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Abstract

Debt presents a dilemma to societies: successful societies benefit from a substantial infrastructure of consumer, commercial, corporate, and sovereign debt but debt can cause substantial private and social harm. Pre- and post-crisis solutions have seesawed between subsidizing and restricting debt, between leveraging and deleveraging. A consensus exists among governments and international financial institutions that financial stability is the fundamental normative principle underlying financial regulation. Financial stability, however, is insensitive to equality concerns and can produce morally impermissible aggregations in which the least advantaged in a society are made worse off. Solutions based only on financial stability can restrict debt without accounting for the risk of harm to persons least able to bear the risk, worsen pre-existing inequalities, destroy or impair the net worth of households, and impose unfavorable distributive consequences. This article offers a new approach to assist policymakers in developing and evaluating regulation to take criteria in addition to financial stability into account, but which do not undermine the aim of financial stability. It calls for a luck egalitarian approach, offering policymakers options to take the debtor's choices into account while still accounting for cognitive mistakes people often make in debt decision making. It offers a *general* framework for the underlying principles for the regulation of debt: its focus is not on any particular forms of debt or its regulation but in structuring debt regulation more generally. It offers a set of recommendations on how regulators can take concerns about luck and equality into account in regulatory design.

Keywords: access to credit, debt, inequality, financial regulation, financial stability

No successful society exists without a substantial infrastructure of consumer, commercial, and sovereign debt. Using a concept familiar in the political theory of John Rawls and Ronald Dworkin, access to credit is a "resource" in many societies, which means that it is a primary means by which persons develop and implement plans for their lives. In many societies, the less net worth a household has, the more that household needs debt to obtain access to adequate housing, decent schools, transportation for good jobs, and an essential measure of security in the event of job loss or other emergencies and catastrophes (Bar Gill & Warren 2008)(Leicht 2012).

Debt is sometimes used as start-up capital for small businesses, often in the form of personal debt held by the owners of the business (Meyer 2017). Sovereign debt plays important welfare-enhancing and resource-distributing functions for entire populations. Governments have used borrowing to finance civil works, education, pensions, and health care for their citizens. Of course, debt is a very common means by which firms finance their operations. Banks fund themselves almost entirely on debt (Admati & Hellwig 2014). Some important social goods should perhaps be delinked from acquisition through debt, but the task here is to apply standard *ceteris paribus* assumptions common to the social sciences to examine the role of the regulatory institutions of debt in societies.

Despite its opportunities to produce good, debt can also cause substantial private and social harm. The rigidity of debt – its essential characteristic of a fixed claim for payment – makes it dangerous when fortunes fall. Default on debt by individuals and households can lead to downward social mobility and even poverty for families, job loss, health problems, stress, marital problems, and family instabilities (Porter 2012). Beyond these private harms, as we have seen in the most recent financial crisis, losses associated with excessive debt in a society can be enormous and lead to systemic failures in national and global economies, with substantial adverse effects disproportionately on persons of limited financial means. The highly-leveraged positions of banks make them dangerous not only to themselves but to entire societies and the world (Admati & Hellwig 2014)(Turner Review 2009)(Financial Crisis Inquiry Commission 2011).

The core claim of this article is that a just society would structure its institutions for the access to credit and allocation of debt in a way that is sensitive to basic concerns about equality. Take as a given in a non-ideal society that persons in that society must use debt to access some basic social goods. If this is the case, then the debt needed to access these basic social goods must comply with the demands of equality. The overriding normative focus of debt regulation is currently on financial stability of the overall economy (Adenas & Chiu 2014)(Arner 2007), with equality playing little if any role, depending on the society in question.[1] When developing regulation and policy relevant to debt, governments need to focus on more than financial stability as the end of managing the effects of debt in society. They need also to focus on equality sensitive access to credit. Governments ought to be sensitive to the dilemma that debt presents to societies: we need debt to make our lives go well, but we also need to avoid debt to make our lives go well. Debt can be bad for people, firms, and governments *but so can restricting it*.

