient than existing rules); Hynes, *Optimal Bankruptcy*, *supra* note 2, at 75–78 (proposing that judges may create a "second-best" bankruptcy system with respect to insurance-type problems by using discretion available to them under chapter 13); Wang & White, *supra* note 2, at 285–86 (proposing that existing bankruptcy law does not require debtors to fully internalize the cost of their bankruptcy insurance and proposing to require debtors to pay a combination of future income and wealth in return for discharge of debts). Others who focus on

In light of the general agreement that consumer bankruptcy functions at least partly as a form of social insurance, it is remarkable that legal scholars have not carefully evaluated the relationships between consumer bankruptcy and other existing social insurance programs. Those who have considered these relationships have generally only glanced in this direction. The scholars behind the Consumer Bankruptcy Project, which has conducted some of the most prominent of recent empirical studies of individual debtors in bankruptcy, have gone further than other bankruptcy scholars in acknowledging the important relationship between bankruptcy and other social insurance programs.[5] For example, these scholars have recently explored how bankruptcy functions as health insurance of last resort,[6] suggesting an important connection between bankruptcy and the availability of public and private health insurance. Others have observed that the volume of bankruptcy cases in the United States is at least in part a product of "gaps" in social insurance programs like unemployment, disability, and health insurance.[7] For the most part, however, these scholars have focused on identifying the characteristics of debtors who file for bankruptcy and the causes of their financial distress.

Significantly, scholars of social insurance have largely neglected the connections between their own field and the operation of consumer bankruptcy law. Some who have taken the broadest view of the design of the American social insurance system have failed to make even the slightest mention of bankruptcy law, let alone discuss bankruptcy as a form of social insurance.[8] Most surprisingly, economists have been very slow to consider these issues as well. Only within the last few years have a handful of economists begun to study the interactions between

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bankruptcy as an insurer of last resort have similarly evaluated whether current bankruptcy law and proposed reforms adequately serve that function. *See, e.g.*, Jacoby, *Collecting Debts*, *supra* note 3, at 250–66 (questioning whether existing bankruptcy law provides adequate protection for individuals who suffer financial trouble as a result of medical problems and whether proposed reforms would be better or worse); Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L.J. 1079, 1101 (1998) (arguing that proposed bankruptcy reforms would undermine role of bankruptcy as a backdrop to the nation's social safety net). It is worth noting that scholars from various perspectives have tended to express skepticism about pending reform proposals that limit the scope of bankruptcy protection under chapter 7—if for different reasons. *See* Zywicki, *supra* note 1, at 3 n.6; Elizabeth Warren, *The Market for Data: The Changing Role of Social Sciences in Shaping the Law*, 2002 WIS. L. REV. 1, 42–43 (2002); *see also* Adler et al., *supra* note 2, at 610–11 (proposing that recent reform schemes designed to shift individuals into chapter 13 may be inefficient); Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 303 (noting that "law professors overwhelmingly oppose the pending bankruptcy reform legislation"); Wang & White, *supra* note 2, at 256.

[5] *See* SULLIVAN, *supra* note 3, at 3; Warren, *supra* note 4, at 1101.

[6] *See* Jacoby, *The Debtor-Patient*, *supra* note 3, at 479–80 (noting the relationship between bankruptcy and other social health care programs); Jacoby et al., *supra* note 3, at 377; Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1, 11 (2004).

[7] *See* Johanna Niemi–Kiesilainen, *Collective or Individual? Constructions of Debtors and Creditors in Consumer Bankruptcy*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 41, 49–60 (Johanna Niemi-Kiesilainen et al. eds., 2003); Braucher, *supra* note 3, at 1065–73. Thomas Jackson was one of the first scholars to focus directly on the relationship between bankruptcy and other social insurance programs. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW, 230–32 (1986). In one important passage of his foundational work on bankruptcy theory, he proposed that the availability of bankruptcy relief reduces individuals' and thus society's reliance on other social welfare programs. *See id*.

[8] *See infra* notes 154–57 and accompanying text.

consumer bankruptcy and other social insurance programs.[9] One recent study modeled the effect of other government programs on an individual's decision to file for bankruptcy, empirically measured these interactions, and found support for the theory that consumer bankruptcy and at least some other social insurance programs are substitutes.[10] Another study developed a theoretical model of the relationship between bankruptcy and social insurance emphasizing the negative effects of each on individuals' incentives to search for employment.[11]

This article aims to draw the attention of legal scholars to the task of defining the optimal relationship between bankruptcy and other social insurance programs. It frames some basic questions—to what extent are various programs substitutes for each other; how can we determine the appropriate allocation of functions among and between programs; and what changes to existing regimes would be necessary to make any desirable reallocation of functions. It contributes to the literature on this topic in at least a couple of ways. First, it considers a broad array of factors beyond incentive effects that must be weighed in evaluating the relative efficiency of alternative institutions. Second, it examines these questions with explicit regard for the institutional details of the legal regimes under consideration.

Part I describes in more detail how bankruptcy and other existing social insurance programs are substitute legal regimes. Recent empirical studies strongly indicate that the social insurance functions of bankruptcy significantly overlap or supplement the functions of various other existing social insurance programs. Available data suggests that consumer bankruptcy effectively insures many individuals against the risks of wage interruption, medical-related expenses, disability, and negative financial effects of marital dissolution.[12] Other social insurance programs such as unemployment insurance, Medicare, disability insurance, and workers' compensation also insure individuals against the financial effects of these risks. Spousal support laws protect individuals against the financial effects of marital dissolution; they are arguably a form of social insurance as well.[13] To the extent that bankruptcy and these other programs insure against the same financial risks, they are substitutes as a matter of theory. In other words, society could theoretically opt to insure individuals against these risks with one or the other program or both. To the extent that an individual can recover benefits under more than one program to compensate for the same financial loss, those programs overlap. Available data suggest that bankruptcy is probably a substitute for, and probably overlaps with, all of the programs mentioned above.

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[9] *See, e.g.*, Athreya & Simpson, *supra* note 2; Fisher, *supra* note 2.

[10] *See* Fisher, *supra* note 2, at 17–18 (finding evidence that bankruptcy and unemployment insurance are substitutes).

[11] *See* Athreya & Simpson, *supra* note 2, at 31–32 (concluding that society should reduce the scope of social insurance generally and that the availability of bankruptcy relief enhances the negative effects of other social insurance programs).

[12] *See infra* notes 167–76 and accompanying text.

[13] As explained below, spousal support laws may or may not satisfy the basic definition of social insurance. *See infra* note 145 and accompanying text. They do serve a similar function, however, and should be considered in relation to consumer bankruptcy.

By under-emphasizing the potential relationships between bankruptcy and these other regimes, legal scholars have avoided confronting important normative questions about the role of bankruptcy law in the broader system of social insurance. Assuming that bankruptcy is a potential substitute for other social insurance programs, society must determine how best to allocate social insurance functions between bankruptcy and those other programs. This Article approaches this question as one of relative efficiency; other normative approaches may be relevant or even dispositive, but they are beyond the scope of this Article.

Part II provides an informal framework for considering the relative efficiency of bankruptcy and other social insurance programs. It does so by way of illustration, considering bankruptcy in comparison to one particular program, unemployment insurance. Both of these programs insure individuals against the financial risk of unemployment. Unemployment insurance does so by providing a financial benefit in the immediate wake of unemployment; bankruptcy protection enables individuals to discharge debts that they cannot repay as a result of their wage interruption, including debts incurred to smooth their consumption during that period and beyond. To determine the optimal allocation of wage insurance functions between these programs, it is necessary to compare the relative costs of each program, including public and private administrative costs, costs related to self-insurance, moral hazard, and effects on credit and labor markets. It is impossible to confidently quantify and compare these costs with available data. Even with more data, it will be extremely difficult to compare the moral hazards and the macro-economic effects of each regime. These challenges aside, identifying the set of most relevant costs will help clarify goals for subsequent research on the relative efficiency of social insurance programs.

Information about the relative efficiency of bankruptcy and other social insurance programs such as unemployment insurance should help policy-makers determine the best allocation of functions across these regimes. To the extent that one of these programs is more efficient than the other at providing certain wage insurance functions, society should prefer to allocate those functions from one to the other. Thus, Part III identifies policy implications that might flow from reliable conclusions about the relative efficiency of the wage insurance functions of bankruptcy and unemployment insurance. One way to reallocate wage insurance functions between bankruptcy and unemployment insurance is to change the scope of the latter. This could be done by adjusting the amount or duration of benefits available to eligible individuals or by altering eligibility rules. The potential advantages of these reforms would have to be weighed against any increased costs, including moral hazard, that get shifted to one regime or the other.

The prospect of reallocating wage insurance functions by reforming bankruptcy law is much more complicated to evaluate. This is largely due to the fact that bankruptcy law is a relatively imprecise tool. It may be difficult to make slight changes to the Bankruptcy Code that would shift particular insurance functions but not others. This is a problem if bankruptcy is currently efficient with respect to some of the social insurance functions that it serves but relatively inefficient with respect to others. In that case, broad reforms to bankruptcy law will likely misallocate at least some of these functions.

Finally, Part III summarily considers the relationships between bankruptcy and other relevant programs besides unemployment insurance, including disability insurance, workers' compensation, Medicare, and spousal support laws. This Article assumes that society is committed to providing some significant level of social insurance but that it is hesitant about devoting necessary public resources. To the extent that these assumptions are true, it is important that the social insurance system be as efficient as possible. Determining the proper role of bankruptcy law within this social insurance system is an important step toward that goal.

I. BANKRUPTCY AS SOCIAL INSURANCE

At this point it will be helpful to elaborate on the descriptive claim that consumer bankruptcy functions, at least in part, as a form of social insurance. Consider the circumstances of the following individuals: Amanda, who is fired from her job as a result of necessary layoffs; Bob, who becomes divorced from his spouse; Cathy, who suffers a temporary medical condition, one that does not interfere with her employment; and David, who suffers a more serious medical condition that temporarily forces him to stop working. Each of these individuals will likely experience negative financial effects as a result of these circumstances, either in the form of lost income, increased expenditures, or both. This is obviously true in the cases of Amanda, Cathy, and David. Amanda will lose most or all of her wage income until she finds another job; Cathy will incur direct medical expenses; and David will incur medical expenses and will also likely lose wage income until he can return to work. Bob may also experience a negative financial effect from his divorce if he had been financially dependent on his spouse during their marriage.

Unless the government intervenes on their behalf in some way, these four individuals must somehow absorb the financial effects of their misfortunes. They might attempt to do so by seeking additional employment or financial contributions from friends or family members. They could also absorb their financial misfortunes by borrowing money—by acquiring necessary goods and services on credit; by getting a traditional loan; or by tapping a revolving line of consumer credit with, say, a credit card.[14] Any of these strategies, if successful, would enable these individuals to continue consuming some or all of the goods and services they were

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[14] *See, e.g.*, Iain Ramsay, *Consumer Credit Society and Consumer Bankruptcy: Reflections on Credit Cards and Bankruptcy in the International Economy*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 7, at 20, 23–25 (noting that consumer credit enables individuals to "smooth volatility in income and expenses"); *see also* Braucher, *supra* note 3, at 1066 (describing the use of credit as a "self-financed safety net"); Melissa B. Jacoby, *Generosity Versus Accessibility: Bankruptcy, Consumer Credit, and Health Care Finance in the US*, *in* CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE, *supra* note 7, at 286–87 (noting that individuals rely on credit to obtain health care goods and services).

consuming before their misfortunes.[15]

A. Insurance

Recognizing the financial risks of things like unemployment, marital dissolution, sickness, and disability, Amanda, Bob, Cathy, or David might, *ex ante*, have decided to set aside some assets or some income to enable them to smooth their consumption *ex post*. They might have set aside income or assets as part of a general savings plan, expecting to use the savings for additional consumption if no negative events occurred. Whether or not it makes sense for any of these individuals to set aside savings for other reasons, it might be a costly strategy for smoothing consumption in the event of financial troubles. This is especially true if the likelihood of a particular negative event is low but the potential financial effect is great. A risk-averse individual would likely want to save a large amount of money to protect against significant though unlikely misfortunes. Given that these resources would most likely not be needed, they might be put to more productive use. Furthermore, individuals who are inclined to save enough to protect themselves against serious financial problems simply may not have enough assets or income to do so.[16]

Given the difficulty and/or cost of saving enough income or assets to protect against financial misfortune, these individuals might reasonably prefer to purchase insurance against the risk of such occurrences. Insurance is, broadly speaking, a mechanism that allows individuals to reallocate economic risks.[17] If one prefers not to bear a certain risk, he or she can offer to pay someone else to bear it—to purchase insurance from the other party. Conventionally, the other party, the insurer, will agree to cover specified expenses or losses if the risk materializes in return for a fee, or premium. Individuals and organizations routinely insure against the risk of such occurrences as fires, accidents, other liabilities, and health problems. Anything is theoretically insurable as long as someone thinks the value of bearing the risk is less than the present value of the premium they can charge.[18] It

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[15] It is possible that some or all of these individuals had undesirable levels of consumption before or after their economic misfortune. This possibility is relevant to questions of moral hazard. *See infra* Part II.*C*.

[16] Recent studies suggest "many individuals do not hold sufficient financial assets to permit complete consumption smoothing." Adler, *supra* note 2, at 585 n.5 (citing George M. Constantinides & Darrell Duffie, *Asset Pricing with Heterogeneous Consumers*, 104 J. POL. ECON. 219 (1996)); Alon Brav et al., *Asset Pricing with Heterogeneous Consumers and Limited Participation: Empirical Evidence* 24 (CRSP Working Paper No. 505, RLW Center Working Paper No. 23-99, 1999), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=189972 (Oct. 1999).

[17] For a good summary of the economic theory of insurance, see TOM BAKER, INSURANCE LAW AND POLICY 1–8 (2003). *See also* Hallinan, *supra* note 2, at 99–109; Gillian Lester, *Unemployment Insurance and Wealth Redistribution*, 49 U.C.L.A. L. REV. 335, 360 (2001). One of the seminal descriptions of the economic theory of insurance is found in ARROW, *supra* note 2, at 134–43.

[18] *See, e.g.*, ARROW, *supra* note 2, at 138–39. It is important to note, however, that private insurers generally refuse to insure individuals against losses resulting from their own intentional wrongful acts, and, in any event, such arrangements are often void as against public policy. *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 334.

follows that a potential insurer must be able to estimate the likelihood of incurring liability on the contract and be able to charge the insured accordingly. But estimating the likelihood of any particular event with confidence is often nearly impossible. By pooling many similar and familiar risks, insurers can effectively spread the risk of any particular liability and thereby reduce the overall uncertainty of their liability.[19] A market for a particular insurance product may be plagued by information asymmetries, however, especially those relating to adverse selection—the tendency of higher-risk entities to purchase insurance and lower risk entities to effectively self-insure.[20] Where such information problems occur, they tend to undermine the risk-spreading function of insurance; theoretically, they may undermine the ability of insurers to cover certain risks at all.

One of the most significant problems of insurance arrangements is the potential that they will create "moral hazard" by reducing an insured party's incentives to avoid a risk that he or she is insured against.[21] For example, if an individual is insured against the risk of loss due to fire, he or she may not take the same precautions to avoid the risk of a fire that he or she would have otherwise taken. An individual with auto collision insurance might feel slightly less cautious on the road. Similarly, an insured individual or entity may not have strong incentives to mitigate or honestly assess losses once a particular risk materializes. Relatedly, insurers have to worry that individuals will make false claims for benefits.[22]

Insurers may attempt to mitigate moral hazard by charging risk-based premiums or by requiring deductibles and other forms of co-insurance.[23] A deductible allocates a portion of losses back upon the insured by making him or her responsible for all losses up to a certain amount before benefits are available. Other co-insurance requirements may shift a portion of risk back to the insured by limiting the amount of coverage an individual can receive in the event that a risk materializes. Risk-based premiums adjust the incentives of an insured by making his or her premiums sensitive to his or her particular risk profile. An individual

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[19] *See* BAKER, *supra* note 17, at 3. It follows that the ability of insurers to spread risk declines to the extent that risks are covariant—that risks are somehow connected or dependent. *See* MICHAEL GRAETZ & JERRY MASHAW, TRUE SECURITY: RETHINKING AMERICAN SOCIAL INSURANCE 16 (1999); Lester, *supra* note 17, at 361; *see also* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1563 (1987) (stating that "as risks become more correlated, premiums must increase").

[20] *See* BAKER, *supra* note 17, at 1–8; GRAETZ & MASHAW, *supra* note 19, at 16; *see also* Hallinan, *supra* note 2, at 100–03; Lester, *supra* note 17, at 361–62. This circumstance is more likely to occur when insured have much better information than insurers do about the likelihood of a risk materializing. There is significant debate over the actual force of adverse selection in insurance markets, with many scholars suggesting that adverse selection is actually quite rare. *See* BAKER *supra* note 17, at 6. *See generally* Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223 (2004) (criticizing standard accounts of the phenomenon of adverse selection).

[21] *See* ARROW, *supra* note 2, at 142; BAKER, *supra* note 17, at 4–5; GRAETZ & MASHAW, *supra* note 19, at 16; Hallinan, *supra* note 2, at 100–03; Lester, *supra* note 17, at 362.

[22] *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 329.

[23] *See* BAKER, *supra* note 17, at 5; Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1065 n.224 (2001) (noting deductibles and co-insurance give individuals incentives to avoid insured accidents); Mark E. Van Der Weide & Satish M. Kini, *Subordinated Debt: A Capital Markets Approach to Bank Regulation*, 41 B.C. L. REV. 195, 206 (2000).

who fails to take reasonable precautions or to mitigate losses should expect to pay a greater amount for insurance in the future where premiums are based on his or her risk profile. If the moral hazard created by a particular insurance arrangement is great enough, the appropriate premium or deductible or co-insurance that an insurer should demand may be high enough to make the product unaffordable or unappealing. Thus, moral hazard, like adverse selection and covariance of risks, may cause some things to be effectively uninsurable.[24]

Perhaps reflecting these problems with insurance arrangements, private markets appear to have shied away from providing insurance against the risks of unemployment or marital dissolution.[25] This should not be surprising: individuals have significant control over the likelihood of these risks occurring, and they probably have much more information about the likelihood of such a risk materializing than a potential second-party insurer. Private disability insurance and medical insurance are more widely available, perhaps because the risks of disability and medical problems are less within the control and exclusive knowledge of potential insureds.[26] Even if insurance against a particular risk is generally available in private markets, however, it may be priced out of reach for high-risk individuals, those who often need it most. Thus, for example, an individual with a very poor driving record may not be able to afford the insurance available to him or her. Similarly, a person with a pre-existing health condition may face prohibitively high health insurance premiums.[27]

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[24] *See* BAKER , *supra* note 17, at 5; *see also* ARROW, *supra* note 2, at 141–43; GRAETZ & MASHAW, *supra* note 19, at 17.

[25] *See* Adler et al., *supra* note 2, at 587 n.5 (noting that private wage insurance is not generally available); *see also* Ann Laquer Estin, *Maintenance, Alimony, and the Rehabilitation of Family Care*, 71 N.C. L. REV. 721, 785 n.241 (1993) ("Divorce insurance . . . has not yet arrived on the scene."); Stephen Sugarman, *Reforming Welfare Through Social Security*, 26 U. MICH. J. L. REF. 817, 842 (1993) (noting that while life and disability insurance are available in private markets, divorce insurance is not). It is worth noting that a few writers have considered the possibility of divorce insurance. *See* Homer H. Clark, Jr., *Divorce Policy and Divorce Reform*, 42 U. COLO. L. REV. 403, 412 (1971); Margorie Engel, *Pockets of Poverty: The Second Wives Club—Examining the Financial [In]security of Women in Remarriages*, 5 WM. & MARY J. WOMEN & L. 309, 327 (1999); Martha Ertman, *Commercializing Marriage: A Proposal for Valuing Women's Work Through Premarital Security Agreements*, 77 TEX. L. REV. 17, 48 (1998); Carol Weisbrod, *Universals and Particulars: A Comment on Women's Human Rights and Religious Marriage Contracts*, 9 S. CAL. REV. L. & WOMEN'S STUD. 77, 90 (1999). *But see* JOHN D. LONG, ETHICS, MORALITY, AND INSURANCE: A LONG-RANGE OUTLOOK 264 n.36 (1971) (referring to divorce insurance as a "bizarre" idea). Also, credit insurance designed to insure against wage loss is increasingly available, but probably not to the extent sufficient to satisfy need or demand. *See* Richard M. Hynes, *Overoptimism and Overborrowing*, 2004 B.Y.U. L. REV. 127, 128–29 (2004) (noting that market failures may impede availability of credit insurance).

