Cambridge University Press
978-1-316-61777-9 — Bankruptcy: The Case for Relief in an Economy of Debt
Joseph Spooner
Excerpt
More Information

1

Introduction

1.1 The Debt Economy: Household Debt and Crises of Financialised Capitalism

This book arrives a decade after the global financial crisis of 2007–8 and the beginning of the Great Recession, at a time when much of the world still labours under problems vividly brought to light by these events. In recent years, book after book appears to have been published identifying fundamental crises in the contemporary economic and political order, from a range of political and ideological perspectives.[1] Mainstream opinion presents a global economy struggling from economic stagnation, significant and widening inequality, and related political discord.[2] Economic growth remains sluggish in advanced economies, with particular problems of low productivity growth and weak demand.[3] Inequality came into sharp focus following the crisis,[4] with US President Barack Obama even proclaiming it 'the defining

[1] See e.g. R. G. Rajan, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton University Press, 2011); D. Harvey, Seventeen Contradictions and the End of Capitalism (Oxford University Press, 2014); R. B. Reich, *Saving Capitalism: For the Many, Not the Few* (Knopf Publishing Group, 2015); W. Streeck, *How Will Capitalism End?: Essays on a Failing System* (Verso Books, 2016); C. Crouch, *Can Neoliberalism Be Saved From Itself?* (Social Europe Edition, 2017); E. Posner and E. Weyl, *Radical Markets: Uprooting Capitalism and Democracy for a Just Society* (Princeton University Press, 2018).

[2] See e.g. 'Subdued Demand: Symptoms and Remedies', *World Economic Outlook* (International Monetary Fund, 2016) xvi.

[3] S. Lo and K. S Rogoff, 'Secular Stagnation, Debt Overhang and Other Rationales for Sluggish Growth, Six Years On' (Bank for International Settlements, 2015) 482 www.bis.org/publ/work482.pdf.

[4] T. Piketty, *Capital in the Twenty-First Century* (Harvard University Press, 2014) 1; A. B. Atkinson, *Inequality* (Harvard University Press, 2015) 1.

challenge of our time'.[5] Macroeconomic policymakers have taken new interest in issues of inequality and distribution following the crisis,[6] while there has been an outpouring of high profile academic literature on the topic.[7] Undoubtedly related to economic sluggishness and inequality, political instability further threatens prosperity, as most clearly exemplified by the Brexit referendum and the election of President Donald Trump.[8]

The starting point of this book is that there is now significant evidence to link these pressing policy problems of economic stagnation, inequality and political discord to high levels of household debt. Perhaps the contribution of debt to these issues is unsurprising, given that commentators such as Nancy Fraser argue that the 'defining feature' of our contemporary regime of financialised capitalism is the 'new centrality of debt'.[9] The increasing recognition of high household debt levels as a key aspect of contemporary advanced economies gives new significance to bankruptcy or personal insolvency law, as a unique point of contact between the legal system and the problem of excessive household debt.[10]

5 B. Obama, 'Remarks by the President on Economic Mobility' (The Arc, Washington DC, 4 December 2013) https://obamawhitehouse.archives.gov/node/248126 accessed 14 June 2018.

6 See e.g. G. Vlieghe, 'Debt, Demographics and the Distribution of Income: New Challenges for Monetary Policy – Speech by Gertjan Vlieghe, Bank of England' (Department of Economics and Centre for Macroeconomics public lecture, London School of Economics, 18 January 2016) 7–8 www.bankofengland.co.uk/publications/pages/speeches/2016/872.aspx accessed 19 January 2016; J. Yellen, 'Macroeconomic Research After the Crisis' ('The Elusive "Great" Recovery: Causes and Implications for Future Business Cycle Dynamics' 60th Annual Economic Conference, Federal Reserve Bank of Boston, Boston, Massachusetts, 14 October 2016) www.federalreserve.gov/newsevents/speech/yellen20161014a.htm?emailid=55ccb821090bff0300e78b62&segmentid=1e887e34-00a5-c328-481c-7a09b5553d9c accessed 25 October 2016; S. Keen, *Can We Avoid Another Financial Crisis?* (Polity Press, 2017) 25–38.