Most of the studies of debt and its effects on society are in economics or what might more broadly be known as a version of welfare utilitarianism. Welfarist approaches hold a powerful influence in policy circles in governments and international financial institutions. This article takes a different turn. It relies on insights from political theory not previously relied upon to evaluate the regulation of debt. This article relies on a prominent version of resource-based luck egalitarianism commonly associated with Ronald Dworkin, though he did not consider himself a luck egalitarian, Eric Rakowski, and others (Dworkin 2000)(Dworkin 2003)(Rakowski 1993). Luck egalitarianism is relevant to evaluating the law on access to credit because it offers an approach that is sensitive to individual responsibility as well as to considerations of justice. It mitigates the harshness of wholly individualized conceptions of risk while still holding people responsible for transactions in which they realistically make choices. Because debt is structured in the form of a transaction in which people at least ostensibly make choices, taking some level of responsibility into account seems essential in making normative judgments about the fairness of debt, though as we shall see, choice about debt may not be as responsibility sensitive as we might at first blush think it might be. We also want to know how circumstances and unchosen or what Dworkin calls “brute” luck affect debtors and creditors.[2]

In the tradition of Rawlsian wide reflective equilibrium, economics and finance are not ignored. These fields hold greatest relevance for corporate and commercial debt. For consumer and possibly sovereign debt, economic policy prescriptions tend to focus on one thing: restricting debt or deleveraging. Deleveraging is a necessary but incomplete focus. A focus on financial stability leads regulators to ignore or downplay concerns about justice and fairness. A look at distribution from an economic point of view can offer significant data-driven insights about cause and effect but economics offers inadequate normative criteria for assessing whether a distribution is morally acceptable. A focus on financial stability is laudable, given the instability that excessive debt caused in the global economy in the most recent financial crisis, but if we do not also focus on how that stability is achieved and at who suffers the burdens of it, the net result could be to needlessly make vulnerable persons worse off. The overriding focus on financial stability has meant that governments have ignored other worthy goals. If financial stability could be achieved by means that impose fewer harms on less well-off groups, or which contribute less to income inequality, then these means need to be identified and prioritized.

Part 1 of the article explains the moral relevance of the access to credit architecture of a society, showing why debt it not only about individual choice. Part 2 elucidates conditions that should be met for debt regulation to comply with moral demands associated with equality. It provides a set of principles to guide policy entrepreneurs towards developing the regulation of debt to be sensitive to the demands of equality.

These principles are not moral principles but a set of intermediate or second order principles that flow from luck egalitarianism. Moreover, while these intermediate principles offer standards for the evaluation of regulation, no single standard can do the job of making debt regulation comply with moral demands. Which principle is more or less relevant will depend on the regulatory context and the particular kind of debt to be regulated. Part 2 argues for a continuum of considerations of equality to apply to the various forms of debt, with some forms of debt requiring more sensitivity to considerations of justice than others. For example, we will find it reasonably acceptable to subject corporate debt to the full logic of economics but will not find it to be reasonably acceptable for home mortgages or student debt. This article makes a case for a more rigorous understanding of how this equality sensitive continuum can operate in a society. Part 3 deals with the regulatory implications for the equality concerns developed in Parts 1 and 2. It offers a framework for incorporating the moral demands of equality, as they are understood in an influential luck egalitarian philosophical account of equality, into the methods of regulatory evaluation and design.

This is not a traditional work of 'pure' political philosophy. It takes empirical considerations and factual contexts into account that will be of interest to policy makers and regulators but perhaps less so to philosophers. It accepts the philosophical apparatus offered by Dworkin and others and does not seek to build upon or critique the concepts found in this work. Its use of philosophy is applied, designed to advance policy debates, in way that may be characterized as 'institutionally sensitive' (Cranor 2007)(Cranor 1999). It is meant to offer alternative guidance to regulators and policy makers that may be overlooked because of the dominance of economic approaches in the making of regulation. Some of its examples or empirical insights might be of less interest to philosophers but are necessary to bring moral concerns about equality to the attention of regulators in governments and central banks.