[26] *See* GRAETZ & MASHAW, *supra* note 19, at 81 (noting that roughly one–quarter of workers in the United States have private short or long term disability insurance coverage); *see also* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 339 (noting that health and disability insurance are widely available in private markets); Jacoby et al., *supra* note 3, at 400 n.101 (citing Census findings suggesting that approximately 85% of people in the United States have health insurance coverage); Eleanor D. Kinney, *Behind the Veil Where the Action is: Private Policy Making and American Health Care*, 51 ADMIN. L. REV. 145, 152 (1999).

[27] *See, e.g.*, Jacoby et al., *supra* note 3, at 406–07 (noting that insurers may require high co-insurance rates for chronic problems and that pre-existing health conditions may not be covered under subsequent policies).

B. Social Insurance

If Amanda, Bob, Cathy, or David cannot successfully absorb their financial misfortunes or insure against them, they will probably have to reduce their consumption of goods and services, perhaps necessary ones. Assume now, however, that society decides that individuals such as these should not bear the full brunt of certain risks; it therefore wants to help enable individuals to smooth their consumption in the wake of temporary financial problems related to those risks.[28] Such government intervention is particularly justified when individuals do not, or cannot, hold sufficient assets to permit smoothing or when private insurance markets are not capable of insuring relevant risks.[29] Societies have many options available to them to implement this policy decision. They can, for example, distribute assistance directly to individuals. Such assistance could be drawn from general governmental revenues or from other sources—from individual beneficiaries or their employers, for example. Alternatively, they could require or encourage private entities to provide insurance coverage or other protections to individuals they would not otherwise insure or protect.

Where beneficiaries of a program actually bear the cost of any benefits or protections—either directly or indirectly—these benefits or protections are properly described as social insurance.[30] Social insurance programs are conceptually different than social assistance programs, which generally provide needs-based benefits and for which recipients do not pay a premium.[31] They are primarily

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[28] *See, e.g.*, Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 339 (noting that market failures may justify intervention). It is important to note that this intervention is not designed to avoid or decrease underlying risks that confront individuals. Governments can, for example, design monetary and labor policies to decrease unemployment in the first place. This article does not address these types of policies. Rather, it assumes that risks of unemployment, health problems, and marital dissolution will continue to be prevalent and it focuses on how society might help individuals smooth consumption when such risks materialize.

[29] *See* Adler et al., *supra* note 2, at 587 n.5; Hynes, *Optimal Bankruptcy*, *supra* note 2, at 2–3; Wang & White, *supra* note 2, at 258–59.

[30] For a description of the standard conception of social insurance, see Alan B. Krueger & Bruce Meyer, *Labor Supply Effects of Social Insurance* 3–4 (Nat'l Bureau of Econ. Research, Working Paper No. W9014, 2002) (defining social insurance as "compulsory, contributory government programs that provide benefits to individuals if certain conditions are met"), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=316793 (June 21, 2002). Professors Graetz and Mashaw use a somewhat broader definition: "collectively determined and legally binding promises to pay defined amounts to or on behalf of particular beneficiaries given the occurrence or continuation of an event or condition that impairs the adequacy of current family income." GRAETZ & MASHAW, *supra* note 19, at 56–57. Traditional examples of social insurance include Social Security, Medicare (as opposed to Medicaid, which generally satisfies the definition of social assistance), unemployment insurance, workers' compensation, and disability insurance. These are discussed *infra* in notes 56–145 and accompanying text. *See also* JONATHAN OBERLANDER, THE POLITICAL LIFE OF MEDICARE 77 (2003) (discussing social insurance).

[31] *See* GEORGE E. REJDA, SOCIAL INSURANCE AND ECONOMIC SECURITY 10–11, 35–36 (1999) (describing general characteristics of social insurance and contrasting social insurance with public assistance); Hallinan, *supra* note 2, at 120 n.275 (distinguishing "social insurance" programs from "social assistance" programs); Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 351–55 (noting that social insurance programs, like debt relief, are not limited to the poor and actually tend to give more generous relief to wealthier individuals).

designed to cushion temporary wealth or income shocks that result from predictable yet unanticipated events. It is important to note that providing social insurance does not necessarily solve the problems that made the insurance scarce or unavailable in private markets. Rather, it may reflect a decision by society that the cost of these problems is worth bearing, perhaps because the insurance is welfare enhancing or because it advances some other normative goal.

C. Bankruptcy

Imagine that society decides to protect these individuals by introducing debt relief in the form of a consumer bankruptcy system.[32] The most general defining characteristic of a bankruptcy system is that it serves as a collective proceeding for the resolution of the financial affairs of a struggling or insolvent debtor.[33] All activities that may affect a debtor's assets, especially debt collection activities, are automatically stayed as soon as a debtor files for bankruptcy protection.[34] Bankruptcy law then provides a set of rules according to which all of the parties that have an interest in a debtor's assets can have their claims and interests resolved in a relatively orderly and efficient manner. One appeal of a bankruptcy system is that it significantly reduces the administrative costs of having to resolve various claims against an insolvent debtor's estate in various fora under various procedural and substantive rules.[35] Such a system can also promote efficient debt collection where a debtor has resources but where these resources will not satisfy all of his or her or its obligations.[36]

As a comparative matter, American consumer bankruptcy law is a somewhat idiosyncratic model of bankruptcy. While most bankruptcy systems provide for

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[32] It is important to remember that consumer bankruptcy is only one particular form of debt relief. *See generally* Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2. This article limits its analysis to bankruptcy and generally does not consider other debt relief alternatives. It does not address the question of whether another form of debt relief might be more desirable than the existing consumer bankruptcy system in the United States.

[33] *See* ELIZABETH WARREN, BUSINESS BANKRUPTCY 5–7 (1993); *see also* JACKSON, *supra* note 7, at 7–19.

[34] *See* Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 TEX. L. REV. 1381, 1419 n.222 (2003); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1840–41 (1998); *see also* Eskanos & Adler, P.C. v. Leetien, 309 F.3d 1210, 1214 (9th Cir. 2002) ("The scope of protections embodied in the automatic stay is quite broad, and serves as one of the most important protections in bankruptcy law.").

[35] *See, e.g.*, Feibelman, *supra* note 34, at 1417 (noting bankruptcy law reduces the cost of debt collection by providing a single forum for resolving most claims relating to an insolvent debtor's estate).

[36] *See* JACKSON, *supra* note 7, at 7–19; *see also* Carlos J. Cuevas, *Bankruptcy Code Section 105(a) Injunctions and State and Local Administrative and Civil Enforcement Proceedings*, 4 AM. BANKR. INST. L. REV. 365, 406 (1996); Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 948 (1991). Under American non-bankruptcy law, for example, collection of unsecured debt is a first-come, first-served affair; when an insolvent debtor runs out of assets, his or her remaining creditors take nothing. This gives creditors an incentive to conduct a wasteful race for a debtor's unsecured assets, causing some otherwise healthy debtors to be liquidated. Bankruptcy halts the race to assets and allows for a more careful choice about whether or not to liquidate the debtor's assets.

some form of discharge of debt for individual debtors, the American system is among the most generous in the world in this respect.[37] Because every individual in the United States enjoys a nonwaivable right to file for bankruptcy protection,[38] most unsecured lending agreements effectively include a mandatory term that the borrower retains the option to file for bankruptcy protection.[39] Under chapter 7, an individual can discharge some or all of his or her unsecured debts[40] in exchange for his or her non-exempt assets.[41] Under chapter 13, an individual can have some or all of his or her debts discharged if he or she pays a portion of his or her future income, generally for a period of three to five years.[42] To facilitate comparison with other social insurance programs, the model of bankruptcy protection analyzed in the remainder of this article is that of chapter 7.[43]

Bankruptcy protection as described above will be of limited direct benefit to Amanda, Bob, Cathy or David if they successfully absorb the financial effects of their misfortunes. If these individuals become insolvent or experience financial distress, however, such protection will enable them to discharge some or all of the obligations that they incurred before the triggering events of their respective misfortunes. In some cases, it will enable them to discharge the direct financial

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[37] *See, e.g.*, Rafael Efrat, *Global Trends in Personal Bankruptcy*, 76 AM. BANKR. L.J. 81, 82–91 (2002) (describing comparative approaches to discharge of debts in various countries, ranging from regimes which do not allow discharge to those with liberal discharge); Jacoby, *supra* note 14, at 290; Wang & White, *supra* note 2, at 255; *see also* Paul B. Lewis, *Can't Pay Your Debts Mate? A Comparison of the Australian and American Personal Bankruptcy Systems*, 18 BANKR. DEV. J. 297, 297 (2002) ("The United States has one of the most debtor-friendly personal bankruptcy vehicles in the industrialized world.").

[38] *See* Adler et al., *supra* note 2, at 587.

[39] *See id*. at 589.

[40] Some unsecured debts are non-dischargeable. *See, e.g.*, 11 U.S.C. § 523(a)(1) (2000) (excepting certain tax debts from discharge); *id*. (a)(4) (excepting debts owed due to fraud while acting in fiduciary capacity); *id*. (a)(5) (excepting debts related to alimony or divorce settlements); *id*. (a)(6) (excepting debts related to willful and malicious injury caused by debtor); *id*. (a)(8) (excepting debts related to student loans).

[41] *See generally* HENRY J. SOMMER, CONSUMER BANKRUPTCY LAW AND PRACTICE (6th ed. 2000); G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 227 (2000); Richard Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 188–90 (2002). Although the relevant exemptions differ by jurisdiction, debtors can generally claim as exempt from creditors some portion of the value of their homes, a motor vehicle, household goods, health-related items, benefits, compensation for previous injuries, and unmatured life insurance. It is possible for individuals to effectively waive many of these exemptions by granting a security interest in property that would otherwise be exempt from collection. *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 348 n.306.

[42] Under chapter 13, a debtor can keep all of his or her assets, but must pay some of his or her future income according to a plan that he or she files with the bankruptcy court. *See* 11 U.S.C. § 1321 (2000). The plan may modify or reduce some of the debtor's obligations. *See id*. § 1322(b); DOUGLAS G. BAIRD ET AL., BANKRUPTCY: CASES, PROBLEMS & MATERIALS 531–33 (2001). It may provide that obligations remaining when the plan is complete be discharged. *See id*. § 1328(a). Generally, chapter 13 plans are for three-year periods, but they can be extended to five years. *See id*. § 1322(a)(1), (d); BAIRD, *supra*, at 531. Reform legislation currently under consideration by Congress would increase the duration of chapter 13 plans for some high-income individuals. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 318 (2005) (enacted).

[43] This choice is also justified by the fact that most debtors opt to file under chapter 7. *See also* Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 127 (noting that most of the debt that is discharged in bankruptcy is discharged in chapter 7).

effects of their misfortune. David and Cathy, for example, will likely be able to discharge the medical-related debt that they incurred as a result of their illnesses. Perhaps most significantly, however, this protection will also enable these individuals to discharge obligations that they incurred in trying to absorb the effects of their misfortunes. If David borrowed money to smooth consumption in the wake of his illness, for example, he should be able to discharge this obligation in the event that he becomes insolvent.

The foregoing discussion assumed that these individuals are borrowing money on an unsecured basis. If they pledged assets to secure any of these loans, the consequences would be significantly different. Such security interests, especially residential mortgages and auto financing arrangements, are extremely common, and they are subject to somewhat complicated rules in bankruptcy. For present purposes, the most significant aspect of a secured credit arrangement is that a secured creditor's interest survives a debtor's bankruptcy discharge (unless the debtor redeems the property by paying the value of the property to the secured creditor).[44] This effectively means that the debt relief and social insurance functions of bankruptcy do not apply to secured credit, or that they apply to a far lesser extent. To appreciate this, imagine that David paid for medical services with a credit card (unsecured) while Cathy obtained a home equity loan (secured by a mortgage on her home) to pay for the same services. If David and Cathy both obtained a discharge in bankruptcy, Cathy's lender's interest in her home would survive her bankruptcy unless she redeemed the property by paying the lender the value of the property.

Debtors who do not actually file for bankruptcy may still get indirect benefits from bankruptcy law, especially if they want to negotiate with their creditors and seek forbearance from them. The potential availability to the debtor of a discharge in bankruptcy may provide a baseline for a creditor's expected recovery. A significant amount of default on debt occurs outside of bankruptcy every year and it appears that many people in financial distress do not file for bankruptcy.[45] It may be in a creditor's interest to adjust or even write off a debtor's obligations regardless of bankruptcy rules; a creditor's inclination to do so is partially a product of the debtor's ability to have his or her obligations discharged in bankruptcy.[46] Furthermore, the potential availability of bankruptcy protection will make it more appealing for these individuals to rely on unsecured credit to try to smooth their

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[44] For an explanation of the treatment of security interests in chapter 7, see BAIRD, *supra* note 42, at 477–81.

[45] *See* Hynes, *supra* note 25, at 139 n.48 (stating that about 70% of consumer credit losses occur outside bankruptcy); *see also* Larry T. Garvin, *Credit, Information, and Trust in the Law of Sales: The Credit Seller's Right of Reclamation*, 44 U.C.L.A. L. REV. 247, 303–04 (1996) (discussing credit problems that do not lead to bankruptcy).

[46] *See* Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 127 (citing Michelle White, *Why Don't More Households File for Bankruptcy?*, 14 J.L. ECON. & ORG. 205 (1998)). Reform legislation currently under consideration by Congress would penalize a creditor who refused to negotiate, through a credit counseling agency, over potential reductions in a debtor's obligations. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 201.

consumption in the wake of their initial financial troubles.[47] Without the availability of discharge, an individual who was experiencing or who could anticipate financial troubles would reasonably be hesitant to take on additional obligations.[48]

The protection provided under American bankruptcy law described above roughly satisfies the conventional definition of social insurance. It is a set of mandatory rules designed to reallocate at least some of the risk of financial distress from debtors to their unsecured creditors. And significantly, debtors bear much if not all of the cost of this reallocation of risk to creditors.[49] Whether or not they eventually file for bankruptcy protection, individuals who obtain credit from voluntary creditors will likely have to pay for the potential availability of a bankruptcy discharge in the form of a higher cost of credit.[50] It follows that bankruptcy protection also gives rise to some or all of the problems associated with insurance arrangements, notably adverse selection, information asymmetries, and moral hazard.

Because it is a mandatory form of protection, bankruptcy itself should not create significant adverse selection problems with respect to filing for protection. Borrowers do not have the choice to opt out of bankruptcy protection *ex ante*, so there is no chance that only high risk individuals will opt for protection in the first place.[51] It is possible, however, that some form of adverse selection affects individuals' decision to use unsecured credit to absorb financial problems in the first place; in other words, riskier borrowers may be more inclined to rely on unsecured credit than other individuals who are more likely to avoid insolvency, and creditors may not be able to tell the difference. This may lead lenders and borrowers to rely on costly screening devices – signals of credit-worthiness – and may ultimately

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[47] *See* Zywicki, *supra* note 1, at 15 (noting that one underlying purpose of bankruptcy is to encourage individuals to take on more debt). *See generally* Ramsay, *supra* note 14, at 23–25 (describing bankruptcy as "the ultimate re-insurance" for credit card use which is "a substitute for social welfare").

[48] *See* Hynes, *supra* note 25, at 132 (noting that under the current rules, a debtor who knows he or she may be on the verge of bankruptcy has incentives to continue spending beyond his or her means). Bankruptcy law does provide some counterweight to these incentives by exempting from discharge certain eve-of-bankruptcy expenditures on "luxury goods or services." *See* 11 U.S.C. § 523(a)(2)(c) (2000) (providing that debts to a single creditor for more than $1,225 for "luxury goods or services" incurred within 60 days before an order for relief under the Bankruptcy Code are presumed to be non-dischargeable). Reform legislation currently under consideration by Congress would expand the definition of debts incurred for luxury goods under this provision by lowering the dollar amount and extending the relevant time period. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 310.

[49] *See* Zywicki, *supra* note 1, at 4 (noting costs of bankruptcy are borne by borrowers, as well as lenders); *see also* Ronald J. Mann, *Credit Card Policy in a Globalized World* 31 (U. of Tex. Law and Econ. Working Paper No. 018, 2004), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=509063 (Feb. 2004); *see also* Braucher, *supra* note 3, at 1076; Hynes, *supra* note 25, at 128–29.

[50] Significantly, involuntary creditors such as tort victims are not in a position to pass along the risk of bankruptcy to debtors though a pricing mechanism. *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 333–35. This Article does not address normative issues related to the treatment of involuntary creditors in bankruptcy. In any event, most debts discharged in bankruptcy are owed to voluntary creditors. *Id*. at 335.

[51] *See* BAKER, *supra* note 17, at 6 (noting that when insurance is mandatory, low-risk individuals are unable to drop out of insurance pool).

force creditors to engage in credit rationing.[52] Perhaps more significantly, however, bankruptcy protection also creates significant potential moral hazard problems. As explored more fully *infra*, the availability of a bankruptcy discharge may reduce individuals' incentives to restrain consumption in advance of financial misfortune or their incentives to be disciplined in absorbing losses in the wake of such misfortunes.

Finally, it is worth noting an important limitation of bankruptcy protection for individuals like Amanda, Bob, Cathy, or David. To reiterate, the ability to discharge debt in bankruptcy primarily benefits individuals to the extent that they have relied on unsecured credit to support their consumption. If an individual borrows money to pay necessary bills or is able to get necessary goods and services on credit, for example, a discharge in bankruptcy will effectively cover those losses by discharging the obligations in the event that the individual cannot repay them. If an individual is unable to borrow money or is unable to secure necessary goods and service on credit, then bankruptcy provides little or no immediate benefit or protection; such an individual may not be able to secure necessaries in the first place without other forms of social assistance or social insurance. Furthermore, if an individual is able to secure credit to purchase necessary goods and services, bankruptcy protection does not provide any direct relief for that individual unless he or she effectively becomes insolvent.[53] Those individuals who can secure credit, who become deeply indebted, but who avoid financial collapse, will receive only the indirect benefits of bankruptcy protection discussed above.[54] Finally, it follows from the points made above that a discharge in bankruptcy is especially valuable to Amanda, Bob, Cathy, or David because each of these individuals will presumably have future income that creditors could otherwise reach. A debtor with no non-exempt assets and no prospect of future income has much less to benefit from a discharge of debts in bankruptcy.[55]

D. Other Social Programs and Analogs

This section introduces other social insurance programs and legal regimes that may actually be available to Amanda, Bob, Cathy, and David. In particular, it introduces unemployment insurance, Medicare, Social Security disability, workers'

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[52] *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 344–45. *See generally* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981).

[53] Technically, there is no requirement that individuals be insolvent to file for bankruptcy protection. *See* 11 U.S.C. § 109 (2000). An individual who is not insolvent, however, may have his or her chapter 7 case dismissed for substantial abuse, see 11 U.S.C. § 707(b) (2000). *See* Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 129 ("The meaning of ['substantial abuse'] is unclear, but many courts assume that it has something to do with the debtor's ability to pay debts as they come due."); Jacoby, *supra* note 14, at 291–92 (noting evidence that bankruptcy courts are actively policing for substantial abuse under section 707(b)); *see also* Westbrook, *supra* note 3, at 2128–29.

[54] *See supra* notes 45–48 and accompanying text.