7 Piketty (n. 4); Atkinson (n. 4); J. Stiglitz, *The Price of Inequality: The Avoidable Causes and Invisible Costs of Inequality* (Allen Lane, 2012).

8 'Gaining Momentum?' *World Economic Outlook* April 2017 (International Monetary Fund, 2017) xvi.

9 N. Fraser, 'Contradictions of Capital and Care', *New Left Review* 99 (2016) 112.

10 This book largely uses the terms 'bankruptcy' and 'insolvency' interchangeably. An exception is when specific references are made to insolvency procedures under English law. Here the bankruptcy procedure is one of four procedures together forming 'personal insolvency law' (alongside the Individual Voluntary Arrangement, Debt Relief Order and County Court Administration Order procedures): I. F. Fletcher, *The Law of Insolvency* 4th revised edn (Sweet & Maxwell, 2009) pt. 1. For reasons set out later in this Chapter related to the need to distinguish issues discussed here from the unrelated field of corporate insolvency, the book considers the term bankruptcy – and particularly consumer bankruptcy – most appropriate. The meaning of 'consumer bankruptcy' in this

The subject of this book is the place of bankruptcy law – and particularly what this chapter later describes as consumer bankruptcy law – in the contemporary financialised economy, and its ability to offer a response to the economic, social and political problems inherent to this regime.[11]

The statement that our current economic order is 'financialised' may be understood in various ways.[12] Financialisation can describe the shift between two major economic regimes – from the post-war Keynesian demand management economy to the contemporary post-Keynesian or neoliberal regime that emerged from the late 1970s.[13] The neoliberal and financialised eras have become synonymous, particularly after the global financial crisis.[14] Financialisation can also refer to the expanded role that financial services play at the household level, and the extent to which households must use financial products (chiefly credit) in order to access essential services, maintain a reasonable living standard, build wealth and participate in society. One aspect of this trend has seen financial risks individualised through the withdrawal of collective and public risk management mechanisms.[15] In this sense, the process has implications for the way in which households use credit and encounter debt difficulty, and so too for the models of credit use and debtor behaviour informing policy-making. Another related aspect of financialisation is the extent to which the logic of finance has permeated our daily lives.[16] This manifests, for example, in the neoliberal paradigm of the individual as an enterprise, an

book is discussed below. Therefore, references to bankruptcy are more frequent than references to insolvency, and include not just the specific bankruptcy procedure, but general legal approaches to regulating the factual insolvency of an individual debtor; or what the World Bank calls 'the constellation of potential approaches to treating that condition': World Bank, *Report on the Treatment of the Insolvency of Natural Persons* (2013) para. 17. Chapter 4 discusses further the range of personal insolvency procedures.

11 While the focus is on English law as located in the UK economy, the economic and political trends discussed are common to many advanced economies, and the book hopes that much of its discussion and argument are more widely applicable.

12 M. Prasad, *Land of Too Much* (Harvard University Press, 2012) 197; M. Sawyer, 'What Is Financialization?', *International Journal of Political Economy* 42 (2013) 5.

13 Sawyer (n. 12); C. Berry, 'Citizenship in a Financialised Society: Financial Inclusion and the State before and after the Crash', *Policy & Politics* 43 (2015) 509, 512; P. Pathak, 'Ethopolitics and the Financial Citizen', *The Sociological Review* 62 (2014) 90, 92.

14 W. Davies, 'Neoliberalism: A Bibliographic Review', *Theory, Culture & Society* 31 (2014) 309, 316.

15 Berry (n. 13) 512; J. S. Hacker, *The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream* Revised edn (Oxford University Press, 2008).