1. *The Moral Relevance of Debt Regulation*

In brief outline, luck egalitarianism can be understood as a set of theories of justice that take the responsibility of the choices people make into account in determining how principles of distributive justice might be relevant (Knight & Stemplowska 2011). Luck egalitarians ask in deciding on how to distribute resources: under what conditions should people be held responsible for their choices when it comes to what they are owed as a matter of distributive justice? Should at least some aspect of justice depend on what people can be held responsible for, based on their choices? Luck egalitarianism is choice sensitive, but unlike economics, the prevalent welfarist alternative, it offers a finer grained conception of choice in which constraints an agent cannot control are not ignored in deciding how and what to allocate or distribute. In luck egalitarian accounts, some constraints negate the salience of choice and this becomes important in regulatory design. Some luck egalitarians rely on a decision procedure akin to Rawls's veil of ignorance in the original position. Dworkin offers perhaps the most prominent example, with his hypothetical insurance market in an equal auction at the beginning of society. When it comes to applying Dworkin (or any other) account that depends on such a decision procedure in the context of regulatory design, the procedure at bottom comes down to asking whether it is reasonable to ask people to bear risks they had no role in creating or cannot control.

People think of debt as a transaction between a debtor and a creditor, requiring a choice by the debtor to borrow and the creditor to lend. Surely, the story goes, our choice to take on debt means that we have taken what Dworkin calls a "calculated gamble" in the form of what he characterizes as "option" luck. Our choice would therefore take debt outside the area of concerns about equality. Egalitarian justice would have no role in relation to debt creating and enforcing institutions.

In this purely choice-oriented conception of debt, the ordinary market risk associated with debt is classic option luck. Ordinary market risk is risk that a person (or entity) assumes for oneself when transacting in a market. If for example an individual buys a home with a mortgage, she assumes the risk that the value of the house will decline and that the mortgage may go underwater if there is insufficient equity in the home. She also assumes the benefit of a rise in the price of the house.

The law frames the concept of debt as choice sensitive. Debt becomes legally binding through the branch of private law creating legal obligations through voluntary exchange – the law of contract. Of course, some private law has developed to protect the vulnerable, but its scope is extremely limited. In the common law of contract, Lord Denning stated in his famous dictum in *Lloyd's Bank v Bundy*[3] that all contract law doctrines dealing with inequality of bargaining power should be developed into a single legal principle, but no such principle has ever developed in Anglo-American contract law, which specifies very limited doctrines of unconscionability, undue influence, and duress to deal only with the worst forms of abuse. In Anglo-American law, the lender-borrower relationship generally does not establish a fiduciary relationship (Pottow 2011). In the language of contract often used in law and economics, fiduciary rules are not part of the terms of the debt contract. On the regulatory side, there is the domestic and European legal apparatus to deal with abusive practices in consumer transactions, but the rules offer sporadic protection in limited cases and often focus primarily on disclosure, a form of regulation that presumes consumers are rational choosers able to take advantage of the information disclosed (Ramsey 2012).

The rational choice version of law and economics frames debt around choice and contract. Contract theory as it is understood in law and economics frames commercial law around contract, in the frame of the Coase Theorem (Kraus & Walt 2007). In this rational choice context, regulation – law that parties cannot choose to include or exclude in their contract - interferes with choice and usually makes contracting parties worse off (Jolls, Sunstein, & Thaler 1998). Of course, a debt contract can be and is regulated but that regulation is understood in the rational choice version of law and economics as exceptional, requiring a market failure justification. Without such justification, regulation in rational choice theory amounts to Pareto inferior choice-interfering mandatory rules imposing transaction costs on rational choosers. According to the rational choice story, people who make decisions in the market for debt take Dworkin's gamble and put themselves at the mercy of their own choices.[4] There is no relationship of debt to inequality in this approach.