[55] *See supra* note 48 and accompanying text; *see also* Braucher, *supra* note 3, at 1089 (suggesting that individuals who have little or no non-exempt assets should file for bankruptcy when they return to work to protect new income).

compensation, and alimony. These programs and regimes are briefly summarized below. The following sections may contain more information than necessary for some readers. These programs are described in some detail to allow for meaningful comparison with consumer bankruptcy. Some readers may wish to skip ahead to Part I.*E*., which begins to describe the relationship between these programs and bankruptcy relief.

1. Unemployment Insurance

The existing unemployment insurance system in the United States is a complicated federal-state system.[56] It was set in place by the Social Security Act of 1935, which authorized federal support for state unemployment insurance funds that comply with guidelines set by the federal law.[57] Currently, all of the state unemployment insurance programs conform to the federal requirements; thus, while programs vary from state to state, they share similar basic attributes.[58] Federal support under the Act is funded primarily by the Federal Unemployment Tax Act (FUTA), which imposes a federal tax on employers equal to .8% of the first $7,000 of wages paid to each covered employee – $56 per covered worker per year.[59] This federal support covers most of the administrative costs of the various state unemployment insurance programs.[60] As explained below in more detail, the monetary benefits given to eligible individuals under the state programs are paid out of funds collected and administered by the various states in accordance with federal guidelines under the FUTA.[61]

Under the FUTA, nearly all employees who receive wages from employers for services rendered in the course of employment are covered under state unemployment insurance programs.[62] Individuals who are covered under the

[56] For a good summary of unemployment insurance programs in the United States, see Lester, *supra* note 17, at 340–58.

[57] *See* 42 U.S.C. §§ 501–504, 1101–108 (2000); Lester, *supra* note 17, at 340.

[58] *See* Lester, *supra* note 17, at 344; Philip J. Weiser, *Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663, 669 (2001) (describing unemployment insurance as an example of cooperative federalism).

[59] Technically, the FUTA imposes a 6.2% tax on employers (6% after 2007) and then gives employers back a 5.4% tax credit conditioned upon the employer's state complying with the federal unemployment insurance guidelines. *See* 26 U.S.C. §§ 3302, 3304 (2000); Lester, *supra* note 17, at 340; *see also* U.S. DEPT. OF LABOR, EMPLOYMENT & TRAINING ADMIN., COMPARISON OF STATE UNEMPLOYMENT LAWS 2-1 (2004) [hereinafter COMPARISON OF STATE UNEMPLOYMENT LAWS], *available at* http://workforcesecurity.doleta.gov/unemploy/uilawcompar/2004/comparison2004.asp (last visited Feb. 11, 2005).

[60] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 2-1; *see also* Sharon M. Dietrich & Cynthia L. Rice, *Timeliness in the Unemployment Compensation Appeals Process: The Need for Federal Oversight*, 29 U. MICH. J.L. REFORM 235, 239 (1995).

[61] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 2-1; Lester, *supra* note 17, at 340.

[62] To be covered, an individual must have been paid wages for services provided to an employer in the course of employment. *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 1-1. It is estimated that 90% of U.S. workers satisfy this definition. In general, state definitions of covered employees

programs in turn become eligible for benefits if they become unemployed and satisfy various criteria. First and foremost, benefits are limited to individuals who are involuntarily unemployed; they are generally not available to workers who quit their jobs voluntarily, unless they have "good cause" for doing so.[63]

Individuals must also satisfy a variety of "workplace participation" requirements.[64] Complicated in their operation, these provisions generally require that an individual have earned a minimum amount of wages during his or her "base period" - the period before filing for unemployment insurance benefits during which the individual became "attached" to the workforce.[65] In almost all states, an individual's base period is the first four quarters of the previous five quarters before the individual became unemployed. States have adopted a variety of schemes to determine whether an individual had become adequately attached to the workforce

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effectively exclude such categories as farm workers, household domestic workers, and independent contractors. *Id*.; Lester, *supra* note 17, at 345 n.36.

[63] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 5-1; *see also* Lester, *supra* note 17, at 350–55, 369–93 (describing the non-monetary requirements for unemployment insurance benefit eligibility and presenting arguments over whether to expand exceptions to the involuntariness requirement). In some states, good cause is limited to faulty behavior by employers or their agents, such as sexual harassment; in others, good cause may include an employee's illness, leaving to join the military, marriage, or the need to perform domestic obligations. *Id*. at 350; COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 5-3, 5-9. The scope of the involuntariness requirement has received much critical attention. *See, e.g.*, Karen Syma Czapanskiy, *Unemployment Insurance Reform for Moms*, 44 SANTA CLARA L. REV. 1093 (2004) (arguing in favor of extending eligibility for unemployment insurance to more part-time workers, expanding exceptions to the involuntariness requirement, and allowing workers that are available for part-time work to be deemed "available for work" under unemployment insurance programs); Deborah Maranville, *Changing Economy, Changing Lives: Unemployment Insurance and the Contingent Workforce*, 4 B.U. PUB. INT. L.J. 291, 322–23 (1995); Deborah Maranville, *Unemployment Insurance Meets Globalization and the Modern Workforce*, 44 SANTA CLARA L. REV. 1129 (2004) (arguing *inter alia* that workforce participation rules should be extended to grant eligibility to more part-time workers and that exceptions to the involuntariness requirement be expanded); Deborah Maranville, *Workplace Mythologies and Unemployment Insurance: Exit, Voice and Exhausting All Reasonable Alternatives to Quitting*, 31 HOFSTRA L. REV. 459 (2002); Mary F. Radford, *Wimberly and Beyond: Analyzing the Refusal to Award Unemployment Compensation to Women Who Terminate Prior Employment Due to Pregnancy*, 63 N.Y.U. L. REV. 532, 539–40 (1988) (reiterating states have provisions disqualifying individuals who voluntarily leave work without "good cause," and generalizing accepted notion that "unemployment benefits should be paid only in the event of involuntary unemployment incurred through no fault of the claimant"); *see also* REBECCA SMITH ET AL., NAT'L EMPLOYMENT LAW PROJECT, BETWEEN A ROCK AND A HARD PLACE: CONFRONTING THE FAILURE OF STATE UNEMPLOYMENT INSURANCE SYSTEMS TO SERVE WOMEN AND WORKING FAMILIES (2003); Wayne Vroman, *Effects of Welfare Reform on Unemployment Insurance, in* URBAN INSTITUTE, NEW FEDERALISM: ISSUES AND OPTIONS FOR STATES (Series A, No. A-22, 1998), *available at* http://www.urban.org/UploadedPDF/anf22.pdf (May 1998); Lucy A. Williams, *Unemployment Insurance and Low-Wage Work, in* HARD LABOR: WOMEN AND WORK IN THE POST-WELFARE ERA (Joel F. Handler and Lucie White eds., 1999); Stephen Bingham, *Replace Welfare for Contingent Workers with Unemployment Insurance*, 22 FORDHAM URB. L.J. 937, 943–47 (1995); Heather Boushey & Jeffrey B. Wenger, *UI is Not a Safety Net for Unemployed Former Welfare Recipients* 2–3 (Ctr. for Econ. and Policy Research, Briefing Paper, 2003), *at* http://www.cepr.net/publications/tanf_ui.pdf (Dec. 4, 2003).

[64] *See* Lester, *supra* note 17, at 346–50 (describing the monetary requirement for eligibility for unemployment insurance benefits); COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 3-1.

[65] *See* Lester, *supra* note 17, at 346–50. *See generally* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59.

during his her base period.[66] Under some state laws, for example, an individual must have earned a certain amount in wages during a particular quarter within that individual's base period. Other states determine monetary eligibility based on total earnings during the base period.[67] Still others require that an individual have worked a certain number of hours at a certain wage (or above) during the base period.[68]

Finally, the various state unemployment insurance programs also require that beneficiaries be able and available to start new employment, and that they actually seek work, during the period they are receiving unemployment compensation.[69] As a result of these various requirements, eligibility for unemployment insurance is carefully circumscribed. While most workers in the United States are formally covered by unemployment insurance, only a fraction of these individuals will be eligible for benefits at the time they become unemployed.[70] In 1999, for example, approximately 37% of unemployed workers seeking employment actually claimed unemployment insurance benefits. Workers who meet these eligibility requirements receive 50% of their lost wages up to a specified amount—generally, the average weekly wage in the state.[71] Some states also provide additional benefits for dependents' allowances.[72] Unemployment insurance benefits are generally available for a period of up to twenty-six (26) weeks,[73] and the state programs generally impose a waiting period of one week before benefits are available.[74]

As noted above, the monetary benefits extended under the various state programs are provided by funds established by each state. These funds are in turn financed by private employers by means of "contributions," *i.e.*, payroll taxes. To qualify for the federal tax credit under FUTA, all states initially require employers

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[66] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 3-3 to 3-8.

[67] *See id*. at 3-5.

[68] *See id*. at 3-6.

[69] *See* Lester, *supra* note 17, at 352–53; COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 5-20, 5-24; *see also* Daniel H. Klepinger et al., *Effect of Unemployment Insurance Work-Search Requirements: The Maryland Experiment*, 56 INDUS. & LAB. REL. REV. 3, 3 (2002).

[70] *See* Wayne Vroman, *Labor Market Changes and Unemployment Insurance Benefit Availability* 60 (U.S. Dep't of Labor, Unemployment Insurance Occasional Paper, 1998), *at* http://www.ows.doleta.gov/dmstree/op/op98/op_03-98.pdf (last revised Jan. 1998); *see also* Krueger & Meyer, *supra* note 30, at 8. Largely due to these eligibility requirements, less than 40% of individuals who become unemployed receive unemployment insurance benefits under current programs. *Id*. According to one study, the falling eligibility numbers are the result of competition among and between the various states. *See* Laurie J. Bassi & Daniel P. McMurrer, *Unemployment Insurance in a Federal System: A Race to the Bottom?* 1, 4 (U.S. Dep't of Labor, Occasional Paper No. 98-5, 1996), *at* http://wdr.doleta.gov/owsdrr/98-5/98-5.pdf (Nov. 1996).

[71] COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 3-8; *see also* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 342 (noting that the maximum weekly unemployment insurance benefit in Virginia in 2003 was $368).

[72] *See id*. at 3-19; *see also* Sharon Dietrich et al., *Work Reform: The Other Side of Welfare Reform*, 9 STAN. L. & POL'Y REV. 53, 62 (1998).

[73] COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 3-21; *see* Stewart J. Schwab, *Predicting the Future of Employment Law: Reflecting or Refracting Market Forces?*, 76 IND. L.J. 29, 38 (2001).

[74] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 3-15 (providing a comparison of waiting periods in forty states).

to contribute a percentage of each covered employee's wages up to at least $7,000[75] to the state unemployment insurance fund.[76] The tax rate to each individual employer, however, can be adjusted based in part on the employer's "experience rating," which is calculated as a function of the employer's history of layoffs. According to federal guidelines, states use experience ratings to grant tax reductions to employers with relatively good histories of unemployment or low benefit costs to the state funds.[77] Employers with histories of more layoffs pay a higher tax rate; some states apply higher rates for employers in particular industries.[78] Maximum state unemployment insurance rates range from 5.4% to over 10%.[79] The average state payroll tax rates range from less than 1% to approximately 4%.[80]

Whatever the rate, unemployment insurance taxes represent a cost of production to employers. In theory, firms adjust to increased costs in a variety of ways. They can absorb the costs and enjoy lower profits; they can pass the costs along downstream to consumers in the form of higher prices; or they can pass the costs upstream to labor by paying lower wages to their employees or by hiring fewer employees in the first place. There is significant evidence that employers pass much or most of the cost of their unemployment insurance premiums on to labor markets.[81]

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[75] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 2-4 to 2-5; *see also* Patricia M. Anderson & Bruce D. Meyer, *Unemployment Insurance Tax Burdens and Benefits: Funding Family Leave and Reforming the Payroll Tax* 1 (Nat'l. Bureau of Econ. Research, Working Paper No. 10043, 2003), *at* http://www.faculty.econ.northwestern.edu/faculty/meyer/UIDist.pdf (Oct. 11, 2003); Stephen A. Woodbury, *Layoffs and Experience Rating of the Unemployment Insurance Payroll Tax: Panel Data Analysis of Employers in Three States* 2–3 (2004), *at* http://www.chicagofed.org/news_and_conferences/conferences_and_events/files/job_loss_paper_woodbury.pdf (Sept. 2004).

[76] *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 2-3 (noting that all states finance the costs of unemployment insurance benefits by imposing payroll taxes, commonly called "contributions," on employers). A few states finance their unemployment insurance funds by imposing taxes on employees rather than on employers. *See id*. at 2-3.

[77] *Id*. at 2-7 to 2-9.

[78] *See* OHIO DEP'T OF JOB AND FAMILY SERVICES, CONTRIBUTION DATA (reflecting higher "new employer" tax rates in the construction industry), *at* http://jfs.ohio.gov/ouc/uctax/rates.stm (last visited Feb. 11, 2005).

[79] Lester, *supra* note 17, at 345; *see also* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 2-16 to 2-18.

[80] *See* Lester, *supra* note 17, at 345 n.34 (noting that the average rates in 1998 ranged from .32% to 3.85%); *see also* Bassi & McMurrer, *supra* note 70, at 1 (noting downward pressure on unemployment insurance tax rates as a result of jurisdictional competition among states).

[81] *See* Patricia M. Anderson & Bruce D. Meyer, *The Effects of the Unemployment Insurance Payroll Tax on Wages, Employment, Claims and Denials*, 78 J. PUB. ECON. 812 (2000) (finding that industry average unemployment insurance tax rates are passed on to workers in the form of lower wages, but that additional experience rating taxes are less effectively shifted to workers and that experience rating therefore reduces turnover and unemployment insurance claims); *see also* Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. DISP. RES. 735, 742 n.40 (2001) (noting studies that confirm that workers bear costs of employee-related taxes imposed on employers).

2. Medicare

Medicare is a federal public health insurance program created by amendments to the Social Security Act passed in 1965.[82] It is occasionally confused with Medicaid, a social assistance program.[83] Part A of Medicare provides hospital insurance to elderly Americans (individuals over sixty-five) who are eligible for general Social Security retirement benefits.[84] It also covers individuals of any age who are eligible for Social Security disability benefits for at least two years, individuals entitled to railroad retirement benefits, and individuals with some particular diseases.[85] Eligibility rules for Social Security retirement benefits in turn include workforce participation requirements similar to those in the unemployment insurance context. To be fully insured for Social Security retirement benefits, an individual must generally have worked for a total of ten years, *i.e.*, forty "quarters of coverage."[86]

Coverage under Medicare's Part A includes ninety days of hospital care for each benefit period,[87] plus a lifetime reserve of sixty days for hospital stays of more than ninety days. Covered hospital services include semi-private rooms, meals, nursing services, operating rooms costs, anesthesia services, intensive care, lab tests, x-rays, medical supplies, drugs, and some rehabilitation services.[88] These services must be "reasonable and necessary for the diagnosis or treatment of illness or injury or to improve the functioning of a malformed body member."[89] Part A Medicare also coinsures 100 days of nursing facility care per benefit period; a lifetime total of 190 days of treatment in psychiatric hospitals; certain home health care visits; and 210 days of hospice care.[90] Medicare's hospital insurance is primarily financed through payroll taxes paid by covered employees and employers.[91] Individuals who are not otherwise eligible can elect to purchase Medicare hospital insurance by paying a

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[82] *See* 2004 MEDICARE HANDBOOK 1-3 (Alfred J. Chiplin & Judith A. Stein eds., 2004) [hereinafter MEDICARE HANDBOOK 2004].

[83] *See* REJDA, *supra* note 31, at 13, 177–79 (noting that Medicaid is social assistance designed for individuals in poverty).

[84] 42 U.S.C. § 1395c (2000); MEDICARE HANDBOOK 2004, *supra* note 82, at 2-4; *see also* CTRS. FOR MEDICARE & MEDICAID, U.S. DEP'T OF HEALTH AND HUMAN SERVS., MEDICARE & YOU 2005 19 [hereinafter MEDICARE & YOU 2005], *available at* http://www.medicare.gov/Publications/Pubs/pdf/10050.pdf (last visited Apr. 3, 2005).

[85] 42 U.S.C. § 1395c; FTC Credit Practices Rule, 42 C.F.R. §§ 406.12–406.13 (2004); MEDICARE HANDBOOK 2004, *supra* note 82, at 2-4; *see also* REJDA, *supra* note 31, at 224.

[86] *See* 42 U.S.C. § 414(a)(2) (2000); STANLEY A. TOMKIEL, THE SOCIAL SECURITY BENEFITS HANDBOOK 140–41 (2001); SOCIAL SECURITY ADMIN., RETIREMENT & MEDICINE, *at* http://www.ssa.gov/r&m2.htm (last visited Feb. 11, 2005).

[87] *See* REJDA, *supra* note 31, at 225.

[88] *See* REJDA, *supra* note 31, at 225; *see also* MEDICARE & YOU 2005, *supra* note 84, at 19.

[89] MEDICARE HANDBOOK 2004, *supra* note 82, at 1-13.

[90] 42 U.S.C. § 1395d(b)(2)–(3) (2000). *See generally* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-13 to 1-19; REJDA, *supra* note 31, at 225–26.

[91] MEDICARE HANDBOOK 2004, *supra* note 82, at 1-6. Under Part A, employers and employees both pay 1.45% of the employee's covered earnings. *See* REJDA, *supra* note 31, at 233. Eligible self-employed individuals pay taxes in the amount of 2.9% of covered earnings. *Id*.

monthly premium. Furthermore, beneficiaries must pay a significant deductible to begin receiving Part A benefits upon falling ill;[92] they must pay a daily co-insurance if they require hospital services between sixty-one and ninety days;[93] and they must make a larger daily coinsurance payment for each lifetime reserve day they use.[94]

In addition to Medicare's hospital insurance, Part B Medicare provides Supplementary Medical Insurance (SMI), which covers various services not covered by Medicare's hospital insurance.[95] Individuals who are eligible for Part A Medicare hospital insurance are automatically enrolled for Part B unless they opt out of the program.[96] Other individuals who are eligible for Part B—including individuals sixty-five and older who do not retire or who otherwise do not qualify for Medicare hospital insurance—must opt in.[97] Individuals covered under Part B pay a monthly premium;[98] the program is also funded by some contributions by the federal government.[99] Part B of Medicare covers 80% of the "reasonable charge" of covered services,[100] which is often less than the actual charge for services. Furthermore, beneficiaries must pay a yearly $100 deductible for coverage under Part B.[101]

Medicare's Part C, the "Medicare+Choice" or "Medicare Advantage" program, created in 1997, allows Medicare beneficiaries to opt for coverage under private plans, preferred provider plans, and medical savings accounts.[102] Private plans under Part C can charge different co-insurance rates and deductibles than those that apply under Part A and B, and they may offer supplemental services for supplemental premiums.[103] Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Part D of Medicare will provide Medicare beneficiaries with assistance in paying for prescription drugs.[104] It will enable beneficiaries to purchase prescription drug benefits through private plans and will

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[92] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-14. The deductible was $876 in 2004. *Id.*; MEDICARE & YOU 2005, *supra* note 84, at 41 (setting forth deductibles for 2005).

[93] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-14 (noting that this amount was $219 per day in 2004); MEDICARE & YOU 2005, *supra* note 84, at 41.

[94] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-14 (noting that the amount was $428 per day in 2004); MEDICARE & YOU 2005, *supra* note 84, at 41.

[95] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-19. The most important services covered under part B are major non-inpatient services, medical equipment, outpatient therapy, lab tests, and some preventative care services. *Id*. at 1-20 to 1-21.

[96] *See* MEDICARE & YOU 2005, *supra* note 84, at 20; *see also* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-19.

[97] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-19.

[98] *Id*. (noting that the premium was $66.60 in 2004 and that it will increase yearly beginning in 2005); *see also* MEDICARE & YOU 2005, *supra* note 84, at 20.

[99] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-6.

[100] *Id*. at 1-19; *see also* MEDICARE & YOU 2005, *supra* note 84, at 25.