16 R. Martin, *Financialization of Daily Life* (Temple University Press, 2002); G. F. Davis, *Managed by the Markets: How Finance Re-Shaped America* reprint (Oxford University Press, 2011).

'entrepreneur of the self' or an investor of her human capital.[17] It may lead policymakers and judges to adopt particular characterisations of debtors as 'financial subjects',[18] judging debtor conduct in accordance with norms of individualisation and responsibilisation,[19] including 'responsibility to the self and the population at large to reduce the collective burden on the welfare state'.[20] Moving from official decision making to the individual, we may also internalise this logic and allow financialisation to shape our individual behaviour.[21] Another perspective views financialisation as the manner in which the financial sector has come to occupy a disproportionate position in the economy, accounting for an increasing share of national income and demonstrating a notable rise in profits relative to other activities (e.g. trade and commodity production).[22] With such economic heft, the financial sector also acquires increasing power and political influence.[23] It holds the ability to shape, for example, the legal and regulatory norms governing household debt and bankruptcy.[24] These various understandings of financialisation are mutually reinforcing.

The financialisation process has involved a dramatic debt expansion, to the point where UK household debt has grown from less than 30 per cent of GDP in the late 1970s to a peak of over 95 per cent per cent during the global financial crisis (Figure 1.1).[25] Household debt-to-disposable incomes had reached 100 per cent by the mid-1990s, before peaking at 175 cent around

[17] M. Lazzarato and J. D. Jordan, *The Making of the Indebted Man: Essay on the Neoliberal Condition* reprint edn (Massachusetts Institute of Technology Press, 2012) 33; W. Brown, *Undoing the Demos: Neoliberalism's Stealth Revolution* (Massachusetts Institute of Technology Press, 2015) 32–45; I. Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of the US and Europe* (Hart Publishing, 2017) 28.
[18] Pathak (n. 13) 96.
[19] S. Soederberg, *Debtfare States and the Poverty Industry: Money, Discipline and the Surplus Population* (Routledge, 2014) 51.
[20] Pathak (n. 13) 97.
[21] Berry (n. 13) 510.
[22] A. Turner, *Between Debt and the Devil: Money, Credit, and Fixing Global Finance* (Princeton University Press, 2015) 19–21; Prasad (n. 12) 197.
[23] C. Deutschmann, 'Limits to Financialization', *European Journal of Sociology/Archives Européennes de Sociologie* 52 (2011) 347; J. Hopkin and K. A. Shaw, 'Organized Combat or Structural Advantage? The Politics of Inequality and the Winner-Take-All Economy in the United Kingdom', *Politics & Society* 44 (2016) 345.
[24] J. Spooner, 'The Quiet-Loud-Quiet Politics of Post-Crisis Consumer Bankruptcy Law: The Case of Ireland and the Troika', *Modern Law Review* 81 (2018) 790–824.
[25] 'BIS Statistics Explorer: Table F3.1: Total Credit to Households (Core Debt) as a Percentage of GDP' (Bank for International Settlements) https://stats.bis.org/statx/srs/table/F3.1?c=&p=20174&m= accessed 8 July 2018.