The rational choice account fails to capture the moral relevance of debt and its regulation for many reasons. Preliminarily, its basic presuppositions fail. A decision by a person to borrow is subject to well-accepted cognitive shortcomings afflicting individuals (Bar Gill 2012)(Harris & Albin 2006). But looking only to cognitive grounds is incomplete because it does not inform us what steps need to be taken to address equality concerns from a moral perspective. We need to get beyond cognitive grounds and investigate unchosen circumstances. We are by now familiar with the brute facts of lotteries: the birth, zip or post code, household net worth, education, and health lotteries affecting people's life chances are examples. The brute facts of inequality itself tell us that choice is but of partial concern when it comes to debt. If a society makes important resource distributing decisions mainly through markets, then the chances are high that the less well off a person is, the more debt she will have relative to her income.

She may also suffer from restrictions on access to credit, leaving her with poor choices (Turner 2016). Life is a lottery we have no choice but to play. Circumstances come prior to choice and choice depends on them. A Rawlsian-type basic structure of society substantially determines what we choose, because it determines what we can choose, our set of available choices, why we are choosing, and how our choices affect quality of life.

Moving beyond the limits of choice, the next question is whether debt, or perhaps more accurately access to credit, is a resource subject to the demands of equality. The version of luck egalitarian relied upon in this article is resource-based. Access to credit is a resource to achieve something important to the life projects of a person, usually to acquire other important resources essential to those life projects, such as in the purchase of a home with mortgage credit, or to borrow to pay for a university degree, to use a credit card to avoid spending savings budgeted for other purposes or to use credit to pay health care bills if government fails to provide access to health care based on need rather than ability to pay. A home mortgage finances more than a place to live. It is finances a mix of consumption and investment. Priced into the housing market is access to good schools, locations with low levels of environmental pollution and health hazards, and access to good transportation and other public infrastructure (Atkinson 2015)(Bar Gill & Warren 2008). So, access to credit takes on major importance as a resource that leads to access to other resources essential to leading a good life.

People make choices about debt that relate to access to resources affecting their life prospects in complex ways. We may not think of forms of corporate or commercial credit as relevant to equality of resource concerns but that may not be true in all cases. There will be cases in which access to credit relates to access to the opportunity to innovate, such as in the promotion of entrepreneurship. Owner-entrepreneurs fund small business start-ups with their personal finances or in combination with financing from family members and a substantial debt component often is present in this financing (Akseli 2012).

Sovereign debt has a substantial resource distributing function. Governments borrow for many of the same reasons that individuals do, to consume more goods today, often in the form of public goods, goods undersupplied by markets, or goods that people cannot afford on their own. Governments could finance these goods by raising taxes, but in some cases is better to borrow and slowly repay the debt over time through taxation into the future. This is known as “tax smoothing” (Barro 1979). Tax smoothing works like consumption smoothing through a home mortgage, an education loan, an auto loan, or on debt on commercial real estate such as a hotel or a university residence hall. These debtors need a large chunk of money now to capitalize an asset, which they pay off with funds from a future income stream. Governments have used borrowing to finance civil works, education, pensions, and health care. In some cases, governments might project these investments as increasing GDP in the future, from which taxes can be drawn to pay off the debt. Of course, governments sometimes get the financing model wrong, particularly when exogenous events alter macroeconomic conditions, requiring sovereign debt to be restructured.

In addition to making resources available to debtors, debt also makes resources available to indirect beneficiaries who are not parties to the debtor-creditor relationship. For example, education has public good characteristics. Society benefits when people earn university degrees. People with higher education earn more than those without it. The global economy provides increasing rewards for jobs requiring university degrees. People with university degrees innovate far more than those without degrees.

University graduates are more civically engaged (Newell 2014)(Flanagan & Levine 2010).