[101] *See* MEDICARE & YOU 2005, *supra* note 84, at 20 (noting that the yearly $100 deductible for coverage under Part B will rise to $110 in 2005); *see also* MEDICARE HANDBOOK 2004, *supra* note 82, at 1-19.

[102] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 7-7. *See generally* MEDICARE & YOU 2005, *supra* note 84, at 36 (providing a general overview of the Medicare Advantage plan).

[103] *See* MEDICARE HANDBOOK 2004, *supra* note 82, at 7-7.

[104] *Id*. at 1-4.

set deductible and co-insurance limits for those plans.[105]

In sum, Medicare primarily insures retired individuals who are also eligible for Social Security retirement benefits. It also provides benefits to other individuals who opt into one or more parts of the Medicare program. At least with respect to the former category, Medicare satisfies the strict definition of a social insurance program; it is to some extent—Part A—a mandatory program. Furthermore, individuals who are insured under Medicare bear some or all of the cost of coverage under the program. Not only do employees and self-employed individuals pay premiums, deductibles, and amounts of co-insurance for services under Medicare, but employers who contribute on behalf of their employees presumably pass some portion of those costs along to their employees.

3. Disability Insurance

There are a variety of public programs in the United States that effectively insure individuals against the risk of disability, the most prominent of which are the federal Social Security disability insurance program and state workers' compensation regimes. This section describes the federal disability insurance program as well as the handful of similar state programs; the next section discusses workers' compensation.

Social Security was expanded in 1956 to provide disability insurance for American workers with long-term disabilities. As with unemployment insurance, most employed individuals in the United States are nominally covered by the SSDI, but a much smaller fraction of these individuals are eligible for benefits if they suffer some form of disability.[106] First, the definition of disability under the program is relatively narrow; it applies to individuals who are unable to work in their previous positions and who cannot do other work as a result of their disability.[107] Their disability must be expected to last for at least one year or to result in death.[108] In addition, to be eligible for federal disability benefits, individuals must meet workforce participation requirements similar to those under unemployment insurance programs and Medicare.[109] The requirements are based on the dollar amount of wages earned in the periods prior to becoming disabled.[110] Younger workers, especially those under thirty, enjoy more generous workforce

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[105] *Id*. at 1-14.

[106] *See* GRAETZ & MASHAW, *supra* note 19, at 81.

[107] *See* REJDA, *supra* note 31, at 215; *see also* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, WHAT WE MEAN BY DISABILITY, *at* http://www.ssa.gov/dibplan/dqualify4.htm (last visited Feb. 11, 2005).

[108] REJDA, *supra* note 31, at 215; *see also* SOCIAL SECURITY ADMIN., *supra* note 107.

[109] *See* REJDA, *supra* note 31, at 215.

[110] *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, HOW MUCH WORK DO YOU NEED?, *at* http://www.ssa.gov/dibplan/dqualify2.htm (last visited Feb. 11, 2005). In 2004, for example, individuals received a "credit" for each $900 in wages they earn. They can receive up to four credits each year. To be eligible for SSDI, for example, individuals over sixty-two must have earned forty credits, twenty of which were earned in the ten years before becoming disabled. *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, HOW MANY CREDITS YOU NEED, *at* http://www.ssa.gov/dibplan/dqualify3.htm (last visited Feb. 11, 2005).

participation requirements than older workers.[111]

Eligible individuals are required, however, to wait for five months after the onset of their disability before federal disability benefits are available.[112] After the five-month waiting period, eligible individuals can receive monthly wage-replacement benefits that depend on the individual's average indexed previous monthly earnings.[113] Their spouses and unmarried children may be eligible to receive benefits as well.[114] These monthly benefits are paid until the individual returns to work at a significant level or recovers from his or her disability.[115] Disability insurance under the Social Security Act is financed by payroll taxes of 1.7% of covered earnings up to a maximum; employees and employers split the tax, while self-employed individuals pay the entire 1.7%.[116] As the foregoing description indicates, SSDI is essentially a partial wage-replacement program for members of the workforce who become disabled; it does not, for example, cover medical expenses related to beneficiaries' disabilities. As noted above, however, individuals under 65 who have received SSDI benefits for two years or more are entitled to Medicare benefits as well.[117]

A handful of states along with Puerto Rico have enacted temporary disability insurance programs.[118] These are designed to pay temporary short-term benefits to individuals who are unable to work as a result of a disability and who meet certain workforce participation requirements. Eligible beneficiaries generally receive one-half of their weekly wages, subject to minimum and maximum amounts.[119] There is generally a waiting period of a few days before eligible individuals can receive benefits under these programs.[120] Benefits are either paid out of a state fund or through contracts made by employers with private insurers, unions, or employees'

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[111] *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, HOW MANY CREDITS YOU NEED, *at* http://www.ssa.gov/dibplan/dqualify3.htm (last visited Feb. 11, 2005). While individuals between thirty-one and sixty-two must have earned twenty credits in the ten years before becoming disabled, the total number of credits required for eligibility decreases with age. Those between thirty-one and forty-two, for example, do not need to have earned more than twenty credits overall. Individuals under twenty-four need only earn six credits in the three years before becoming disabled. Those between twenty-four and thirty must have four credits for one-half the number of years between their age and twenty-one, *e.g.*, a twenty-five year old would need eight credits to be eligible (four times two years). *Id*.

[112] *See* REJDA, *supra* note 31, at 216; SOCIAL SECURITY ADMIN., DISABILITY PLANNER, WHEN YOUR BENEFITS START, *at* http://www.ssa.gov/dibplan/dapproval.htm (last visited Feb. 11, 2005).

[113] *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, HOW MUCH YOU WILL RECEIVE, *at* http://www.ssa.gov/dibplan/dapproval2.htm (last visited Feb. 11, 2005).

[114] *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, FAMILY BENEFITS, *at* http://www.ssa.gov/dibplan/dfamily.htm (last visited Feb. 11, 2005).

[115] *See* SOCIAL SECURITY ADMIN., DISABILITY PLANNER, WHAT CAN CAUSE BENEFITS TO STOP?, *at* http://www.ssa.gov/dibplan/dwork2.htm (last visited Feb. 11, 2005). Beneficiaries can receive benefits during a trial work period. *See* REJDA, *supra* note 31, at 218.

[116] REJDA, *supra* note 31, at 219; *see* Jonathan Barry Forman, *Whose Pension is it Anyway? Protecting Spousal Rights in a Privatized Social Security System*, 76 N.C. L. REV. 1653, 1656 n.12 (1998).

[117] *See supra* note 85 and accompanying text.

[118] *See* REJDA, *supra* note 31, at 237; Katherine Elizabeth Ulrich, *Insuring Family Risks: Suggestions for a National Family Policy and Wage Replacement*, 14 YALE J.L. & FEMINISM 1, 44 (2002).

[119] *See* REJDA, *supra* note 31, at 239.

[120] *See* REJDA, *supra* note 31, at 239; *see also* Ulrich, *supra* note 107, at 47.

associations.[121] These benefits are generally financed by payroll taxes paid by employees, although employers pay part of the tax in some jurisdictions.[122]

4. Workers' Compensation

Often overlooked in the panoply of social insurance programs, workers' compensation was one of the country's first of such programs.[123] It was forged at the state level at the turn of the century out of compromises between advocates for workers, who were becoming increasingly vulnerable to workplace injuries, and business interests, who were increasingly concerned about unpredictable litigation liabilities.[124] Today, every state has some form of workers' compensation program that covers most workers in most occupations.[125] Under these programs, a covered worker must suffer an accident or illness that arises out of his or her employment to be eligible for workers' compensation benefits.[126] Thus, as noted above, workers' compensation addresses an important segment of disability-related financial problems that confront some individuals in the United States.

For individuals who are eligible for workers' compensation, these benefits usually include medical care, disability income, death benefits, and rehabilitation benefits.[127] Benefits are generally determined as a percentage – usually near 70% – of a worker's weekly wage and by the degree of the worker's disability.[128] Many states, however, set maximum benefit amounts that effectively lower the wage replacement rate of workers' compensation with respect to many individuals.[129] Eligible workers under most programs can begin receiving disability benefits within three to seven days after an injury or illness.[130] Death benefits generally include

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[121] *See* REJDA, *supra* note 27, at 238.

[122] *See* Ulrich, *supra* note 118, at 45–46 (describing various funding methods, including contributions into pooled state funds, employers using private plans, contributions from employees, and imposition of payroll taxes, and explaining that such methods are often combined).

[123] For a wide-ranging study of the history of workers compensation laws in the United States, *see* JOHN FABIAN WITT, THE ACCIDENTAL REPUBLIC: CRIPPLED WORKINGMEN, DESTITUTE WIDOWS, AND THE REMAKING OF AMERICAN LAW 148–49 (2004); *see also* Robert J. Lampman & Robert M. Hutchens, *The Future of Workers' Compensation*, *in* NEW PERSPECTIVES IN WORKERS' COMPENSATION 113 (John F. Burton, Jr. ed., 1988) (describing workers' compensation as the nation's first social insurance program).

[124] *See* GRAETZ & MASHAW, *supra* note 19, at 82. *See generally* John Fabian Witt, *Toward a New History of American Accident Law: Classical Tort Law and the Cooperative First-Party Insurance Movement*, 114 HARV. L. REV. 690, 699–707 (2001).

[125] *See* GRAETZ & MASHAW, *supra* note 19, at 82; REJDA, *supra* note 31, at 264 (noting that farm workers and domestic employees are generally not covered by these laws).

[126] *See* REJDA, *supra* note 31, at 264–65; *see also* Jordan Yospe, *U.S. Industries v. Director: "Claim" Versus "Condition" in the Analysis of Workers' Compensation Cases*, 12 AM. J.L. & MED. 273, 273–75 (1986).

[127] *See* REJDA, *supra* note 31, at 265–67; *see also* Robert I. Correales, *Workers' Compensation and Vocational Rehabilitation Benefits for Undocumented Workers: Reconciling the Purported Conflicts Between State Law, Federal Immigration Law, and Equal Protection to Prevent the Creation of a Disposable Workforce*, 81 DENV. U. L. REV. 347, 358–62 (2003).

[128] REJDA, *supra* note 31, at 265; *see also* GRAETZ & MASHAW, *supra* note 19, at 84.

[129] *See* GRAETZ & MASHAW, *supra* note 19, at 84.

[130] *See* REJDA, *supra* note 31, at 265.

burial allowances and payments made to survivors.[131]

Workers' compensation programs are financed by premiums paid by employers. In many jurisdictions, smaller firms pay the same rate, while larger firms are subject to experience ratings similar in theory and in operation to those under unemployment insurance.[132] According to a 1996 study, costs to employers related to workers' compensation were approximately 2.61% of payroll.[133] Like other payroll taxes, a significant portion of these costs are passed on to labor.[134] In most states, workers' compensation laws are compulsory. In the few states where employers are allowed to elect whether to participate or not, most employers do participate; those who do not participate face unfriendly legal standards in lawsuits brought by injured workers.[135]

5. Spousal Support

Alimony, or spousal support, is different than the programs discussed in the foregoing sections in significant ways. As discussed below, it is debatable whether spousal support laws satisfy the conventional definition of social insurance. In any event, they are included in this discussion because of their potential relationship with consumer bankruptcy.

Because spousal support laws are often conceptually and practically confused with rules relating to disposition of marital property, it is important to distinguish the two. When a marriage is dissolved, the assets and debts of the spouses must be allocated between them. Marital property rules facilitate this process.[136] Spouses have significant freedom to influence or determine this allocation *ex ante* or *ex post* by agreement,[137] but courts have significant discretion to make this allocation in the absence of agreement between the former spouses.[138] The modern trend, however,

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[131] REJDA, *supra* note 31, at 267. *But see* Keith N. Hylton & Steven E. Laymon, *The Internalization Paradox and Workers' Compensation*, 21 HOFSTRA L. REV. 109, 172 (1992) (discussing limitations in state workers' compensation laws regarding burial expenses and benefits paid surviving spouses).

[132] *See* REJDA, *supra* note 31, at 268.

[133] *Id*. at 268 (citing 1998 WORKERS' COMPENSATION YEAR BOOK (Horsham, PA: LRP Publications, 1997), Table 2, p. I-34).

[134] *See supra* note 81 and accompanying text; Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 357 (noting that employers pass along workers' compensation costs in particular); *see also* Alice G. Abreu, *Untangling Tax Reform: Simple Taxes, Complex Choices*, 33 SAN DIEGO L. REV. 1355, 1396 (1996) (noting that employers pass economic burdens of payroll taxes to employees); Lior Jacob Strahilevitz, *The Uneasy Case for Devolution of the Individual Income Tax*, 85 IOWA L. REV. 907, 935–36 n.123 (2000).

[135] *See* REJDA, *supra* note 31, at 263.

[136] *See* WALTER WADLINGTON & RAYMOND C. O'BRIEN, DOMESTIC RELATIONS: CASES AND MATERIALS, 368 (5th ed. 2002); *see also* Carolyn J. Frantz, *Should the Rules of Marital Property be Normative?*, 2001 U. CHI. LEGAL F. 265, 267 (2004).

[137] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 370; *see also* Ralph C. Brashier, *Disinheritance and the Modern Family*, 45 CASE W. RES. L. REV. 83, 143–44 (1994); Michael S. Finch, *Choice-of-Law and Property*, 26 STETSON L. REV. 257, 261–62 (1996).

[138] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 369; *see also* Peter Nash Swisher, *The ALI Principles: A Farewell to Fault—But What Remedy for the Egregious Marital Misconduct of an Abusive Spouse?*, 8 DUKE J. GENDER L. & POL'Y 213, 223 n.62 (2001); Craig W. Dallon, *The Likely Impact of the*

appears to be toward a default rule that would divide marital property equally at divorce.[139]

Laws relating to alimony or spousal support are conceptually distinct from those governing the allocation of marital property. Spousal support laws are designed to provide financial support to a former spouse upon separation and/or divorce. Although the various state laws governing such support are not uniform, such laws aim to ensure that the spouse seeking support has necessaries such as food, clothing, habitation, transportation, and to help maintain the spouse's "station in life."[140] There are three main categories of alimony or support provisions: 1) temporary alimony, which is support or maintenance provided during the course of divorce or separation proceedings;[141] 2) permanent alimony, which is support provided in a judgment of separation or divorce;[142] and 3) rehabilitative alimony, which is support specifically designed to enable the recipient spouse to become self-sufficient.

As with rules relating to the division of marital property, spousal support is essentially a default regime; courts generally uphold prior agreements or settlements regarding support or maintenance.[143] In other words, most jurisdictions appear to honor settlements and pre-nuptial agreements that foreclose alimony or other forms of statutory or court-ordered support. In some jurisdictions, however, there appear to be significant limitations to the ability of individuals to contract around spousal support rules, and some courts may not be willing to enforce private agreements modifying spousal support rules if the modification would cause a spouse to become a "public charge."[144] To the extent that such private agreements are not enforceable, spousal support is properly understood as a mandatory or compulsory regime.

ALI Principles of the Law of Family Dissolution on Property Division, 2001 B.Y.U. L. REV. 891, 895 (2001).

[139] *See* Lara Lenzotti Kappalla, Comment, *Some Assembly Required: Why States Should Not Adopt the ALI's System of Presumptive Alimony Awards in Its Current Form*, 2004 MICH. ST. L. REV. 207, 214 (2004) (noting the modern trend of equally dividing marital property (citing AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS 24 (2000))).

[140] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 369; Kappalla, *supra* note 139, at 213–14.

[141] Temporary alimony is often referred to "alimony pendente lite" or "alimony ad interim." WADLINGTON & O'BRIEN, *supra* note 136, at 395; *see also* UNIFORM MARRIAGE AND DIVORCE ACT § 304(a), 9A U.L.A. 201 (1998) [hereinafter UMDA].

[142] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 396; *see also* UMDA § 308(a), 9A U.L.A. 347 ("In a proceeding for dissolution of marriage . . . the court may grant a maintenance order for either spouse only if it finds that the spouse seeking maintenance . . . lacks sufficient property to provide for his reasonable needs . . . .").

[143] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 520–21, 547–48; *see also* UMDA § 3(a)(4), 9C U.L.A. 43 ("Parties to a premarital agreement may contract with respect to . . . the modification or elimination of spousal support.").

[144] *See* WADLINGTON & O'BRIEN, *supra* note 136, at 547; *see also* Kristine Alton, *The Enforceability in California's Court of Premarital Agreements Containing Provisions Regarding Spousal Support*, 11 J. CONTEMP. LEGAL ISSUES 139 (2000).

6. Conclusion

With the exception of spousal supports laws, all of the legal regimes discussed above easily satisfy the conventional definition of social insurance. First, they are mandatory arrangements that shift at least some of the financial risk of the occurrence of particular events from individuals to some other entity. And second, each program effectively requires that the covered individuals bear some cost for this reallocation of risk *ex ante*. In the case of unemployment insurance and workers' compensation, employers bear the initial cost of their employees' coverage, but they pass much of that cost along to the employees. In the case of Medicare and disability insurance, employees pay some of the initial cost directly and presumably bear much of their employers' costs indirectly.

Spousal support differs from these other formal social insurance programs because individuals who benefit from these rules do not appear to bear any direct cost of this coverage *ex ante*. If they do not bear such costs, spousal support seems more like a social assistance regime, one funded by beneficiaries' former spouses. Also, like social assistance programs, spousal support is effectively means-tested to the extent that individuals do not receive spousal support if they have adequate means for support. Nonetheless, the inclusion of spousal support in this subsection is intended to underscore that, at the very least, such support serves a function very similar to social insurance programs. It provides a benefit that is designed to replace wealth or income lost as the result of a triggering event; it shifts some of the risks of marital dissolution from one spouse to another. Furthermore, as explained above, it is arguably a compulsory benefit in at least some jurisdictions. Finally, there is perhaps an uneasy case to be made that individuals do in fact bear some of the cost of their protection under support laws. It is possible to argue that such laws provide compensation for contributions a spouse makes to the marriage or to the other spouse.[145] To the extent that any of these theories of spousal support indicate that individuals in fact bear some cost for their protection under such laws, then these laws start to seem more analogous to social insurance. This article only proposes that spousal support regimes share characteristics of both social assistance programs and social insurance programs.

E. Functional Substitutes and Overlap

Because bankruptcy and the other programs described in the previous section respond to similar risks, it is reasonable to ask whether some of them are substitutes

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[145] *See, e.g.*, Ira Mark Ellman, *The Theory of Alimony*, 77 CAL. L. REV. 1, 3 (1989) (proposing a theory of alimony based on "societal policy of encouraging sharing behavior in marriage by requiring compensation, at divorce, for the loss in earning capacity arising from such sharing behavior."); Jana B. Singer, *Alimony and Efficiency: The Gendered Costs and Benefits of the Economic Justification for Alimony*, 82 GEO. L.J. 2423, 2453–60 (1994); Joan Williams, *Is Coverture Dead? Beyond a New Theory of Alimony*, 82 GEO. L.J. 2227, 2229 (1994). *See generally* Aspasia Tsaoussis, *Protecting Homemakers' Marriage-Specific Investments Under No-Fault Divorce: A Model for Restructuring Alimony in Civil Law Countries*, 6 AM. L. & ECON. REV. 217 (2004).

for each other; whether they actually overlap in functions; or both. For present purposes, programs are substitutes for each other if they serve the same social insurance function—if they effectively insure against the same risk. For example, disability insurance is potentially a substitute for unemployment insurance or public health insurance or both. The financial harms of a disability are primarily lost income or medical expenditures—recall David from above, who suffers from a medical condition that interrupts his wage income. Either disability insurance or unemployment insurance could theoretically be designed to insure him against the risk of wage interruption due to his disability. With respect to David's situation, these two programs could theoretically be substitute forms of wage insurance. Similarly, to the extent that David's disability causes him to incur medical expenses, disability insurance and health insurance would be potential substitutes.