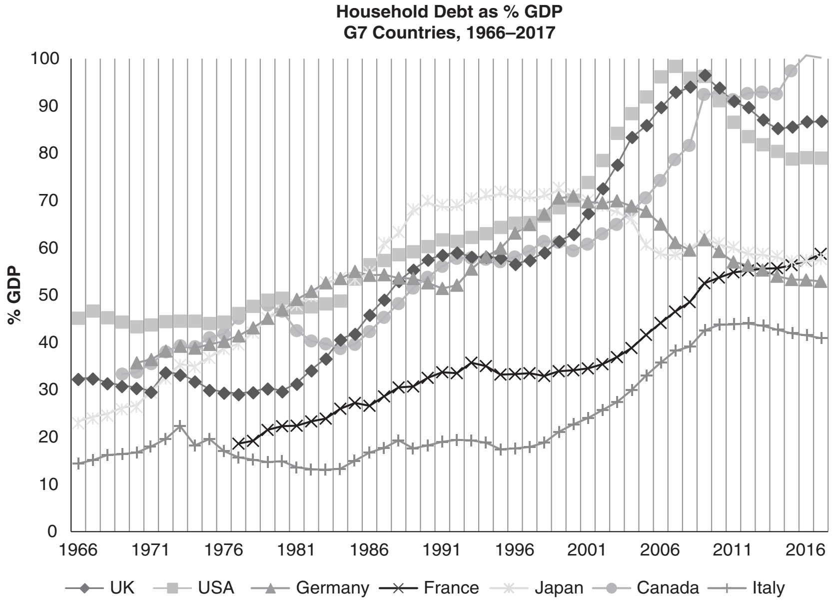

Figure 1.1: Household debt as percentage of GDP. Source: Bank for International Settlements

a decade later (Figure 1.2).[26] Mainstream institutions such as the Council of Europe can now state that 'member states have entered an era where the use of credit has become an essential part of their economies'.[27] Maurizio Lazzarato characterises contemporary conditions as forming a 'debt economy', with neoliberalism 'making the creditor–debtor relationship a centrepiece of politics' and developing debt into the 'archetype of social relations'.[28] Despite the neoliberal era being widely seen as characterised by a renewed embrace of free marketised exchange,[29] Lazzarato (similarly to David Graeber[30]) argues that it is debt – rather than exchange – which forms the 'constitution of society' and represents the most general and global power relation, and the site of contemporary class struggle.[31] On this view, the

[26] 'Household Accounts – Household Debt – OECD Data' (Organisation for Economic Cooperation and Development) http://data.oecd.org/hha/household-debt.htm accessed 10 July 2018.
[27] Council of Europe, 'Recommendation CM/Rec(2007)8 of the Committee of Ministers to Member States on Legal Solutions to Debt Problems'.
[28] Lazzarato and Jordan (n. 17) 20, 23, 33.
[29] See e.g. Davies (n. 14).
[30] D. Graeber, *Debt: The First 5,000 Years* (Melville House, 2012).
[31] Lazzarato and Jordan (n. 17) 39, 89.

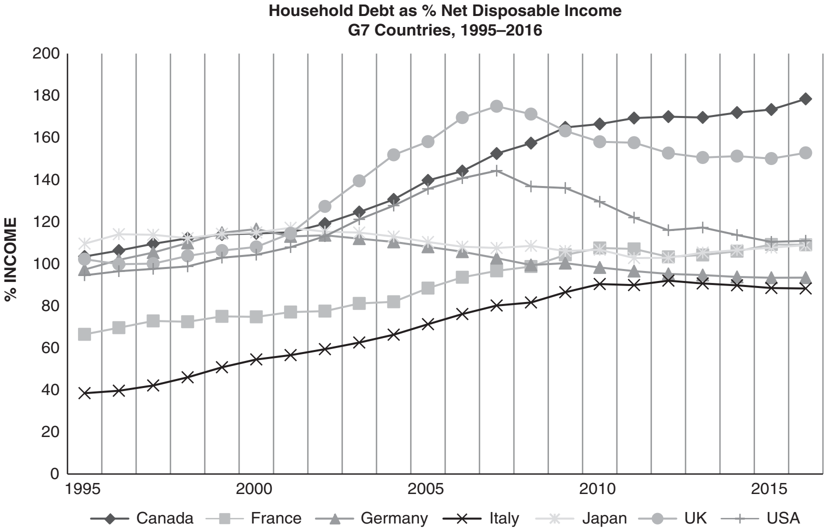

Figure 1.2: Household debt as percentage of disposable income. Source: OECD

dominance of debt explains the condition of contemporary society more effectively than other distinctions such a shift from production to consumption.[32] Many of our contemporary relationships and interactions have been reduced to debtor–creditor dynamics, including those between capital and labour, welfare state services and citizens, and businesses and consumers.[33] Wolfgang Streeck characterises contemporary advanced societies as taking the form of 'debt states', under which neoliberal reforms have reduced taxation and increased public borrowing, but also reduced state public service provision and triggered a rise in household debt to pay for newly marketised social rights.[34] Susanne Soederbergh similarly describes a 'debtfare' economic regime, under which official policies support the expansion of credit markets to augment or replace wages for the poor in the face of income stagnation and inequality.[35]