There is a similar story of private home ownership. Owners take better care of their properties than tenants. Crime is lower in neighborhoods with substantial levels of private home ownership (Dietz & Haurin 2003). Home owners are more civically engaged than tenants (Glaeser & Di Pasquale 1999)(Verba, Schlozman, & Brady 1995). Private home owners tend to have higher net worth than renters, which they can use as resources to support their families and children, such as in the funding of higher education. The relationship between housing, wealth, and inequality is substantial and further combines with other factors such as inequality between generations within families to race and ethnicity (Case, Quigley, & Shiller 2005)(Krivo & Kaufman 2004).[5]

The potential harm from debt is also significant. Systemic risk in finance has substantial moral implications (Linarelli 2017). Systemic risk differs from market risk because the risk is explicitly on persons who are not parties to the debt contract. My transaction does not impose a risk on me, or at least not only on me, but also on others. The distinction between ordinary market risk and systemic risk aligns closely with Dworkin's distinction between option luck and brute luck. Everyone in society is vulnerable to the risk of indisputably bad brute luck because of systemic risk. Systemic financial risk has the potential to harm someone even if they had nothing to do with the transactions causing the harm. Exposure to systemic financial risk is an unfortunate circumstance having nothing to do with choosing but with being a member of a society.

Finally, the regulatory institutions for debt are relevant on egalitarian grounds because debt is a more important institution for the distribution of resources for the poor than the rich. Debt often distributes resources to the less fortunate in morally perverse ways. Mortgage lending offers a good example. Mortgage lenders, usually in the form of banks, obtain liquidity for lending from their investors: depositors, who are actually a class of creditors in the bank, other creditors, and shareholders. Atif Mian and Amir Sufi refer to these providers of liquidity as “savers” (Mian & Sufi 2014). When we say a bank has a mortgage in a home, we are really saying that savers have a property right, understood from a functional or economic point of view, in the borrower’s home. Now consider how debtor-creditor law and regulation affects equality. Savers usually have high net worth and borrowers low net worth, or at least the net worth of borrowers is low enough cause them to borrow to buy a home. Because debt is rigid, if house prices decline, the losses concentrate on the borrowing homeowners. If they are poor enough, family net worth disappears when house prices decline. The ruination of the finances of low net worth households can have dire consequences for entire families (Glater 2015)(Leicht 2012) (Warren 2002). But savers in a down market fare relatively better (Mian & Sufi 2014). They bear no loss on individual mortgages because debt is rigid and represents a fixed claim for payment regardless of the value of the asset securing it. Savers may lose in some repossession or foreclosure contexts if their home is in a jurisdiction that makes it difficult to collect on the borrower beyond the value of the home or when the borrower is judgment proof, but given that they are affluent, they are likely diversified and have relatively little debt themselves, so they suffer far less. The result is that the distribution of losses in the down market falls disproportionately on low net worth borrowers, those least able to bear the losses. Of course, borrowers benefit when house prices appreciate, though their gains are relatively illiquid unless they can access the gains through even more debt in the form of a second mortgage, but savers benefit too when house prices appreciate, as their diversified portfolios rise in value and they continue to collect fixed payments on mortgage debt.

These arguments relate to the structure of debt generally and extend beyond mortgages. We can apply a similar line of argument to non-consumer forms of debt, for example, to government and corporate debt. In some cases, debt is morally unobjectionable, as in the case of some corporate bond contexts. We should not worry too much about diversified and sophisticated debtors and creditors or investors in capital markets. Contract and choice can play more prominent roles in regulating these relationships. But when debt is used to acquire resources for an effective plan of life, moral concerns become salient.