Programs that are potential substitutes may or may not actually serve similar social insurance functions; and those that serve similar insurance functions may or may not overlap in operation. Programs serve similar social insurance functions if they actually insure individuals against the same type of financial loss. For example, if a disability insurance program in fact replaces income lost due to a disability, it serves a wage insurance function, similar to the wage insurance function of unemployment insurance programs. These programs will not overlap in operation unless both provide benefits to an individual to compensate for the same occurrence—if both replace wage income that a particular individual loses as the result of a disability.

Many of the non-bankruptcy programs described above do in fact serve similar social insurance functions. As currently designed, for example, disability insurance, workers' compensation, and unemployment insurance all serve wage insurance functions. Workers' compensation and Medicare both serve such health insurance functions, but disability insurance generally does not.[146]

Some of these programs do serve similar social insurance functions. For example, in some states, unemployment compensation will not be available to an individual who becomes unemployed as the result of a disability or illness.[147] As a result, unemployment insurance and disability insurance do not overlap in operation in these jurisdictions. Where unemployment insurance benefits are available to individuals who become unemployed due to a disability, the overlap of unemployment insurance and disability insurance programs is still minimized. The five- or six-month waiting period for federal disability insurance benefits[148] generally coincides with the period during which an individual may recover unemployment insurance benefits.[149] Thus, while individuals in some jurisdictions are insured against wage loss due to disability by both programs, they will generally

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[146] *See supra* text accompanying note 106 (noting that disability insurance benefits generally do not cover medical expenses).

[147] *See supra* note 63 and accompanying text.

[148] *See supra* note 112 and accompanying text.

[149] *See supra* note 73 and accompanying text.

not receive benefits from both at the same time.[150] In other contexts—where, for example, workers' compensation awards are deducted from disability benefits[151]—policies that avoid overlap in functions are more direct.

Thus, the design of the various non-bankruptcy social insurance programs may suggest that policy-makers have been at least somewhat attentive to the actual and potential relationships between these various programs. In recent years, a handful of legal scholars have increasingly focused on these relationships and the boundaries between existing social insurance programs. Professors Graetz and Mashaw's critical study of the American social insurance system is a notable example.[152] These authors have conducted a wide-ranging study of the social insurance system in the United States, identifying underlying normative impulses across the system and critiquing the overall design of various programs in light of those normative commitments.[153] In their view, a fundamental underlying purpose of social insurance programs is to protect individuals and their families against the effects of income loss due to the occurrence of various specific risks.[154] They recommend an array of innovative institutional reforms that they claim will provide better protection against the threat of income loss than the current institutional configuration.[155] While these authors acknowledge that a wide-variety of legal regimes serve social insurance functions,[156] the scope of their inquiry does not extend so far as to include the bankruptcy system. In fact, there is no mention of consumer bankruptcy in their otherwise comprehensive study.[157]

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[150] One important exception to this observation is the fact that unemployment insurance benefits can be extended beyond 26 weeks in some circumstances. *See* REJDA, *supra* note 31, at 312–13.

[151] *See id*. at 218 (noting the offset in social security benefits for workers compensation benefits or other disability benefits but also stating that private insurance benefits are not counted for offset purposes). Also, under state disability insurance programs, eligibility is generally not extended to individuals who are receiving workers' compensation or unemployment insurance. *Id*. at 239.

[152] *See* GRATZ & MASHAW, *supra* note 19.

[153] According to Professors Graetz and Mashaw:

> [A] careful, thoughtful, and detailed examination of particular programs and particular problems is necessary. But it has been a long time – about seven decades – since Americans have considered broadly what types of social insurance they want and how much they want to pay for those protections. There is a critical need to expand the conversation to try to make sense of our social insurance arrangements and to ask how existing programs relate to the overall purpose of cushioning economic risks in a capitalist society.

Id. at 6–7.

[154] *See id*. at 281–84.

[155] *Id*. at 163–278.

[156] *Id*. at 7–8 (noting that tax policies promoting private employment-based pensions and health insurance and individual retirement savings plans are part of the social insurance system broadly conceived).

[157] *See also* JACOB S. HACKER, THE DIVIDED WELFARE STATE: THE BATTLE OVER PUBLIC AND PRIVATE SOCIAL BENEFITS IN THE UNITED STATES (2002) (omitting bankruptcy from a comprehensive evaluation of public and private social welfare programs); MICHAEL B. KATZ, THE PRICE OF CITIZENSHIP: REDRESSING THE AMERICAN WELFARE STATE (2001) (discussing bankruptcy only in passing in the course of a comprehensive study of American social insurance and social assistance programs); REJDA, *supra* note 31 (overlooking bankruptcy in a comprehensive study of social insurance and social assistance programs in the United States).

In theory, bankruptcy protection is a potential substitute for almost any imaginable social insurance program. Consider again Amanda, who lost her job as a result of lay-offs.[158] In theory, individuals like Amanda could be insured against wage interruption through any number of different programs or legal regimes, including traditional unemployment insurance and a discharge of debts in bankruptcy. If Amanda receives unemployment insurance benefits, for example, these benefits will replace some of Amanda's lost income, enabling her to smooth her consumption to some extent. Extending to Amanda the right to discharge debts in bankruptcy should also enable her to smooth consumption somewhat. A discharge will enable her to avoid obligations that she cannot pay as a result of her loss of income. With some exceptions,[159] it will also enable her to retain new income that she receives after her spell of unemployment.[160] The availability of bankruptcy might also make it more appealing for Amanda to rely on credit during her period of wage interruption.[161] In other words, Amanda may be more willing to maintain some of her consumption during her wage interruption by borrowing money or purchasing goods and services on credit knowing that she can potentially discharge these obligations in bankruptcy. In the broadest sense, then, bankruptcy and unemployment insurance can potentially serve a similar wage insurance function for Amanda—provide her with insurance against the negative effects of unemployment.

A similar analysis applies to the other individuals we have been considering. Bankruptcy might effectively insure Cathy and David against the negative effects of their medical-related expenses, or Bob against the financial effects of his divorce. Bankruptcy relief might also help insure others from the negative financial effects of a disability. Thus, at least in theory, bankruptcy should be thought of as a potential wage insurance, health insurance, disability insurance, workers' compensation, and divorce insurance program rolled into one.[162] It is important to note that these do not exhaust the functions of consumer bankruptcy. In addition to these social insurance functions, scholars have argued that consumer bankruptcy also functions to limit liability for entrepreneurs and sole-proprietors.[163] It is also

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[158] *See supra* introduction to Part I.

[159] *See supra* note 40 (explaining that some debts are non-dischargeable). It is also important to note that bankruptcy law allows individuals to reaffirm debts that have been discharged in bankruptcy. *See generally* Marianne B. Culhane & Michael M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709 (1999); *see also* Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 130; Jacoby, *supra* note 14, at 292.

[160] *See* Braucher, *supra* note 3, at 1089.

[161] *See supra* note 48 and accompanying text.

[162] *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 330 (noting that debt relief is effectively insurance against a variety of risks, including illness, unemployment, and divorce). Bankruptcy also effectively insures against tort liability, *id*. at 334, but as noted above, this aspect of bankruptcy is beyond the scope of this article.

[163] *See* Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J.L. & ECON. 543 (2003). *But see* Teresa A. Sullivan et al., *Folklore and Facts: A Preliminary Report from the Consumer Bankruptcy Project*, 60 AM. BANKR. L.J. 293, 309 (1986) (suggesting that the bankruptcy system may fail to provide adequate debt relief to entrepreneurs).

possible that consumer bankruptcy promotes consumer spending, which may serve important macroeconomic functions.[164] Finally, it is possible that consumer bankruptcy functions to some extent as a form of social assistance, as opposed to social insurance, and helps some lower-income individuals negotiate the effects of poverty.[165]

Moving from the realm of theory to that of observation, it appears that bankruptcy does in fact serve the social insurance functions described above. In the last decade or so, there has been a quick upsurge of research into who files for bankruptcy and why.[166] According to one prominent empirical study of consumer bankruptcy filings, nearly two-thirds of debtors cite job interruption or job loss,[167] while 22% of individuals in bankruptcy cite family-related problems—including divorce—in the months leading up to their filing for bankruptcy.[168] That same study found that nearly 20% percent of debtors cite medical problems,[169] which in some cases were likely to be related to injury or disability.[170] Subsequent research has indicated that the percentage of individuals for whom medical problems are an important determinant of bankruptcy is even higher.[171] Available data suggest that a relatively small percentage of those who end up in bankruptcy do so simply because of reckless borrowing,[172] although it is reasonable to conclude that reckless consumption may make some individuals more susceptible to wealth and income shocks.[173] It is important to note that some scholars are skeptical of these findings, however, and debate over the determinants of bankruptcy continues to be robust.[174]

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[164] *See* Nathalie Martin, *Common-Law Bankruptcy Systems: Similarities and Differences*, 11 AM. BANKR. INST. L. REV. 367, 407 (2003) ("[A] free-market approach to consumer credit is balanced by a forgiving consumer bankruptcy system."); *see also* Dean M. Maki, *The Growth of Consumer Credit and the Household Debt Service Burden*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 43 (Thomas A. Durkin & Michael E. Staten eds., 2002) ("Consumer spending accounts for over two-thirds of the U.S. gross domestic product, and has been a key driver of the strong economic growth of the country has experienced since the early 1990s . . . ."). There has been relatively little research on the role of consumer credit in the economy. *See id.*

[165] *See, e.g.*, Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 352–53 (discussing the possibility that debt relief might help fight poverty as opposed to insure middle-class individuals against financial risks); *see also* Fisher, *supra* note 2, at 3 (finding that many individuals who file for bankruptcy also receive benefits from social assistance programs designed to address the effect of poverty, especially Aid to Families with Dependent Children). It is more likely that bankruptcy would serve this function for individuals who are making a transition to long-term poverty after a period of financial viability. It is at least possible that such individuals could benefit from discharging their debts despite the fact that they will not have meaningful future income or non-exempt assets to protect.

[166] *See* Westbrook, *supra* note 3, at 2124.

[167] *See* SULLIVAN ET AL., *supra* note 3, at 16.

[168] *Id*.

[169] *Id*.

[170] *Id*. at 157–62.

[171] *See* Jacoby, *The Debtor-Patient*, *supra* note 3, at 456–61 (discussing medical-related problems as a major determinant of bankruptcy); Jacoby et al., *supra* note 3, at 386–404.

[172] *See* MANN, *supra* note 49, at 32.

[173] *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 330 (citing Warren, *The Bankruptcy Crisis*, *supra* note 4, at 1081).

[174] *See generally* Zywicki, *supra* note 1 (challenging the "traditional" argument that rising bankruptcy rates primarily reflect social and economic problems).

Some writers have suggested that the causes of bankruptcy are likely to be more endogenous than recent empirical studies suggest.[175] If so, recent studies may underestimate the extent to which over-consumption causes people to become insolvent.

There are two important points to make in relation to these arguments over endogeneity and over-consumption. First, the fact that the causes of bankruptcy are at least somewhat endogenous does not undermine the claim that bankruptcy is a form of insurance. Many insurance arrangements cover risks that are endogenous. Collision insurance, for example, is expressly designed to cover losses that may be caused by the insured's negligent or reckless behavior.[176] These concerns are more properly addressed as concerns about moral hazard.[177] Second, and more important for present purposes, even the critics of recent empirical studies acknowledge that the causes of many bankruptcies are exogenous to some significant extent.[178] In doing so, they acknowledge the underlying insight of the empirical data – that bankruptcy does function, at least in part, as a form of wage insurance, divorce insurance, disability insurance, and health insurance. To the extent it does so, it is important to bear in mind that bankruptcy serves the same social insurance functions as unemployment insurance, Medicare, disability insurance, workers' compensation, and spousal support laws.

Given that bankruptcy does serve the same functions as other social insurance programs, it would be useful to know whether and how much these functions overlap. It is theoretically possible that bankruptcy does not overlap with any of these programs at all—that each particular wage insurance function is perfectly divided between bankruptcy and other programs. If beneficiaries of unemployment insurance or Medicare were not allowed to file for bankruptcy, for example, neither program would overlap with the bankruptcy system. In that case, bankruptcy and these regimes would still be providing insurance against similar financial risks, *i.e.*, serving similar social insurance functions, but they would be providing that insurance to entirely separate subsets of individuals. They would be providing mutually supplemental protection. As it turns out, these suppositions are counterfactual. Under current rules, the same individuals can simultaneously receive bankruptcy protection and unemployment insurance or Medicare benefits.[179] Unfortunately, there is very little available data regarding the extent to which the functions of bankruptcy and other social insurance programs overlap.

The conclusion that bankruptcy is a potential substitute for, supplements, and likely overlaps with functions of other social insurance programs begs a normative question of institutional design: What combination of these programs best serves

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[175] *See* Adler et al., *supra* note 2, at 589. *See generally* Zywicki, *supra* note 1.

[176] *See* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 331.

[177] *See infra* Part II.C.

[178] *See, e.g.*, Zywicki, *supra* note 1, at 11.

[179] In one study of a group of consumers, approximately 38% of individuals who filed for bankruptcy protection received income from at least one social insurance or social assistance program. *See* Fisher, *supra* note 2, at 3; Jacoby, *The Debtor-Patient, supra* note 3, at 480.

those social insurance functions that society is committed to providing? As noted above, some scholars of social insurance have addressed this question with respect to non-bankruptcy social insurance programs,[180] but they have not factored the role of bankruptcy into their evaluations. Bankruptcy scholars who have described consumer bankruptcy as an insurer of last resort, as the back-stop of a social safety net filled with "gaps," have implicitly acknowledged the question. But these scholars have not pursued the question by proposing the optimal boundaries between bankruptcy and other social insurance programs. If anything, they have tended to assume what the boundaries should be – that other programs like health insurance or unemployment insurance should be designed to protect individuals from exogenous risks as much as possible.

According to this account, filing for bankruptcy represents a failure of other regimes or social institutions, not a policy choice to insure at least some individuals through bankruptcy instead.[181] This perspective makes it difficult to appreciate that the social insurance system might be purposefully designed to allocate some significant functions to bankruptcy. In other words, society might prefer that certain individuals receive protection in bankruptcy rather than, or in addition to, benefits under other social insurance programs. As noted above, economists have recently begun to address this issue by exploring the potential for substitution between bankruptcy and other social insurance programs and the possible welfare effects of doing so.[182] Such initial work raises far more questions about institutional design than it answers, and this Article aims to help frame these questions.

II. COMPARING DESIGNS: BANKRUPTCY AND UNEMPLOYMENT INSURANCE

Determining the optimal role of bankruptcy in a broader social insurance system would require one to evaluate the allocation of functions across all existing and potential social insurance programs, including bankruptcy. This is an extremely complicated task; it is a problem with many different variables, each of which is difficult to analyze. Introducing bankruptcy into an analysis of the social insurance system will be especially complicated because, as noted above, bankruptcy is a substitute for almost every other social insurance program. This part takes a step in this direction by isolating the relationship between bankruptcy and one particular social insurance program; it compares the wage insurance functions of bankruptcy and traditional unemployment insurance. As explained above, both regimes serve wage insurance functions, and individuals may currently enjoy benefits under both to compensate for the same financial loss. This part aims to identify important factors of comparison and to suggest how, with perfect information, one might evaluate the relative costs of bankruptcy protection and

[180] *See supra* notes 153–54 and accompanying text.

[181] *See, e.g.*, Warren, *supra* note 4, at 1100–01; *see also* Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 358 (suggesting that some of these scholars may tend to view debt relief as a complement or supplement to other social insurance programs, rather than as a substitute).

[182] *See supra* notes 9–11 and accompanying text.

those of unemployment insurance. As explained below, these include public and private administrative costs; costs related to self-insurance; moral hazard; and costs to credit and labor.[183]

A. Administrative Costs

Any program that provides wage or unemployment insurance will necessarily entail some administrative costs. The entity in charge of administering such a program must design and maintain a process by which individuals secure benefits. It must verify the information that individuals provide, determine the benefit(s) they are entitled to receive, and then actually deliver the benefits in some manner. At least initially, these are public costs, although they might be allocated to private parties in some fashion. In addition to these public costs, however, beneficiaries themselves will inevitably have private costs associated with applying for and receiving their benefit. Other parties—employers who are responsible for paying insurance premiums, for example—may also have similar private administrative costs.

The public administrative costs of running a bankruptcy system include the costs of maintaining courtrooms, hiring judges and clerks and trustees, and managing significant amounts of paper work. These public costs are currently borne to some extent by federal taxpayers and in significant part by debtors who file for bankruptcy relief. Individual debtors must pay $209 to file for chapter 7 and $194 to file for chapter 13 bankruptcy protection.[184] There are additional fees for other proceedings in bankruptcy that debtors or other parties might initiate.[185] For the present purpose of comparing the cost of bankruptcy with that of unemployment insurance, it is important to bear in mind that only a portion of the public administrative costs of bankruptcy can be attributed to its wage insurance function.

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[183] This part does not address the possibility that either or both of these regimes could be reformed to reduce these costs in the first place. It is entirely possible that the costs of both systems could be reduced by internal reforms to each regime. Such reforms, if successful, would obviously alter the relative efficiency of the two regimes. This part only attempts to identify current costs for the purpose of proposing a framework for comparison.

[184] *See* 28 U.S.C. § 1930 (2000) (outlining fees including a $39 administrative fee and a $15 trustee fee for chapter 7 filers). For arguments about bankruptcy fees, see generally Rafael Efrat, *The Disadvantaged in Bankruptcy*, 19 BANK. DEV. J. 71, 74 (2002) (hypothesizing that filing costs, combined with the cost of an attorney, may disproportionately discourage disadvantaged groups from filing bankruptcy); Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 15 (1991); Otis B. Grant, *Are the Indigent too Poor for Bankruptcy? A Critical Legal Interpretation of the Theory of Fresh Start within a Law and Economics Paradigm*, 33 U. TOL. L. REV. 773 (2001); Nathaniel C. Nichols, *The Poor Need Not Apply: Moralistic Barriers to Bankruptcy's Fresh Start*, 25 RUTGERS L.J. 329 (1994). Reform legislation currently under consideration by Congress would expand opportunities for *in forma pauperis* filings for certain low-income debtors. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 418 (2005) (enacted).

[185] For a schedule of bankruptcy court fees, see NATIONAL CONSUMER LAW CENTER, CONSUMER BANKRUPTCY LAW AND PRACTICE 687 (2000). *See* 28 U.S.C. § 1930(b) (requiring fees for services performed by bankruptcy clerks); *see also* Karen Gross, *In Forma Pauperis in Bankruptcy: Reflecting on and Beyond United States v. Kras*, 2 AM. BANKR. INST. L. REV. 57, 61–62 (1994).

This is due to the fact that, as explained above, consumer bankruptcy serves a variety of insurance functions.[186] Furthermore, a large portion of the administrative costs of the bankruptcy system are attributable to corporate bankruptcies. A corporate bankruptcy is much more likely than a consumer bankruptcy to require judicial resources.

In addition to these public administrative costs, however, individual debtors in bankruptcy bear significant private administrative costs, especially the cost of legal counsel. Even in cases without controversy, it is often in an individual's interest to hire a lawyer. In fact, it appears that the majority of debtors hire a lawyer to help them file for bankruptcy relief.[187] According to one recent study, the cost of a lawyer for a personal bankruptcy case can be between $750 and $1,500.[188] Although the private administrative costs of bankruptcy to debtors may have decreased in recent years,[189] they appear to be significant. Furthermore, these costs do not begin to account for the litigation costs and other private administrative costs that creditors must pay when their debtors file for bankruptcy. Compared with the public administrative costs discussed above, it is easier to attribute such private costs to particular functions of bankruptcy such as wage insurance; they are costs that increase each time an individual debtor uses bankruptcy protection as a means of wage insurance.

If consumer bankruptcy is a combined administrative and judicial system, unemployment insurance programs are primarily administrative systems.[190] The various state unemployment insurance programs must hire staff to operate the various aspects of the programs—to process applications from unemployed individuals, to determine employer tax rates, to hear appeals from employers and applicants, to track benefits and beneficiaries, and to manage the state fund from which benefits are paid. The overall administrative costs of the system are

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[186] *See supra* note 162 and accompanying text.

