

By Invitation

Society should be more forgiving of bankrupts

Recent changes to the law strike a better balance between the needs of the indebted, creditors and society



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For *The Straits Times*

Bankruptcy may be a financial failure, but recent changes to the law show that it need not be regarded as a moral failure also.

Not long ago, a staff member at an organisation in Singapore told her boss that she was resigning. As she was a productive employee and had seemed happy, her supervisor inquired as to her reasons: Was it a better job; problems at work?

Eventually, she disclosed that the reason was that her husband had just been declared bankrupt and she did not want to bring the organisation into disrepute.

Last month saw amendments to Singapore's Bankruptcy Act that raise the threshold for entering bankruptcy and make it easier for those declared bankrupt to discharge their obligations.

The changes to the law are a sensible rebalancing of the interests of debtors, creditors and society as a whole. But whether they will alter the moral stigma associated with bankruptcy is another question entirely.

When I lived in New York, one of the things that struck me while riding on the subway was the number of people talking about "Chapter 11".

At first, I thought it was a literary reference – frustrated writers working on a particularly difficult part of their first novel, perhaps.

But in the United States Bankruptcy Code, Chapter 11 offers individuals or businesses that cannot pay their debts protection so that they can reorganise themselves. In the aftermath of the dot.com bubble, it was reasonably common for companies and individuals to avail themselves of such protection.

The US has always had a more forgiving attitude towards debt than many other countries. Though it inherited debtors' prisons from England, the notion of a bankruptcy regime that was more forgiving soon came to be identified as a political as much as a financial cause. Indeed, some historians have argued that the American Revolution was itself essentially a form of debt relief, freeing the new country from its debts to the old.

By the mid-19th century, the French historian Alexis de Tocqueville remarked on the "strange indulgence which is shown to bankrupts" in the US.

But he linked it to the boldness of enterprise that he also documented, in which fortunes were lost and regained while the state continued to prosper. Such an appetite for risk can lead, of course, to the excesses of Wall Street and the global financial crisis. But at the individual level, we should consider whether bankruptcy is a financial failure as well as a moral one.

CURBING THE LENDERS, NOT JUST BORROWERS

The purpose of bankruptcy is, in part, to allow for the orderly resolution of debts. That means holding debtors accountable – but not at all costs.

In ancient Greece, people who could not pay their debts could be forced into debt bondage or slavery, to work off their debts through labour. Their families often joined them.

Such practices are now prohibited by international law, in particular the 1956 Supplementary Convention on the Abolition of Slavery. Nevertheless, an estimated 21 million people are still engaged in forced labour, according to the International Labour Organisation.

As for debtors' prisons, today they are known to most people only through the novels of Charles Dickens, whose father spent time in the Marshalsea in South London, providing the setting for his novel, *Little Dorrit*.