32 George Ritzer, '"Hyperconsumption" and "Hyperdebt": A "Hypercritical" Analysis' in *A Debtor World: Interdisciplinary Perspectives on Debt* (Oxford University Press, 2012) 61–2; L. Cohen, *A Consumers' Republic: The Politics of Mass Consumption in Postwar America* (Vintage Books, 2004).

33 Lazzarato and Jordan (n. 17) 30.

34 W. Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism* (Verso Books, 2014) 73.

35 Soederberg (n. 19).

A range of perspectives therefore identify a 'debtor world', characterised by 'the global phenomenon of increased indebtedness and societal dependence thereon'.[36] Many questions are raised by the central role of high levels of household debt, even regarding the sustainability of this financialised economic order.[37] The global financial crisis did not involve the rethinking of principles of economic organisation that many would have expected, and our financialised economy has not been overhauled. Nonetheless, the prolonged economic slump of the Great Recession has convinced mainstream technical opinion, if not yet politicians and policymakers, to depart from the pre-crisis consensus that widespread access to credit and extensive household debt are always welfare enhancing. International institutions now recognise that many of the pressing problems of financialised capitalism can be linked to excessive household debt, including economic stagnation, inequality and political instability inherent in a debt-dependent economy. The focus of this book lies on these problems, and on the policy role that bankruptcy law and policy might play in response.

1.1.1 Debt and Economic Stagnation

Excessive household debt is now recognised as a leading explanation for the prolonged global economic slump following the financial crisis of the late 2000s.[38] Recent reports issued by the Bank for International Settlements note that a 'growing body of evidence points to the existence of a "boom and bust" pattern in the relationship between household debt and GDP growth [under which an] increase in credit predicts higher growth in the near term but lower growth in the medium term'.[39] The global financial crisis brought into sharp relief the risks to financial stability caused by mass household indebtedness,[40] and the build-up of household (both mortgage and unsecured) debt remains 'a key source of

36 R. Brubaker, R. M. Lawless and C. J. Tabb (eds.), *A Debtor World: Interdisciplinary Perspectives on Debt* (Oxford University Press USA, 2012) ix.
37 M. Blyth and M. Matthijs, 'Black Swans, Lame Ducks, and the Mystery of IPE's Missing Macroeconomy', *Review of International Political Economy* 24 (2017) 203.
38 Lo and Rogoff (n. 3) 8.
39 A. Zabai, 'Household Debt: Recent Developments and Challenges' *Bank for International Settlements Quarterly Review* 39 (2017) 47; 'The Global Economy: Maturing Recoveries, Turning Financial Cycles?' (Bank for International Settlements, 2017).
40 Financial Stability Board, *Consumer Finance Protection with Particular Focus on Credit* (2011); R. J. Shiller, *The Subprime Solution* (Princeton University Press, 2012); A. Mian and A. Sufi, *House of Debt* (University of Chicago Press, 2014).

risk to financial and economic stability'.[41] In recent years scholars and policy institutions have increasingly recognised a 'debt overhang' problem, and the contribution of excessive household debt to sluggish economic growth and slow 'recovery' throughout the Great Recession and its aftermath.[42] Mian and Sufi argue that common understandings of the Great Recession as being caused by a banking crisis are misplaced, and instead it represented a crisis of consumer spending as heavily indebted households reduced expenditure in response to economic shocks.[43] Debt contracts carry many inherent risks,[44] including shifting the costs of economic downturns away from creditors (whose claims remain unaffected) onto society's debtors (who lose equity in homes and whose obligations remain intact while income and assets diminish). When society's debtors are those with the highest marginal propensity to consume and the least ability to self-insure, the shifting of losses from creditors to debtors reduces society's overall consumption levels.[45] This effect has continued after the immediate shock of the crisis to produce longer term effects, as highly leveraged households focus resources on debt service rather than consumer spending.[46]