2. *Developing Equality Sensitive Debt Regulation*

How can the above points be put to work in the development of regulation for debt and access to credit in a manner that complies with the demands of equality? The aim is to develop a set of principles that governments can use to evaluate whether regulation meets these demands. As explained above, these are not moral principles, but a set of intermediate principles grounded in the moral assessment of the preceding part. They are designed to supplement the financial stability principle. In the discussion of these principles, paradigmatic forms of debt, as they are created by the law and regulation, are evaluated to determine whether they comply with relevant moral demands.

2.1 *Avoid Financing Public Goods Primarily Through Private Debt*

The state should not require persons to take out significant debt to further a policy aim, unless that policy aim has no role other than to benefit the debtor, the debtor can make an unbiased choice about the debt, and the debt does not substantially impair the life projects of the debtor. Some goods are important and valuable both for individuals and for society to flourish. These goods have both private and public benefits. Economists characterize these goods with mixed characteristics as imperfect public goods. Government ought not generally impose debt on persons to pay for goods that others benefit from, unless it can justify the debt as effectively a tax on those able to pay. The private features of such goods might mean that they are amenable to acquisition by persons individually, possibly through debt, but cases will exist in which even the private benefit aspects of these goods mandate government assistance where the debtor's circumstances are such that self-financing is morally objectionable because, for example, such self-financing does not meet standards of egalitarian justice.

Student loans are an example of the kind of debt that can violate this first principle. It is well accepted that higher education has both public and private goods characteristics (Toutkouschian & Paulsen 2016)(Marginson 2014). Moreover, degrees and inequality very positively correlate. The wealthier a student's family, the greater the chances that she will enroll in higher education. Richer students with lower academic indicators have a better chance of earning an undergraduate degree than poorer students with higher academic indicators, throwing into doubt merit-based arguments about university admissions. A structure for financing university education cannot simultaneously (i) impose substantial debt burdens on graduates from more modest family backgrounds and (ii) expect these graduates to shoulder the costs of the public goods aspects of university education.

Student debt data for the United States is startling. It quintupled in the United States in the past three decades (Akers & Chingos 2016).[6] The latest available data on student loans in the United States puts it at about $1.25 trillion, amounting to about ½ of the GDP of the United Kingdom, with almost 42 million borrowers. Those over sixty years of age hold over $43 billion in student debt. Empirical research shows that student debt adversely affects the life prospects and social mobility of graduates in substantial ways, impairing their net worth for a lifetime, making it difficult to borrow for homes, and generally diminishing their life prospects (Konczal 2014). Availability of student loans in the United States comprise part of the reason for tuition fee increases far outstripping general price increases (Baum 2016)(Glater 2016(Glater 2015).[7]

The United Kingdom is another country that uses substantial student debt to finance higher education. It is difficult to compare data between the United States and the United Kingdom because American student loans include substantial numbers of graduate students as well as students not at four-year institutions. Data on the growth of student debt when fees became significant in the United Kingdom show steady growth from £7.8 billion in lending in 2012-13 to £12.2 billion in 2015-16. Student debt in the UK accumulates to £86.2 billion. The data shows a remarkable participation rate of 90 percent from 2013-2016 and 89 percent for 2012-13 (Bolton 2016)(Bolton 2012)(Crawford, Crawford, & Jin 2014).

Access to higher education is a resource in any resource-based account of egalitarian justice if it is an essential or important means by which to achieve life goals. The primary means by which to obtain that access would qualify in these conditions as a resource as well. The College Board in the United States estimates that the lifetime earnings for bachelor's degree graduates are 66 percent higher than those with a high school diploma. The data is robust that in addition to the so-called wage or income premium that higher education creates relates to better health outcomes, people who earn an undergraduate degree are less likely to commit a crime, more likely to be civically engaged (Baum 2016)(Taylor *et al.* 2014)(Edmiston, Brooks, & Shepelwich 2015)(Browne 2010)(Glater 2016).[8] As summed up in the Milburn Report in the United Kingdom, "In short, graduates are wealthier, healthier and happier" (Milburn 2012).