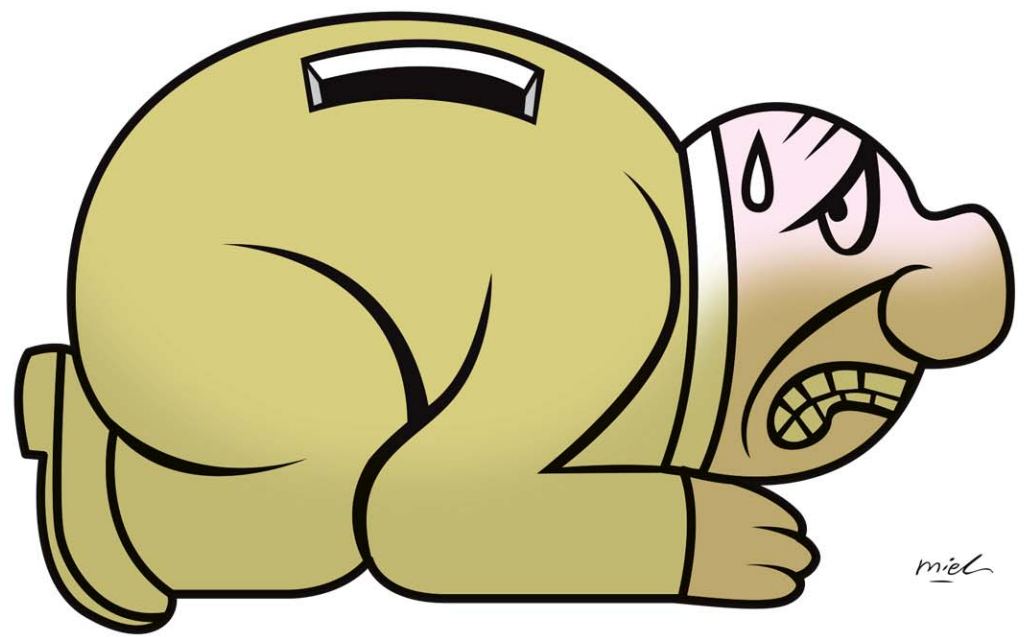
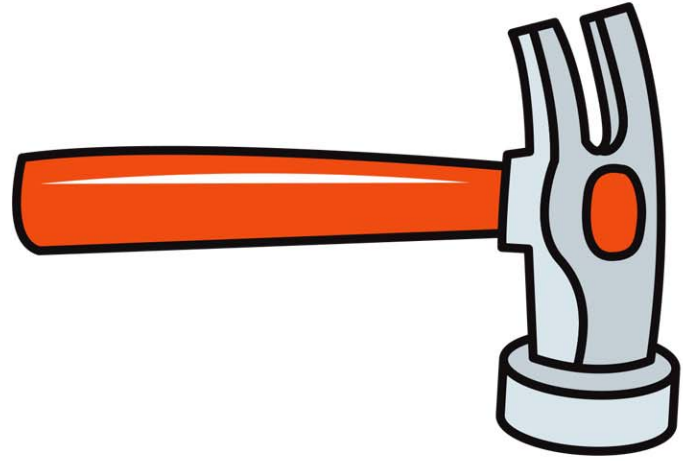
They remain a reality in countries such as the United Arab Emirates,

though even there the laws were relaxed somewhat last year.

Bankruptcy is a disincentive against borrowing more than you ought to, or paying back less than you can. But it need not ruin your life. As Senior Minister of State for Law Indranee Rajah said during her second reading speech of the recent amendments, it should be possible for a bankrupt to make a fresh start after a reasonable period of time.

This is not simply a question of forgiveness. Moderating the cost of bankruptcy is also intended to encourage entrepreneurship and risk-taking. In this way, it is similar to the idea of limited liability in corporate law. Unless individuals can manage their exposure, or pick themselves up after a failure, they may be less likely to launch a new start-up – or if they do and it does not succeed, it will be their last.

Those who pay their target contributions in full can have their names expunged from the record five years later. In this way, the law now provides the opportunity for a fresh start. But it remains to be seen whether the social stigma of bankruptcy will be as forgiving.



As Professor John Armour and Professor Douglas Cumming have shown in their paper *Bankruptcy Law And Entrepreneurship*, there is a statistically and economically significant link between the relative forgiveness of personal bankruptcy laws and self-employment rates across 15 countries in Europe and North America. Not all risk-taking is socially useful, of course. A recent paper by colleagues at the National University of Singapore Business School suggests that men are more likely than women to file for bankruptcy. But they found that both men and women who have filed for bankruptcy are also more likely to have motor accidents. Risk-taking entrepreneurs are a net positive; reckless debtors are not.

For that reason, the changes to the legislation are also intended to deter over-extension of credit by banks and other lenders. This is an area in which the US still has much to learn. The housing bubble that played a key role in the 2007 global financial crisis was encouraged by lenders offering credit to high-risk borrowers at ever more generous terms. In 2006, almost half of first-time home buyers purchased their homes with "no-money-down" loans – requiring no initial payment, but risking their home being worth less than the money they owed on it.

Simplifying bankruptcy puts at least some of the onus on creditors, forcing them to be more prudent

when making loans in the first place.

OPTION OF LAST RESORT

Bankruptcy is and should remain an option of last resort. It brings with it significant restrictions on one's ability to travel, obtain credit, or manage a business. As the Ministry of Law website warns, it may also cause "difficulties in looking for a job". In Singapore, it also precludes one from holding or taking up public office.

But it should not be a torment without end. The new law allows first-time bankrupts to be discharged in three to seven years, providing more certainty than the prior regime – though this is still far longer than the automatic discharge regime in England and Wales, which kicks in at 12 months.

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As for the woman who had offered to resign to insulate the organisation from the shame of her bankrupt husband, she was persuaded to stay.

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