[187] *See* F.H. Buckley & Margaret F. Brinig, *The Bankruptcy Puzzle*, 27 J. LEGAL STUD. 187, 196 (1998). In one sizable 1981 study, only 4% of debtors in bankruptcy did not hire a lawyer. TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 113 (1981). There is significant variation across districts, with the percentage of *pro se* filings in some districts reaching as high as 50%. *See* Susan Block-Lieb, *A Comparison of Pro Bono Representation Programs for Consumer Debtors*, 2 AM. BANKR. INST. L. REV. 37, 40–41 (1994).

[188] *See* SULLIVAN, *supra* note 3, at 11; *see also* Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 436–37 (1999) (observing that average attorney's fees fall approximately between $1,200 and $1,800). It is important to note that scholars can only estimate these costs. *See* Westbrook, *supra* note 3, at 2128–29 (noting that scholars do not have good data on how, or how much, bankruptcy lawyers get paid).

[189] While there is little firm evidence of decreasing costs, there are reasons to believe that they are in fact decreasing, including the increase in competition among bankruptcy lawyers in recent years. *See* Buckley & Brinig, *supra* note 187, at 195; *see also* David B. Gross & Nicholas S. Souleles, *An Empirical Analysis of Personal Bankruptcy and Delinquency* 1–2 (Wharton Fin. Inst. Center, Working Paper No. 98-28-B, 2001), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=209189 (Nov. 1, 1999).

[190] There is an administrative process for appealing decisions relating to unemployment insurance benefits and eligibility. *See* COMPARISON OF STATE UNEMPLOYMENT LAWS, *supra* note 59, at 7-1 to 7-6. The process generally requires individuals to appeal to administrative bodies before seeking judicial review. *Id*.

significant, an estimated $4 billion in fiscal year 2004.[191] As noted above, the federal government pays for most of the public administrative costs associated with the various state unemployment insurance programs. In fiscal year 2004, this amount is estimated to be $2.8 billion of the total administrative costs of unemployment insurance; the remaining $1.2 billion are federal administrative costs.[192] Given that 10.2 million individuals are expected to receive unemployment insurance benefits in that period,[193] the rough average public administrative cost per recipient will be approximately $400 in 2004.[194]

It appears that most of the private administrative costs of unemployment insurance currently fall on employers, who are generally required to register and regularly file reports with their state unemployment insurance programs.[195] It is reasonable to believe that employers may also incur accounting and legal costs in determining their unemployment insurance tax liabilities. In addition, beneficiaries of unemployment insurance do face some private administrative costs. They are required to fill out applications to receive their benefits, for example, and they are generally required to look for a job while they are receiving benefits. In some circumstances, individuals have disputes about eligibility with their state unemployment insurance programs.[196] They may expend time and resources appealing eligibility decisions to the programs. In some circumstances, these disputes will lead to private administrative costs.

B. Costs of Self-Insurance

Another significant set of factors affecting the direct costs of consumer bankruptcy and unemployment insurance are those related to self-insurance. As noted above, individuals may self-insure or co-insure against various risks by absorbing all or some of the financial losses that result if the risks materialize. By design, both bankruptcy and unemployment insurance require beneficiaries to self-insure or co-insure to some extent. The difference in the amount of risk they require individuals to bear is largely a function of the timing and the scope of benefits under each regime.

In the context of unemployment insurance, self-insurance costs will generally

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[191] OFFICE OF WORKFORCE SEC., U.S. DEP'T OF LABOR, UNEMPLOYMENT COMPENSATION: FEDERAL-STATE PARTNERSHIP 2 (2004) [hereinafter UNEMPLOYMENT COMPENSATION: FEDERAL-STATE PARTNERSHIP], *at* http://atlas.doleta.gov/unemploy/pdf/partnership2004.pdf (Nov. 2004).

[192] *See id*.

[193] *Id*.

[194] Because some of the administrative costs of the unemployment insurance programs are likely to be fixed costs, the actual marginal costs per recipient are likely to be lower than this number.

[195] *See, e.g.*, OHIO DEP'T OF JOB AND FAMILY SERV., EMPLOYER REGISTRATION, *at* http://jfs.ohio.gov/ouc/uctax/registering_as_an_employer.stm (last visited Feb. 11, 2005). In general, employers must report quarterly the number of their employees and wages paid. *See, e.g.*, OHIO DEP'T OF JOB AND FAMILY SERV., EMPLOYER'S CONTRIBUTION REPORT AND REPORT TO DETERMINE LIABILITY, *available at* http://www.odjfs.state.oh.us/forms/pdf/66105.pdf (last visited Feb. 11, 2005).

[196] *See, e.g.*, Jacoby, *supra* note 14, at 285–86 (discussing the potential costs of disputes over eligibility for social insurance programs in general).

amount to those costs required to supplement the benefit itself. To make this more concrete, recall Amanda who lost her job as a result of layoffs. Assuming that she is eligible for unemployment insurance benefits, she will receive no more than one-half of her wage income for up to twenty-six weeks immediately upon the interruption of her employment. This partial wage replacement should allow her to smooth her consumption, at least in part, until she begins receiving wage income again. To more perfectly smooth consumption during this period, she may need to rely on other sources of support such as savings, gifts, or credit. The cost of credit to her should be counted as a cost of Amanda's partial self-insurance. In fact, there is significant debate about the actual cost of consumer credit and a growing body of scholarship that raises concerns about the use of credit as a form of self-insurance.[197] Amanda's use of accumulated savings or perhaps even her sense of

[197] There are (at least) three significant issues in contemporary debates about consumer credit—the cost of consumer credit generally, trends toward over-indebtedness, and the role of credit cards as a mode of consumer finance. All three topics are inextricably linked. First, it is not clear whether overall consumer finance costs have increased or decreased. *Compare* Mann, *supra* note 49, at 8 (noting the initial lower cost structure of credit card lending), *with* TAMARA DRAUT & JAVIER SILVA, DEMOS, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE '90S 13 (2003) [hereinafter BORROWING TO MAKE ENDS MEET] (noting deregulation of consumer finance industry removed rules designed to limit costs and protect individuals from unfair cost structures), *available at* http://www.demos-usa.org/pubs/borrowing_to_make_ends_meet.pdf (Sept. 2003). Second, there is increasing concern that too many individuals are becoming "over-indebted." *See, e.g.*, Braucher, *supra* note 3, at 1068, 1072 (discussing concerns about "over-indebtedness" and arguing that the use of credit to self-insure is particularly risky when individuals are already carrying a high debt load). But this observation begs a question—what is the appropriate level of indebtedness for any particular individual. *See* Hynes, *supra* note 25, at 134. Without resolving this underlying question, scholars point to two likely reasons that people become over-indebted. The first is that behavioral factors lead people to misjudge how much credit they should obtain. *Id*. at 134–35. The second is that the credit industry encourages individuals to borrow when it is not in their interest to do so, particularly by promoting the use of credit cards. *See* SULLIVAN, *supra* note 3, at 134–40; Lawrence M. Ausebel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 251 (1997); *see also* BORROWING TO MAKE ENDS MEET, *supra*, at 9–11. For good studies of credit card usage and policy, see Mann, *supra* note 49; Joanna Stavins, *Credit Card Borrowing, Delinquency, and Personal Bankruptcy*, 2000 NEW ENG. ECON. REV. 15, 18. Finally, there is significant debate about whether credit card lending is more likely to lead to bankruptcy than other forms of consumer finance. *See* Mann, *supra* note 49, at 32 (noting that it is difficult to establish causal links between credit card usage and bankruptcy). In fact, it has been difficult for scholars to determine the relationship between debt and bankruptcy. *See* Zywicki, *supra* note 1, at 10–14 (noting that expansion of credit markets has increased individuals' susceptibility for bankruptcy but questioning the direct correlation between high debt load and bankruptcy filings); *see also* Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79 (2002) (arguing that "the analytical premises that underlie the purported link between credit cards and bankruptcy are suspect"). The issue is complicated by disagreement over how to measure debt loads in the first place. *See* Thomas A. Durkin, *Discussion of Lenol Calder, The Evolution of Consumer Credit in the United States*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 36, 40 (Thomas A. Durkin & Michael E. Staten eds., 2002) [hereinafter IMPACT OF PUBLIC POLICY] (noting that consumer credit as a ratio of net worth has remained constant over 4 decades). *But see* Maki, *supra* note 164, at 43 (noting that household debt is at a record high relative to disposable income); Robert M. Lawless, *The Relationship Between Nonbusiness Bankruptcy Filings and Various Basic Measures of Consumer Debt* (2004) (noting a lack of strong correlation between service burden and rates of bankruptcy filings, but a strong relationship between overall debt and filings), *at* http://www.law.unlv.edu/faculty/rlawless/busbkr/body_filings.htm (last modified Jan. 10, 2004).

For a broad perspective on these questions, see Lendol Calder, *The Evolution of Consumer Credit in the United States*, *in* IMPACT OF PUBLIC POLICY, *supra*, at 23–32 (discussing two "myths" of consumer obligation stemming from gifts may also be properly understood as costs of self- or co-insurance.

The self-insurance costs of bankruptcy protection are more complicated to evaluate; by design, they are likely to be more significant than those of unemployment insurance. This is primarily due to the fact that individuals are generally able to benefit from bankruptcy relief only after they reach the point of insolvency or significant financial distress.[198] Imagine, for example, that bankruptcy protection is Amanda's only form of wage insurance. In this case, she will need to self-insure entirely until the point that she becomes insolvent or can otherwise benefit from bankruptcy protection. In other words, Amanda's bankruptcy protection is premised on her inability to adequately self-insure and her subsequent financial collapse. This means, first of all, that she will incur many of the same forms of self-insurance costs—especially credit costs—as she would incur if she received partial wage replacement via unemployment insurance. Because she will be receiving no replacement income upon becoming unemployed, these costs will likely be greater as creditors will determine that she presents a greater default risk.

More important, however, is the fact that Amanda's financial collapse may itself hinder Amanda's ability to earn income and return to solvency. Financial collapse creates its own costs.[199] It often gives rise to obligations like late fees, default penalties, finance charges, and utility reconnection fees. If an individual loses his or her car or home to creditors, he or she will likely incur a host of transaction costs in having to spend time and resources to find substitute transportation or a new place to live. The time needed to arrange these replacements may be especially valuable to a person who is also looking for a new job or wanting to work more hours at a current job. Finally, financial collapse creates additional intangible costs, especially emotional costs. Such costs may be hard measure, but they are important to consider.[200] The emotional burdens of financial collapse have economic consequences, consequences that in some cases may be greater than the direct, immediate effects of wage disruption. They may lead to medical problems, both physical and psychological. Such burdens may also place acute stress on important social relationships. They may lead to marital problems and they may also negatively affect an individual's productivity.

C. Moral Hazard

As discussed above, the availability of insurance tends to give rise to moral

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credit—the myth of credit as great democratizer and the myth of lost economic virtue—and proposing a third story, that the modern development of consumer credit reflects "regulated abundance" and a rise of "budgetism").

[198] *See supra* text accompanying notes 45–48.

[199] *See* Mann, *supra* note 49, at 30.

[200] *See, e.g.*, Braucher, *supra* note 3, at 1077–78 (noting the emotional and social costs of debtors with high debt burdens); Hallinan, *supra* note 2, at 130; Jacoby, *The Debtor-Patient*, *supra* note 3, at 476–77 (discussing the connection between financial distress, emotional stress, and health problems); *see also* John C. Akard, *The Human Side of Bankruptcy*, 18-1 AM. BANKR. INST. J. 28, 28 (Feb. 1999).

hazard—the hazard that an insured may have less incentive to make an effort to avoid the risk or to minimize losses if losses occur.[201] Bankruptcy scholars have long recognized the potential moral hazard created by the availability of bankruptcy relief.[202] The availability of bankruptcy relief presumably decreases individuals' incentives to constrain their consumption and to avoid incurring obligations that they may not be able to repay. This effect may be strongest in the period immediately before an individual files for bankruptcy protection; once an individual expects to actually obtain a discharge in bankruptcy, they may have particularly weak incentives to be careful in taking on financial obligations.[203] Furthermore, bankruptcy also potentially decreases individuals' incentives to make the strongest efforts to repay obligations they have incurred once they experience financial troubles. These factors are arguably exacerbated by the fact that bankruptcy is a no-fault regime. Any individual who resides, is domiciled, or has property in the United States can file for bankruptcy under chapter 7.[204] The availability of bankruptcy relief is generally not related to the reasons for an individual's financial collapse; with few exceptions, it is equally available to the spendthrift as it is to the honest but unfortunate debtor.[205]

Various aspects of bankruptcy law are designed to counteract the potential moral hazard created by the availability of bankruptcy relief.[206] As noted above, debtors must pay filing costs to enter bankruptcy.[207] They must also give up non-exempt assets to their creditors to receive a discharge of debts under chapter 7.[208] Both of these requirements function as the equivalent of a deductible.[209] As noted above, such a deductible operates like an equity cushion—it reallocates some of the risk of loss back to the insured party and improves that individual's incentives to try to avoid or mitigate losses.[210] Complicating this analysis, it is worth noting that most bankruptcies are in fact no-asset chapter 7 bankruptcies; nearly all individuals who file for chapter 7 have no non-exempt assets to turn over to creditors.[211] Where a debtor does not have to turn over any assets to creditors, chapter 7 arguably

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[201] *See supra* notes 21–23 and accompanying text.

[202] *See, e.g.*, Adler et al., *supra* note 2, at 589–90; Athreya & Simpson, *supra* note 2, at 3; Hallinan, *supra* note 2, at 100–03; Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 329–31.

[203] *See supra* note 48 and accompanying text (noting that some eve-of-bankruptcy debts are non-dischargeable).

[204] *See* 11 U.S.C. § 109(a) (2000); 2 COLLIER ON BANKRUPTCY ¶ 109.01 (15th ed. 1979). Reform legislation currently under consideration by Congress would limit the availability of chapter 7 relief with respect to individuals whose income, excluding certain deductions, would enable them to pay a significant portion of their unsecured claims. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 102 (2005) (enacted).

[205] As noted *supra* note 53, however, relief may be denied in cases of "substantial abuse."

[206] *See* Hallinan, *supra* note 2, at 103–04; Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1427–28 (1985).

[207] *See supra* note 185 and accompanying text.

[208] *See supra* notes 148–49 and accompanying text.

[209] *See* Hallinan, *supra* note 2, at 103.

[210] *See supra* note 23 and accompanying text.

[211] *See* Braucher, *supra* note 3, at 108; Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 326–27 (noting that unsecured creditors yield nothing in 95% of chapter 7 cases).

includes no deductible function. Since they do not bear a portion of the risk of default in the form of their own assets, their incentives to avoid the risk of financial collapse are arguably not improved.

It is possible, however, that the chapter 7 deductible reduces the effects of moral hazard in other, less visible ways. It is difficult, if not impossible, to determine, for example, how many individuals make successful efforts to avoid bankruptcy because they have non-exempt assets they would have to turn over in chapter 7. It is possible that there are many individuals who fit this description who might otherwise be likely candidates to file for bankruptcy protection. In fact, some of the individuals who currently file for protection under chapter 13 may fall into this category.[212]

There are other aspects of bankruptcy and bankruptcy law that also counteract the potential moral hazard associated with bankruptcy relief. For example, most debtors who receive a discharge of debts in bankruptcy are barred from receiving another discharge within six years.[213] To the extent that an individual is informed about this limitation on re-filing and can evaluate the possibility that he or she will want bankruptcy protection again within the next six years, this limitation should affect his or her incentives to avoid insolvency or to file for bankruptcy in the first place. In addition to the formal limit on refiling, filing for bankruptcy may adversely affect an individual's ability to obtain credit in the future. Filing for bankruptcy becomes part of an individual's credit history,[214] reflecting an increased risk of default to potential creditors. While many creditors will lend to individuals who have recently filed for bankruptcy,[215] receiving a discharge in bankruptcy should raise the cost of credit for that individual; in some cases, it may prove a bar

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[212] *See* Adler et al., *supra* note 2, at 586 n.7 ("The data clearly suggest that . . . Chapter 13 debtors are protecting asset holdings by their choice of chapter." (quoting Ian Domonwitz & Robert L. Sartain, *Incentives and Bankruptcy Chapter Choice: Evidence from the Reform Act of 1978*, 28 J. LEGAL STUD. 461, 472 (1999))). *But see* Michelle J. White, *Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Bankruptcy Law and a Proposal for Change*, 65 U. CHI. L. REV. 685 (1998) (arguing that debtors can easily convert non-exempt assets into exempt assets).

[213] *See* 11 U.S.C. § 727(a)(8)–(9) (2000). This limitation applies by its terms to debtors who file under chapter 7 after having debts discharged under chapter 7, and, in many circumstances, under chapter 13 as well. It does not explicitly apply to subsequent cases under chapter 13, and courts have allowed debtors to file subsequent cases under that chapter. *See, e.g.*, Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 165 (noting that pending reforms to bankruptcy law may alter these rules); *see also In re* Baker, 736 F.2d 481, 482 (8th Cir. 1984); *In re* Ciotta, 4 B.R. 253, 254 (Bankr. E.D.N.Y. 1980). Reform legislation currently under consideration by Congress would increase the six-year limit on refiling to an eight-year limit. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 312 (2005) (enacted).

[214] *See* 15 U.S.C. § 1681c(a)(1) (2000) (prohibiting credit reporting agencies from including a prior bankruptcy in an individual's credit history after 10 years has passed from date of adjudication); Hynes, *Why (Consumer) Bankruptcy?*, *supra* note 2, at 162; *see also* Ronald C. Claiborne, *Credit Reports and the Fair Credit Reporting Act*, 28 J. MARSHALL L. REV. 365, 367 (1995).

[215] *See* NAT'L. BANKR. REV. COMM'N, FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS 94 (1997), *available at* http://govinfo.library.unt.edu/nbrc/reportcont.html (Oct. 20, 1997); Braucher, *supra* note 3, at 1067.

to borrowing at all.[216] To the extent that individuals are aware that filing for bankruptcy will increase the cost or decrease the availability of credit to them in the future, this awareness may diminish the moral hazard of bankruptcy.

Finally, there are certain social and emotional consequences of filing for bankruptcy protection that may also counteract the moral hazard of bankruptcy relief. As noted above, individuals are often subject to negative social and/or emotional effects of their financial collapse.[217] In contemplating the possibility of bankruptcy, individuals may experience some degree of shame based on personal or cultural values associated with honoring obligations. Furthermore, filing for bankruptcy is often a very public and unambiguous admission of financial trouble or failure. An individual who files for bankruptcy may experience, or worry about experiencing, some form of social stigma as a result of filing. Regardless of whether these social and/or emotional aspects of bankruptcy are based on reasonable beliefs and assumptions, they likely create incentives to avoid filing for bankruptcy, even when it would be economically desirable for them to do so.[218] While it is possible that the stigma associated with bankruptcy is decreasing,[219] it still appears to be a significant factor in the motivations of individuals facing insolvency.

Like bankruptcy, unemployment insurance presumably gives rise to moral hazard.[220] Workers who know they can receive unemployment insurance benefits may have weaker incentives to try to avoid becoming unemployed. They may not try as hard to be productive at work because they know they will likely receive compensation if they are fired; they may tend to shirk responsibilities, or, if possible, they might opt not to work at all. Perhaps more important, individuals who are receiving an unemployment insurance benefit may not search as hard for a new job as they would if the benefit were not available.

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[216] In fact, the effect of a prior bankruptcy in an individual's ability to obtain credit is not well understood. According to one early study, some individuals find it harder to obtain credit after filing for bankruptcy, but many are able to make major purchases. *See* Scott Fay et al., *The Bankruptcy Decision: Does Stigma Matter?* 8 (Search Term Begin Univ. of Mich., Dep't of Econ., Working Paper No. 98–01, 1998), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=70915 (Jan. 1998); *see also* DAVID T. STANLEY & MARGORIE L. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 62–63 (The Brookings Study, 1971).