1.1.2 Debt and Inequality

A fascinating development in recent policy literature has been the recognition of the negative aggregate effects of inequality for the overall economy

[41] 'Financial Stability Report: June 2017' (Bank of England 2017) 41 1, 1–19 'Fiscal Monitor – Debt: Use It Wisely' (International Monetary Fund, 2016) www.imf.org/external/pubs/ft/fm/2016/02/fmindex.htm accessed 4 January 2017; 'Household Debt and Financial Stability', Global Financial Stability Report October 2017 (International Monetary Fund, 2017); Zabai (n. 39) 48–51.

[42] See e.g. ' Dealing with Household Debt', World Economic Outlook 2012 (International Monetary Fund, 2012) www.imf.org/external/pubs/ft/weo/2012/01/pdf/c3.pdf; World Bank (n. 10); Mian and Sufi (n. 40); Turner (n. 22); P. Bunn and M. Rostom, 'Household Debt and Spending in the UK' (Bank of England, 2015) 554; Lo and Rogoff (n. 3) 10; International Monetary Fund, 'Fiscal Monitor – Debt: Use It Wisely' (n. 38); 'The Global Economy: Maturing Recoveries, Turning Financial Cycles?' (Bank for International Settlements, 2017) 48–9; International Monetary Fund, 'Household Debt and Financial Stability' (n. 38). The 'debt overhang' externality of household debt is discussed in more detail in Chapter 3 (text to notes 165–78).

[43] Mian and Sufi (n. 40) 46–59.

[44] Turner (n. 22) 54–7.

[45] International Monetary Fund, 'Dealing with Household Debt' (n. 42) 9–13; Zabai (n. 39) 43–6.

[46] Bunn and Rostom (n. 42); International Monetary Fund, 'Household Debt and Financial Stability' (n. 41); Zabai (n. 39).

and society, and the breakdown of the long-held consensus that there is a necessary trade-off between efficiency and equity.[47] An understanding of the effects of excessive household debt furthers this recognition, given how the inequality of debt may exacerbate negative aggregate economic effects. A primary mechanism through which excessive debt jeopardises economic prosperity is through its unequal distribution of economic risks onto the least well-resourced members of society. Technical accounts explain that in terms of aggregate demand, the distribution of debt among households is crucial, since most negative effects arise where high debt levels are concentrated among households with the most limited resources and 'less scope for self-insurance'.[48] This means that links between excessive debt and economic stagnation turn on the fact that the economy's debtors are those with a higher marginal propensity to consume and limited recourse to wealth reserves to protect themselves against economic downturns. The imposition of financial losses on this group will cause them to reduce expenditure significantly, reducing aggregate demand upon which economic growth depends.

Both the structure of debt contracts and the wider structure of household credit markets can contribute to inequality. Caplovitz taught us half a century ago that contemporary credit markets are both born of inequality and exacerbate the unequal distribution of resources.[49] At the supply side, rising inequality allows increasingly wealthy, high income groups to invest income in financial assets backed by loans extended to low income groups, creating a need for more profitable household debt to provide further fields for reinvestment.[50] Meanwhile growing income inequality intensifies the demand for credit among lower income households who receive an increasingly small proportion of aggregate income.[51] Rising household borrowing partly involves attempts by low and middle income

[47] Atkinson (n. 4) 243–62. For recognition of the macroeconomic risks of inequality, see e.g. International Monetary Fund, 'Gaining Momentum? '*World Economic Outlook* April 2017 (n. 8); Era Dabla-Norris and others, 'Causes and Consequences of Income Inequality: A Global Perspective' (IMF 2015) IMF Staff Discussion Note.