[217] *See supra* note 200 and accompanying text.

[218] Most individuals who default on debts do not file bankruptcy. *See* Hynes, *supra* note 25, at 139. This may be evidence of psychological factors that discourage people from filing for bankruptcy who might otherwise benefit from doing so. *See generally* John M. Czarnetzky, *The Individual and Failure: A Theory of Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393 (2000). In recent years, a number of scholars have considered the effect of stigma and/or shame on individuals' decisions whether or not to file for bankruptcy protection. *See, e.g.*, Buckley & Brinig, *supra* note 187, at 196; Fay, *supra* note 216.

[219] *See* Buckley & Brinig, *supra* note 187, at 194 (concluding that increased bankruptcy filings may be attributed to a decline in social sanctions); A. Mechele Dickerson, *America's Uneasy Relationship With the Working Poor*, 51 HASTINGS L.J. 17, 41 (1999) (noting a decline in bankruptcy social stigma); Fay, *supra* note 216, at 8–11; Judge Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 B.Y.U. L. REV. 177, 215–21 (noting a decline in social stigma associated with bankruptcy).

[220] *See* Lester, *supra* note 17, at 364; Sachin S. Pandya, Note, *Retrofitting Unemployment Insurance To Cover Temporary Workers*, 17 YALE L. & POL'Y REV. 907, 914 (1999); Michael Rappaport, *The Private Provision of Unemployment Insurance*, 1992 WIS. L. REV. 61, 88–92.

Traditional unemployment insurance programs are designed to mute these effects on employees' incentives in a variety of ways, primarily through rules governing individuals' eligibility to receive benefits. As noted above, benefits are only available to individuals who are involuntarily unemployed; they are generally not available to workers who quit their jobs voluntarily.[221] This largely removes the possibility that an individual might choose to quit his or her job based on the availability of unemployment insurance. Furthermore, benefits are not available to individuals who are fired for cause. If an individual is inclined to engage in strategic behavior to become unemployed and receive benefits, they run the risk of being fired for cause. In addition to the requirement of involuntariness, individuals must satisfy the workforce participation provisions described above to be eligible for unemployment insurance benefits.[222] These requirements likely reduce the incentives that individuals might have to work for a period of time simply for the purpose of qualifying for unemployment insurance benefits.

The fact that unemployment insurance is only a partial insurance regime also presumably reduces the potential moral hazard that the insurance coverage creates because it operates as a rather severe co-insurance requirement. Co-insurance, like a deductible, reallocates some of the risk of insurance back upon the insured.[223] As noted above, individuals who are eligible for unemployment insurance benefits can receive up to one-half of their prior income, subject to a maximum, for up to 26 months.[224] These limitations effectively function as a co-insurance requirement because an individual who receives a wage replacement benefit of no more than half of their previous weekly income effectively co-insures to the extent of no less than half of his or her income. This is a relatively high co-insurance amount, and it is fair to presume that it has a significant effect on individuals' incentives to rely on unemployment insurance.[225] Finally, unemployment insurance programs also address potential moral hazard problems by requiring that beneficiaries look for a new job while they are receiving unemployment compensation.[226] The significance of this provision varies across jurisdictions, however, because it appears that some states enforce this requirement more rigorously than others.[227]

D. Macroeconomic Costs

Both consumer bankruptcy and traditional unemployment insurance programs create certain macroeconomic costs. Social insurance programs inevitably impose a tax, or the equivalent of a tax, on some segment of the economy—federal tax

[221] *See supra* note 63 and accompanying text.

[222] *See supra* notes 64–68 and accompanying text.

[223] *See supra* note 23 and accompanying text.

[224] *See supra* notes 71–73 and accompanying text.

[225] *See, e.g.*, Hynes, *Non-Procrustean Bankruptcy*, *supra* note 2, at 342 (noting that the limited wage replacement for unemployment insurance will not likely motivate an individual to quit work if he or she is required to repay some of his or her debts).

[226] *See supra* note 69 and accompanying text; *see also* Pandya, *supra* note 220, at 908.

[227] *See* Klepinger, *supra* note 69, at 4.

payers, consumers, employers, corporations, etc.—to fund the benefit or relief that the program provides. As noted above, the individuals or entities that bear the initial burden of the tax may internalize the cost, or they may in turn pass that burden along to other segments of the economy. In the case of bankruptcy, creditors bear the initial burden of bankruptcy relief as obligations owed to them by debtors in bankruptcy may be discharged or otherwise altered.[228] Voluntary creditors presumably pass most, if not all, of this burden along to current or future debtors in the form of higher interest rates. To the extent that they do, the effect of bankruptcy protection is to increase the cost of credit to individuals and/or reduce its availability in the economy in general. In the case of unemployment insurance, the initial cost of insurance benefits falls upon employers, who pay taxes that fund state unemployment insurance benefits. Employers pass along most, if not all, of this tax upstream to labor in the form of lower wages or fewer jobs.[229] What they cannot pass along to labor, they either internalize or pass downstream to consumers in the form of higher prices. Thus, the broad economic effects of traditional unemployment insurance are presumably increased prices for consumers and lower wages or fewer jobs for employees.

The relative macroeconomic effects of bankruptcy and of unemployment insurance are extremely difficult to evaluate. First, it is hard to determine these effects with respect to each regime independently. Second, assuming the first calculations can be made, it will be very hard to make a relative assessment. This will essentially entail determining whether a particular tax on labor is more disruptive than a particular tax on credit. It will also entail determining whether it is easier or harder under one program or the other to pass the costs along to the beneficiaries of the program. Despite such complications, comparing such effects is extremely important to evaluating the relative efficiency of bankruptcy and unemployment insurance as wage insurance programs. It is worth noting that these macro-economic costs could, in theory, be equalized. This could be accomplished by altering the financial underpinnings of either or both programs, *e.g.*, by financing unemployment insurance through a tax on credit or by financing debt relief with a tax on labor.

E. Conclusion

To analyze the relative efficiency of substitute social insurance programs, it is necessary to consider the various costs that each program entails. Eventually, this analysis should be applied across the social insurance system, providing comparisons among and between all programs that serve similar social insurance functions. This part has proposed a set of relevant points of comparison of the costs of consumer bankruptcy and unemployment insurance in particular. These include public and private administrative costs, costs of self-insurance, moral hazard, and

[228] *See supra* notes 39–40 and accompanying text.
[229] *See supra* note 81 and accompanying text.

costs of taxing labor and credit. This part has aimed only to propose an informal framework for comparing these costs and to identify important topics for subsequent research.

The analysis of this section suggests that it would be especially useful to obtain reliable data about private administrative costs of bankruptcy, especially legal costs of debtors and creditors, as well as the direct and indirect collateral costs associated with financial distress. Policymakers should also seek to better understand the effects of the moral hazard of bankruptcy and unemployment insurance and to better gauge the economic effects that these programs have on credit and labor, respectively. With more data regarding such costs, policymakers should be able to evaluate the strengths and weakness of these two programs as instruments for providing partial wage insurance. The following part expands on the normative dimension of this comparison by proposing various policy implications that might flow from the analysis proposed above.

III. POLICY IMPLICATIONS

Assuming that it is possible to compare the relative efficiency of bankruptcy and unemployment insurance as wage insurance programs, the comparison should point toward a more efficient design of social wage insurance in the United States. Given the foregoing analysis, it should be clear that the overall costs of these two programs are interrelated. Because they are substitutes to some extent, it is possible that some of the costs of providing bankruptcy relief can be shifted to the unemployment insurance system and vice versa. Such a shift of costs is presumably desirable if it causes overall costs of providing wage insurance to decline. This part explains how information about the relative costs of bankruptcy and unemployment insurance might be useful in considering the allocation of wage insurance functions between them. In other words, considering the relative costs of each program, if society wants to provide Amanda with a measure of wage insurance, should it prefer to extend to her an unemployment insurance benefit or the right to discharge her debts in bankruptcy if she becomes insolvent or some combination of both? Or, viewing the question from an *ex ante* perspective: If Amanda could choose to be insured against wage interruption through either program or both, what form of insurance would she prefer?

This part considers the potential reallocation of wage insurance functions in detail and the allocation of other insurance functions more briefly. As with the previous part, it considers the relationship between bankruptcy and each other social insurance program in isolation, acknowledging that this is counterfactual. For the sake of introducing the bankruptcy variable into the evaluation of the broad social insurance system, this part oversimplifies the tasks of allocating various social insurance functions and of designing the optimal social insurance system. It follows, then, that the analysis of this part is illustrative and not conclusive.

A. Allocating the Wage Insurance Function

Empirical comparison of bankruptcy and unemployment insurance may reveal that some wage insurance functions should be allocated from one regime to the other. Consider, for example, the unlikely possibility that unemployment insurance benefits are universally more efficient than bankruptcy at insuring against wage interruption. In that case, society might prefer to provide wage insurance exclusively through unemployment insurance benefits. To effect this change, policymakers might dramatically increase the scope of eligibility for unemployment insurance programs and increase the amount of benefits that are available to eligible workers under those programs. It is also possible that society might want to limit the bankruptcy relief available to these individuals. Now consider the equally unlikely possibility that the wage insurance function of bankruptcy is univerally more efficient than unemployment insurance. In that case, policymakers might prefer to eliminate unemployment insurance altogether, perhaps also increasing the relief available in bankruptcy to provide the optimal level of wage insurance.

It is probably not the case that either bankruptcy or unemployment insurance is universally more efficient than the other at providing wage insurance. For reasons explained above and below, it is more likely that unemployment insurance is the preferable wage insurance vehicle for some individuals in some situations and that bankruptcy is preferable for others. It is likely that for some individuals, some combination of the two is preferable. Thus, as explained below in more detail, there are good reasons to believe that an optimal system of social wage insurance would allocate some wage insurance functions to bankruptcy and some to traditional unemployment insurance. Assuming this to be the case, the difficult task for scholars and policymakers is to determine the appropriate boundaries between the two regimes—the appropriate allocation of wage insurance functions across bankruptcy and unemployment insurance.

To accommodate the uncertainty about the actual relative costs and efficiency of the two programs, this part provides an informal analysis under two different assumptions. The first assumption is that the direct costs (excluding moral hazard and the effects of taxing labor and credit) of bankruptcy significantly exceed those of unemployment insurance. The second assumption reverses this relationship—it assumes that the direct costs of unemployment insurance significantly exceed those of bankruptcy.

1. Assumption #1: Costly Bankruptcy

If the direct costs of bankruptcy significantly exceed those of unemployment insurance, this raises the possibility that society should prefer to reallocate some or all of the wage insurance function of bankruptcy to unemployment insurance programs. In other words, some of the individuals who are currently being insured against wage interruption through bankruptcy might be more efficiently insured through traditional unemployment insurance. This section proposes that one way to effect this would be to increase the scope of the latter. By increasing the scope of traditional unemployment insurance, some increased number of individuals will presumably be able to weather financial distress and avoid financial collapse. These individuals should not ultimately need bankruptcy protection; they will be "exported" from the bankruptcy system.

Increasing the scope of unemployment insurance would require either increasing unemployment insurance benefits or relaxing eligibility requirements for benefits or both. The generosity of benefits and the eligibility rules of unemployment insurance are the subject of long-standing policy debates surrounding the efficiency of these various aspects of existing unemployment insurance programs.[230] This article does not aim to resolve any of these long-standing debates. Rather, it proposes that, in addressing such questions, scholars and policymakers have generally neglected to consider the fact that unemployment insurance and consumer bankruptcy are effectively substitute wage insurance programs. In other words, they have not fully accommodated the likelihood that limiting the scope of unemployment insurance shifts costs to bankruptcy. If the relationship between these regimes were taken into consideration, the grounds of debate over the scope of unemployment insurance might change significantly. With that in mind, this section considers whether and how society might increase the scope of unemployment insurance in a world where bankruptcy is, at least with respect to some individuals, an inefficient wage insurance program. To increase the scope of unemployment insurance benefits, state programs might replace a larger percentage of beneficiaries' lost wage income than they currently do or they might provide benefits for a longer period of time.

a. Increasing Unemployment Insurance Benefits

Consider the possibility of 1) increasing the period during which an individual could receive unemployment benefits and/or 2) increasing the percentage of wage replacement available under unemployment insurance. In theory, and based on the limited available evidence, there are reasons to believe that these reforms would enable a certain number of individuals to avoid filing for bankruptcy who would otherwise do so. According to the only empirical study of potential substitution between bankruptcy and unemployment insurance, for example, an increase in average unemployment insurance benefits of 8% would lead to a decrease of bankruptcy filings of approximately 3.3%.[231] Assuming that these reforms succeeded in exporting some individuals from bankruptcy, they would allow those individuals to avoid bankruptcy-related costs.

These savings in bankruptcy costs would have to be evaluated against any possible increase in costs related to the expansion of unemployment insurance benefits. First, such reforms would presumably increase the moral hazard of unemployment insurance. They would presumably decrease individuals' incentives to avoid becoming involuntarily unemployed. Perhaps more important, these

[230] *See supra* notes 63–64, 69–70 and accompanying text.
[231] Fisher, *supra* note 2, at 16–17.

reforms would also dampen their motivation to find new employment once they begin receiving benefits. Second, these reforms would also presumably increase the cost to labor and consumers of funding unemployment insurance. Assuming that any increase in benefits was funded through increased payroll taxes, and assuming that most of those costs will be passed on to labor, workers would pay a premium for the increase in benefits.

If the increased costs of such a premium, added to the increase in moral hazard costs, exceed the savings in bankruptcy-related costs, then these reforms would presumably not be desirable. It seems possible, however, that a modest increase in the duration of benefits or in the amount of wage replacement under unemployment insurance programs could efficiently export some individuals from bankruptcy. In a world where bankruptcy costs are high as compared to unemployment insurance costs, it is possible, for example, that the savings to society of exporting 3.3% of bankruptcy filers to unemployment insurance would be greater than the additional cost of increasing unemployment insurance benefits by 8%.

b. Relaxing Unemployment Insurance Eligibility Requirements

State programs could also dramatically increase the scope of unemployment insurance by relaxing their eligibility requirements. For example, states could relax the requirement that individuals be involuntarily unemployed to receive benefits. As discussed above, with certain limited exceptions, individuals who voluntarily quit their jobs are currently not eligible for unemployment insurance benefits.[232] Like the other measures discussed above, such a reform would likely enable some percentage of individuals who would otherwise end up in bankruptcy to avoid financial collapse in the first place. Again, however, the savings of doing so would have to be weighed against a likely increase in moral hazard costs and costs to labor. A program that extended benefits to all voluntarily unemployed individuals, for example, would likely create untenable moral hazard costs. Under such a regime, many individuals would rationally decide to quit their jobs in exchange for temporary, partial wage replacement. Yet more moderate measures are available. State unemployment insurance programs could, for example, marginally increase the scope and/or number of existing exceptions to the requirement. Currently most states extend eligibility for unemployment insurance to individuals who quit their jobs if they do so for good cause.[233] Some states consider circumstances such as illness, marriage or domestic responsibilities.[234] Other states might adopt these definitions of good cause and even expand them to include such circumstances as divorce or the illness of a relative.

To relax eligibility requirements, unemployment insurance programs could also loosen the workforce participation requirements of the current system. As noted

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[232] *See supra* note 63 and accompanying text.
[233] *See supra* note 63 and accompanying text.
[234] *See supra* note 63 and accompanying text.

above, these requirements provide that individuals must have earned a certain amount of income in the period before they become unemployed to be eligible for benefits.[235] Programs could allow individuals who have earned a smaller amount of income during the period before their unemployment to be eligible for benefits. Such changes would presumably extend eligibility to individuals who would be ineligible under current rules, especially temporary and low-wage workers and individuals who recently joined the workforce.[236] Like increasing the scope of unemployment insurance benefits, relaxing workforce participation requirements would presumably allow some individuals to avoid filing for bankruptcy and thereby save bankruptcy-related costs. Again, in a world where bankruptcy is relatively costly, relaxing unemployment insurance eligibility requirements would be desirable up to the point that the costs of such reform outweigh the savings in bankruptcy-related costs.

There are reasons to suspect that the moral hazard costs of relaxing workforce participation requirements would be less than those created by increasing the scope of benefits of unemployment insurance or by relaxing the involuntariness requirement. As noted above, workforce participation requirements likely increase individuals' incentives to strategically obtain employment for a brief period to become eligible for unemployment benefits.[237] But the incentive to obtain a job for the purpose of becoming eligible for unemployment insurance benefits may be a rather attenuated moral hazard to begin with. The greater hazard, it seems, is that individuals will strategically quit, or try to get fired from, jobs they already have. It stands to reason, therefore, that the involuntariness requirement is a much more important balance against moral hazard.

If it is true that the workforce participation requirements serve as a more modest balance against moral hazard, then conservatively loosening them would probably not significantly increase the moral hazard associated with unemployment insurance. It is true that by increasing the number of individuals who are eligible for unemployment insurance benefits, however, such reforms would increase the number of individuals who are affected by *other* moral hazards of unemployment insurance—incentives to become unemployed, for example, or to avoid searching for new work. In addition, the additional funds needed to provide benefits to newly eligible individuals would presumably lead to increased costs to labor. In sum, despite these potential costs there appear to be reasons to think that modest reforms to the involuntariness requirement and to workforce participation rules are better ways to reallocate functions from bankruptcy to unemployment insurance than increasing the generosity of benefits.

c. Decreasing the Scope of Bankruptcy Protection

[235] *See supra* notes 64–68 and accompanying text.
[236] *See supra* notes 63–70 and accompanying text.
[237] *See supra* notes 64–68 and accompanying text.

If society wants to attempt to reallocate some wage insurance functions from the bankruptcy system to unemployment insurance programs, reforming some aspects of bankruptcy law may also facilitate this process. Ideally, these reforms should target those individuals who currently file for bankruptcy relief as a result of wage interruption and should not affect other functions of bankruptcy protection unless doing so is desirable for other reasons. Consider, for example, the possibility of decreasing the availability of bankruptcy protection for individuals who receive unemployment insurance benefits—either completely or for a period of time. Under such a rule, if an individual receives unemployment insurance benefits, his or her ability to file for bankruptcy might be limited or certain debts might become non-dischargeable. Especially if coupled with an increase in the scope of unemployment insurance benefits, such a rule may assist in reallocating wage insurance functions to the unemployment insurance system.

One significant potential problem with bankruptcy reforms designed to reallocate wage insurance functions to unemployment insurance is that they are likely to be too blunt for their own purpose. As suggested above, the optimal allocation of wage insurance functions will most likely include both unemployment insurance and bankruptcy protection. In an optimal system, these regimes would probably overlap with respect to at least some individuals. In other words, it is very likely that it will be efficient for some individuals to receive unemployment insurance benefits and still file for bankruptcy protection. Reforms designed to prohibit this result, or to make it unfeasible, would probably only be desirable if all wage insurance functions are to be allocated to unemployment insurance. It would be particularly difficult to design reforms to bankruptcy law that would target only those beneficiaries of unemployment insurance who should not benefit from bankruptcy relief as well. At the very least, any such effort would first require identifying those beneficiaries, which, as this article indicates, is a very complicated endeavor.

Furthermore, limiting bankruptcy protection to unemployment insurance beneficiaries runs the risk of distorting individuals' decisions about filing for unemployment insurance benefits in the first place. For these reasons, reforms to bankruptcy law specifically designed to export individuals to unemployment insurance may be too unwieldy to be effective. Although this part has isolated the relationship between unemployment insurance and bankruptcy, it is worth re-emphasizing that bankruptcy is a substitute for various other social insurance programs. Any broad changes to bankruptcy law, including those embodied in the present bankruptcy reform legislation, will have to be evaluated with respect to numerous programs and regimes that serve social insurance functions.