[48] Zabai (n. 39) 45.

[49] D. Caplovitz, *Poor Pay More: Consumer Practices of Low Income Families* (Free Press, 1968); N. I. Silber, 'Discovering That the Poor Pay More: Race Riots, Poverty, and the Rise of Consumer Law Symposium: How the Poor Still Pay More – A Reexamination of Urban Poverty in the Twenty-First Century', *Fordham Urban Law Journal* 44 (2017) 1319.

[50] Dabla-Norris and others (n. 47) 8; M. Kumhof, R. Rancière and P. Winant, 'Inequality, Leverage, and Crises', *American Economic Review* 105 (2015) 1217.

[51] P. Lucchino and S. Morelli, *Inequality, Debt and Growth* (Resolution Foundation, 2012) 2; Turner (n. 22) 119–24.

households to maintain both their absolute standards of living and relative standards of consumption[52] and bridge the gap between stagnant wages and rising costs of living.[53] Joseph Stiglitz identifies a key role for contemporary credit markets in exacerbating inequality through the rent-seeking activities of consumer lenders in 'preying upon [poor and uninformed] groups with predatory lending and abusive credit card practices'.[54] Stiglitz also points to creditor-friendly US bankruptcy law as amplifying these effects.[55] David Harvey notes that consumer marketplaces are new sites for class conflict and exploitation, arguing that collective gains workers may win from capital in the workplace can quickly be erased through excess value extracted from consumers by businesses in the marketplace.[56] Soederberg advances this idea, arguing that while workplaces involve primary exploitation of labour by capital, consumer credit markets (particularly those used among low-income groups) produce 'secondary forms of exploitation whereby workers' real income can be modified . . . in the sphere of exchange through the extraction of interest and fees from a loan'.[57] In this way debt creates inequality, while also arising *from* existing inequality.[58]

At a more basic level, some commentators argue that fundamental features of our legal system establish so-called 'ground rules' of capitalism that tend towards inequality.[59] Various basic laws of capitalism give excessive market power to certain parties, while protecting and

[52] A. Barba and M. Pivetti, 'Rising Household Debt: Its Causes and Macroeconomic Implications – a Long-Period Analysis', *Cambridge Journal of Economics* 33 (2009) 113, 122; T. A Sullivan, 'Debt and the Simulation of Social Class' in R. Brubaker, R. M. Lawless and C. J. Tabb (eds.), *A Debtor World: Interdisciplinary Perspectives on Debt* (Oxford University Press, 2012) 54.

[53] See Barba and Pivetti (n. 52) 124–5; Lucchino and Morelli (n. 51) 2.

[54] Stiglitz (n. 7) 37. See Chapter 3's discussion of failures in consumer credit markets (text to notes 97–138).

[55] ibid. The changes to bankruptcy law were enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. See e.g. R. M. Lawless and others, 'Did Bankruptcy Reform Fail – An Empirical Study of Consumer Debtors', *American Bankruptcy Law Journal* 82 (2008) 349.

[56] D. Harvey, *The Enigma of Capital: And the Crises of Capitalism* (Profile Books, 2011) 66–8.

[57] Soederberg (n. 19) 37.

[58] S. Soederberg, 'The US Debtfare State and the Credit Card Industry: Forging Spaces of Dispossession', *Antipode* 45 (2013) 493, 494.

[59] For example, Campbell points to monopoly rights granted through intellectual property law, and the privileges afforded to managers of public companies by principles of limited liability and the separation of ownership and control: D. Campbell, 'The Fetishism of Divergence: A Critique of Piketty', *Journal of Corporate Law Studies* 15 (2015) 183, 212–13. Reich (n. 1) xiii; D. S. Grewal, 'Book Review – The Laws of Capitalism', *Harvard Law Review* 128 (2014) 626.