2. Assumption #2: Relatively Costly Unemployment Insurance

If the direct costs of unemployment insurance are significantly greater than those of bankruptcy, then society may want to consider reallocating some wage insurance functions from the former to the latter. Predictably, this is exactly the opposite goal as the one considered in the previous section. It might be achieved by decreasing the scope of unemployment insurance or by increasing the scope of bankruptcy relief or by doing both of these.

a. Decreasing the Scope of Unemployment Insurance

As detailed above, the existing social insurance system allocates significant wage insurance functions to bankruptcy by limiting the scope and availability of unemployment insurance.[238] Society relies on bankruptcy to provide wage insurance to individuals who do not meet the eligibility requirements of unemployment insurance, for example, to those who become voluntarily unemployed, and to those who need more insurance protection than the benefits provided under unemployment insurance programs. It should be possible to allocate additional functions to bankruptcy by further limiting the scope of unemployment insurance. Society could, for example, decrease the amount of wage replacement available with unemployment insurance, decrease the duration of benefits, tighten workforce participation requirements, and/or eliminate exceptions to the involuntariness eligibility requirement. These reforms would likely result in an increase in the number of individuals who would need to rely on bankruptcy protection to be insured against wage interruption. In a world where the administrative costs of unemployment insurance are greater than those of bankruptcy, limiting the scope of the former would be desirable so long as the savings in unemployment insurance costs outweigh increases in other bankruptcy-related costs.

As explained above, using bankruptcy as wage insurance requires individuals to absorb the financial effects of lost income up until the point that bankruptcy would become either necessary or financially viable. Limiting eligibility for unemployment insurance will predictably increase the extent of self-insurance against wage interruption. Individuals who must self-insure to a greater extent will likely rely on additional debt; as discussed above, self-insurance through the use of credit entails significant costs.[239] Decreasing the scope of unemployment insurance will also predictably lead more people to experience financial distress or collapse. This, in turn, would lead to increased costs related to financial collapse. Also, increasing the appeal or the likelihood of bankruptcy might increase moral hazard costs. As noted above, individuals may have weaker incentives to be careful in taking on credit as bankruptcy becomes a more probable event.[240] Finally, if more individuals experience financial distress and end up defaulting on obligations, this would presumably result in further increases in the cost of credit.

Decreasing the scope of unemployment insurance might be desirable if the resulting bankruptcy-related costs discussed in this section are not overwhelming. It is reasonable to suspect that dramatic decreases in the scope of unemployment

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[238] *See supra* notes 63–70 and accompanying text.
[239] *See supra* note 197 and accompanying text.
[240] *See supra* note 48 and accompanying text.

insurance might trigger overwhelming bankruptcy costs. Imagine reducing the duration of unemployment insurance benefits by more than half, for example. Such a change would presumably make many individuals significantly more vulnerable to financial collapse in the wake of wage interruption. Modest decreases in benefits or narrowing of eligibility requirements under unemployment insurance are more likely to yield a more optimal balance of wage insurance functions in a world where unemployment insurance is relatively costly.

b. Increasing the Scope of Bankruptcy Protection

In theory, an increase in the scope of bankruptcy protection should lead to decreased reliance on unemployment insurance.[241] As bankruptcy provides individuals with more protection against the effects of wage interruption, they should need to rely less on unemployment insurance.[242] If so, increasing the scope of bankruptcy protection is a potential strategy for reallocating wage insurance functions from unemployment insurance programs to bankruptcy. The scope of bankruptcy protection might be increased by making exemptions from collection more generous or by limiting provisions that make some obligations non-dischargeable. Making student loan or taxes generally dischargeable, for example, would dramatically increase the scope of bankruptcy protection.

Consider the possibility of increasing the generosity of rules exempting assets from collection under either state or federal law.[243] Increasing these exemptions should theoretically make bankruptcy more appealing to individuals who currently have assets that they would have to turn over in chapter 7,[244] especially if these were exemptions under federal law and not state law.[245] If these individuals file for

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[241] *See* Fischer, *supra* note 2, at 17.

[242] To better imagine this, consider an individual, like Amanda, who has become unemployed. That individual may be disinclined to begin work that pays less than her unemployment insurance benefits, especially if these are her only form of insurance benefits. As bankruptcy relief becomes more appealing, this individual may be more inclined to take that job and forego her unemployment insurance benefits.

[243] For a review of the literature on exemptions, see Hynes & Posner, *supra* note 41, at 188–90 (discussing and evaluating studies that suggest that exemptions do not have a significant effect on bankruptcy filing rates). *See also* Reint Gropp, Karl Scholz & Michelle J. White, *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. ECON. 217 (1997); Andreas Lehnert & Dean Maki, *Consumption, Debt and Portfolio Choice: Testing the Effect of Bankruptcy Law* 3 (Fed. Reserve Bd., Fin. and Econ. Series, No. 2002-14, 2002), *at* http://www.federalreserve.gov/pubs/feds/2002/200214/200214pap.pdf (Feb. 20, 2002); Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1 (1987). Regardless of whether exemptions have affected bankruptcy filing rates, they certainly help determine the degree of debt relief an individual can receive in bankruptcy. *See* Hynes & Posner, *supra* note 41, at 190. Furthermore, it is hard to measure the effect of exemptions on filing rates because individuals can take advantage of exemptions without filing for bankruptcy. *See id*. at 189.

[244] As noted *supra* in note 212 and accompanying text, most individuals who file for chapter 7 have no non-exempt assets. This may be partly due to the fact that some individuals do not file for bankruptcy because they have non-exempt assets.

[245] *See* Hynes & Posner, *supra* note 41, at 189. Otherwise, individuals could take advantage of these exemptions without filing for bankruptcy. For the same reason that this Article does not consider the relative merit of bankruptcy and other forms of debt relief, it does not mean to propose that federal exemptions are preferable to state law exemptions.

bankruptcy protection in the wake of wage interruption, their need for unemployment insurance benefits will presumably decrease. In this way, increasing exemptions should facilitate reallocating wage insurance functions to bankruptcy from unemployment insurance. Bankruptcy scholars have addressed and debated normative concerns over increasing exemptions. Yet scholarship in this area has failed to consider the significant overlap in function between bankruptcy, unemployment insurance, and other social insurance programs. In a world of costly unemployment insurance, it is possible that increasing exemptions would reduce the overall cost of the social insurance system. This may make such reforms more desirable than existing scholarship would suggest. Once the relationship between bankruptcy and the larger social insurance system is fully appreciated, debates over exemption levels should be revisited.

Of more immediate concern, attempts to import individuals to the bankruptcy system from unemployment insurance will face some threshold problems in the form of formal and informal obstacles to bankruptcy protection. These include the social stigma historically associated with filing for bankruptcy[246] and bankruptcy filing costs.[247] Both of these factors may affect individuals' decision to file for bankruptcy protection by making it less appealing or cost-prohibitive to do so. As noted above, these threshold hurdles presumably reduce moral hazard costs by improving individuals' incentives to avoid bankruptcy.[248] Yet, they may have an even greater effect for some individuals. Some individuals may fear stigma to a degree that they will not file for bankruptcy even when it is clearly in their interest to do so. Similarly, filing costs may be high enough to preclude individuals from obtaining bankruptcy relief. For bankruptcy to function properly as a form of social insurance, it is important that the decision about whether to file for protection not be distorted. Individuals should file for relief when it is an efficient way for them to respond to wage interruption or other risks. If stigma or filing costs or other threshold factors primarily determine the decision as to whether or not to file for bankruptcy, there is a significant risk that bankruptcy will not adequately serve whatever social insurance functions are allocated to it. This is a general problem with the design of bankruptcy law, but it is one that becomes more significant as more social insurance functions are allocated to the bankruptcy system.

3. Conclusion

Determining *how* to reallocate wage insurance functions will be at least as difficult as determining whether to do so in the first place. Each reform discussed above presumably creates a set of additional costs and a set of savings. Choosing from among these reforms requires a careful assessment and calibration of these costs and savings. Also, it is entirely possible that the actual process of reallocating

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[246] *See supra* notes 219–20 and accompanying text.
[247] *See supra* note 184 and accompanying text.
[248] *See supra* notes 207–09, 219–20 and accompanying text.

functions may be difficult. Currently, the relationship between bankruptcy and unemployment insurance is poorly understood, and it is impossible to predict with confidence which mechanisms will most effectively shift beneficiaries and functions from one to the other. This part has suggested that the most promising mechanisms for doing so are changing the scope of unemployment insurance and changing the generosity of exemptions that apply in bankruptcy.

B. Allocating Other Social Insurance Functions

Any broad reform of the social insurance system will inevitably require a comparison of the relative efficiency of bankruptcy and other social insurance regimes such as Medicare, disability insurance, and alimony. Comparing the relative costs of these programs and bankruptcy should suggest ways in which various other social insurance functions might be reallocated. Although this Article does not explore the relationship between bankruptcy and these other programs at length, the following sections briefly elaborate a few particular issues that would likely arise in assessing the allocation of insurance functions between bankruptcy and these various programs.

1. Medicare

As explained above, Medicare primarily provides public health insurance to retired individuals who qualify for Social Security benefits.[249] Currently, a significant amount of public health insurance functions are allocated to the bankruptcy system.[250] A comparison of the relative costs of bankruptcy and Medicare might suggest that some of these functions should be allocated to Medicare or some other public health insurance initiative.

As with unemployment insurance, health insurance functions could likely be reallocated from bankruptcy to Medicare by increasing the scope of the latter, *e.g.*, by relaxing eligibility requirements or by increasing the generosity of benefits. If more individuals received Medicare benefits, or if beneficiaries received more generous benefits, presumably some additional number of individuals would avoid filing for bankruptcy. As with the analysis above, any benefits gained by avoiding bankruptcy costs would have to be weighed against any increases in Medicare-related costs. Shifting health insurance functions from bankruptcy to Medicare would presumably increase the moral hazard costs of the latter.[251] Doing so would also likely require an increase in business or payroll taxes, assuming they were used to finance the increased scope of Medicare. This would presumably impose

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[249] *See supra* note 84 and accompanying text.

[250] *See supra* notes 168–71 and accompanying text.

[251] *See* Bruce C. Vladeck, *The Struggle for The Soul of Medicare*, 32 J.L. MED. & ETHICS 410, 412 (2004) (noting debates over moral hazards and other problems with health insurance); *see also* Gary T. Schwartz, *The Beginning and the Possible End of the Rise of Modern Americans Tort Law*, 26 GA. L. REV. 601, 693 (1992) (explaining that the moral hazard of Medicare is excessive utilization of medical services).

additional costs on labor. As noted above, however, if such taxes represent too great a cost to labor, an increase in the scope of Medicare could be financed through other means, including federal tax revenues.

It is at least theoretically possible that an optimal design of public health insurance would reallocate functions from Medicare to bankruptcy. The most straightforward way to do this would be to decrease the scope of Medicare by narrowing eligibility requirements and/or by decreasing benefits. This prospect is more difficult to evaluate than the possibility of decreasing the scope of, say, unemployment insurance. While unemployment insurance replaces income, health insurance is designed to make medical care available to individuals. Bankruptcy is primarily valuable as a form of health insurance to the extent that individuals will be able to smooth consumption and purchase medical care on credit. Predictably, some individuals will not be able to do so without more direct intervention. If bankruptcy is the only form of social insurance available and an individual cannot obtain credit, he or she will presumably not be able to smooth consumption and may not be able to purchase necessary medical goods or services. While the inability to smooth consumption in general is worrisome, the inability to purchase necessary medical goods and services may be much more so.[252] Thus, normative commitments unrelated to efficiency may significantly limit the extent to which health care insurance can be allocated to the bankruptcy system.

2. Disability and Workers' Compensation

According to one study, all public and private disability insurance benefits combined replace about 25% of income lost to disability.[253] It is particularly difficult to determine what disability insurance functions the bankruptcy system is currently serving because it is hard to distinguish debtors who suffer disabilities from those who suffer illness in the available data. Also, as with wage and health insurance, there is no available data on the relative efficiency of bankruptcy and other existing disability insurance programs. Assuming such data were available, the process of reallocating disability insurance functions would likely be similar in most respects to that of reallocating wage insurance functions. This is true to the extent that disability benefits generally provide wage replacement but not medical expenses. As with other programs we have considered, allocating more functions to disability insurance would most likely be best accomplished by extending the scope of coverage federal and/or state disability programs. This would be desirable if the costs of additional disability insurance coverage are less than the savings in bankruptcy-related costs. Increasing the scope of disability insurance programs would presumably increase the cost of labor if financed through payroll taxes and

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[252] *See, e.g.*, Jacoby, *The Debtor-Patient*, *supra* note 3, at 462–65, 477–78 (discussing the difficulties that some individuals may have securing medical goods and services before, during, and after filing for bankruptcy protection).

[253] GRAETZ & MASHAW, *supra* note 19, at 84. For a general discussion of non-bankruptcy disability insurance programs, see *id*. at 82–87.

would presumably increase moral hazard costs.

There are reasons to believe, however, that the increase in these moral hazard costs might be less than the increase in similar costs of unemployment insurance considered above. The occurrence of a disability is arguably less endogenous than involuntary unemployment (*i.e.*, it is less within the control of the insured). Even if the causes of disability are fully endogenous, it is reasonable to believe that many (if not most) people would rather avoid becoming disabled than receive a partial wage replacement. If the moral hazard costs of traditional disability insurance are in fact relatively low, this increases the potential for efficiently allocating disability insurance functions away from bankruptcy to programs such as federal disability insurance and workers compensation.

3. Alimony

The relationship between spousal support and bankruptcy is much more complicated than most of the issues addressed above. The precise aims of spousal support are probably more context-specific than most of the other programs addressed in this article. This is perhaps reflected in the fact that these laws are largely default rules, not mandatory provisions. Thus, it will be exceptionally difficult to evaluate the relative costs of insuring individuals against marital dissolution through spousal support laws and insuring them through bankruptcy.

Assuming that it is possible to evaluate these costs, it will also be difficult to determine how these functions might be efficiently reallocated. It would be especially hard to measure or anticipate the effects of increasing or decreasing the scope of protections under spousal support laws. For one thing, the cost of such support is currently borne by an individual—the beneficiary's former spouse—who may or may not be able to absorb or pass along increased support responsibilities. Furthermore, any expansion of benefits under spousal support laws would be subject to contrary agreements between spouses unless support is to become a mandatory rather than a default benefit. The question of whether and how to limit the ability of spouses and former spouses to reach agreements and settlements on issues relating to support raises thorny normative questions that extend well-beyond the informal efficiency analysis of this article.

With these caveats aside, this article aims to raise basic questions about whether it is desirable and/or possible to reallocate functions between spousal support laws and bankruptcy. Whether or not spousal support laws satisfy the conventional definition of social insurance, there is strong evidence that such rules are potential substitutes for bankruptcy protection, and do serve functions that overlap with bankruptcy. Both regimes function at least in part to insure spouses against the financial risk of separation or marital dissolution. As with the other programs discussed in this article, policy-makers should determine whether the current allocation of these divorce insurance functions is optimal. If it is not optimal, this may create a strong presumption that these functions should be reallocated.

C. Comparative Insights

As some writers have noted, there appear to be recognizable comparative patterns in the social and economic role of bankruptcy.[254] As a general rule, countries that tend to have generous social safety nets also tend to grant relatively weak protections under bankruptcy law; countries with generous bankruptcy relief (mostly the United States) tend to have markedly more modest social safety nets.[255] These observations seem to have implications for the analysis that this article proposes—that as long as bankruptcy relief in the United States is generous, other social programs will be modest; as those programs become more robust, bankruptcy relief will be scaled back. In the foregoing sections, this article implicitly contemplates that such a dynamic might exist. As noted above, if it is desirable to reallocate wage insurance functions from bankruptcy to unemployment insurance or vice versa, it may also be desirable or necessary to limit benefits currently available under one of these programs. If so, this would be consistent with the broad comparative patterns; bankruptcy protection would expand in scope as other safety net programs contract or vice versa.

There are good reasons to be skeptical that the general comparative rule applies in full force with respect to the United States. This is primarily due to the fact that consumer bankruptcy in the United States may serve some functions that are not core social insurance functions. As noted above, for example, consumer bankruptcy may provide a form of limited liability function for entrepreneurs and sole proprietors.[256] There are also reasons to believe that bankruptcy relief supports high levels of consumer spending, an important component of the American economy.[257] To the extent that bankruptcy serves these functions, they may provide independent reasons not to limit the scope of bankruptcy protection in this country.

Thus, it is entirely possible that, even if society decides to reallocate social insurance functions from bankruptcy to other programs, it may not want to change the broad, general contours of bankruptcy protection. For these and other reasons discussed above, this article shies away from considering broad reforms to bankruptcy law. Such changes may ultimately be required to efficiently allocate social insurance functions in the United States, but any confident assessment about this should probably wait until bankruptcy has been comprehensively evaluated with respect to all of the major American social insurance programs.

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[254] *See, e.g.*, Efrat, *supra* note 37, at 82–91.

[255] *See id*.; *see also* Martin, *supra* note 164, at 407–08 (suggesting that consumer bankruptcy in the United States substitutes for the more expansive social safety nets in other countries that have less generous bankruptcy protection). *But see generally* HACKER, *supra* note 157 (questioning the conventional wisdom of "American exceptionalism" with regard to social welfare expenditures and arguing that, when private social benefits are considered, total welfare-related expenditures in the United States are similar to those in other affluent countries).

[256] *See supra* note 163 and accompanying text; *see also* Efrat, *supra* note 37, at 81 (proposing that the scope of bankruptcy protection adopted by a country is largely affected by efforts to promote entrepreneurship).

[257] *See supra* note 164 and accompanying text.

CONCLUSION

This article has aimed to introduce and elaborate on some of the challenging questions that flow from the basic observation that bankruptcy is a form of social insurance. It has framed a set of basic questions designed to help determine the appropriate role of consumer bankruptcy within the American social insurance system. First, it is necessary to determine precisely what social insurance functions bankruptcy can and does perform. Current empirical research into the determinants of bankruptcy is useful in answering this question. Based on existing research it appears that bankruptcy primarily insures individuals against the financial effects of wage interruption (due to various problems including layoffs, disability, sickness, etc.), medical problems, and family/marital dissolution. Hopefully, information about these determinants will be refined over time, and scholars will be in a better position to clearly understand these functions of bankruptcy and the relationships between them. Second, it is necessary to identify other programs and regimes that can and do serve similar functions. As explained above, these include unemployment insurance, Medicare, disability insurance (including workers' compensation), and alimony. With additional data, it should be possible to determine the extent to which bankruptcy currently overlaps in function with these other programs. It would be helpful, for example, to have more comprehensive information about how many individuals who receive benefits from other programs also file for bankruptcy and what benefits debtors in bankruptcy receive or have received from these programs. Third, policymakers should attempt to evaluate the relative efficiency of these various programs, including bankruptcy. With a better sense of the relative efficiency of each of these programs and bankruptcy, it may be possible to identify particular reforms that would improve the American social insurance system.

By way of illustration, this article has contemplated a comparison of two programs, bankruptcy and unemployment insurance, with respect to one insurance function, wage insurance. Working with limited available data, this Article has only aimed to identify the important factors of such an assessment, especially the basic incentive effects and the general economic impact of these two forms of social insurance. If such comparisons can be made, however, they will enable policymakers to reevaluate the boundaries between and among various social insurance programs including bankruptcy.

As discussed above, it appears that the relationship between bankruptcy and other social insurance programs has begun to attract the attention of economists interested in consumer finance. This article contributes to this research by exploring a broader range of relevant factors of comparison and, especially, by considering the institutional background against which evaluations must be made. Less modestly, this article aspires to bring normative questions about the relationship between bankruptcy and other social insurance programs into the foreground of legal scholarship on these subjects. Contemporary scholarship on bankruptcy increasingly recognizes that there is an important relationship between bankruptcy and other social insurance programs. While some legal scholars have explicitly addressed the relative effectiveness of bankruptcy and other programs, these discussions have tended to graze the subject. In framing some fundamental factors of institutional design, this article has described what a comprehensive assessment of the optimal design of the American social insurance system, including consumer bankruptcy, might entail.