To comply with standards of egalitarian justice as laid out in Part 1, the state must neutralize bad brute luck if its aims are morally principled. The relationship between student debt and egalitarian justice can be understood around three questions: (1) do fees by themselves breach standards for egalitarian justice?; (2) if not, how could debt for higher education be made to meet standards of egalitarian justice?; and (3) what does egalitarian justice have to do with the fact that higher education has both public and private benefits?

As for the first question: It seems clear that charging tuition fees to gain access to higher education with no government assistance breaches egalitarian standards of justice. With substantial tuition fees, only students from wealthy families would be able to take advantage of the benefits of higher education. Having students pay for their own higher education without any financial assistance from the state would violate basic principles of moral equality because students lack equal starting points resulting from circumstances entirely beyond their control and not from their own choices. This is classic brute luck.

Access to higher education very directly relates to household wealth. This is true even when government grants and subsidized lending are available. Several studies show that the wealthier the family, the more likely the student is to attend and graduate from college or university. US Department of Education data show that high-income students scoring relatively low on standardized tests are more likely to earn degrees than low-income students with higher test scores (Blundell, Green, & Jin 2016) (Gould 2012)(Bailey & Dynarski 2011). These studies are all done in the context of a substantial debt infrastructure to assist students in need of funds to pay tuition fees for college or university. They reveal that merit works in the *opposite* direction: ability to pay is overriding when it comes to access to higher education. While we cannot test for a situation in which fees are charged in the absence of government assistance, we can reasonably infer that the situation would likely be worse in such a case.

Add to the household wealth lottery the geography lottery: students may through no choice of their own reside in regions in a country charging higher tuition fees for access to their public system of higher education than students in other regions. Students residing in Scotland, for example, pay no tuition fees, while students residing in England pay substantial fees. Students residing in California pay lower fees in their public system of higher education than students residing in Pennsylvania.[9] Add to the geography lottery that some US states maintain generous grant systems while others have none at all.

Finally, the intergenerational effects of student tuition fees have to be considered. Tuition fees for higher education have the real potential to undermine social mobility and entrench bad brute luck across generations. There are various kinds of bad brute luck and one such kind is the luck one has in the initial opportunity phase of one's life (Vallentyne 2002).

But let us assume for the sake of argument that there may be a way to finance higher education in a just manner through debt. Given the above-identified bad brute luck lotteries, we now face the second question: how could debt for higher education be made to meet demands of equality? Do student loans as they currently exist in the United States and the United Kingdom, for example, two societies in which students in higher education pay substantial tuition fees, neutralize bad brute luck?

The second question can be answered by looking at the terms of the student debt contract and how it is regulated. For many years in the United States, student loans did the opposite of neutralizing bad brute luck. Rather, they aggravated the effects of bad brute luck because of the extreme rigidity of student loans. UK student loan debt suffers less from this rigidity because the loan repayment conditions that make it more flexible have been in place for the most part since the inception of the loan program, unlike in the United States. Rigidity refers to the characteristics of debt as a legal obligation for scheduled fixed payments from the debtor to the creditor regardless of the debtor's circumstances or market conditions. Making debt less rigid would make it more amenable to accommodating life circumstances and thus more sensitive to equality concerns as they are understood in this article. As will be further explained in part 2.3 below, student loans have historically been more rigid than most debt, typically not dischargeable even when the debtor files for personal bankruptcy. The injustice that can flow from debt rigidity is covered in part 2.3 below.

On to the third question: what does egalitarian justice have to do with the fact that higher education has both private and public benefits? It advises governments on the need for balance and risk sharing in the financing of higher education. College and university degrees produce public benefits. Graduates produce positive externalities to societies. To the extent that poor and less affluent students must rely on loans and these loans subsidize higher education and societies, these students are in a position to object from a moral point of view. Adequate assistance must be provided. The relaxing of loan rigidity of loans is an important step. It provides for risk sharing between society and students. But an expanded grants system to reduce the ratio of loans to outright assistance would be an improvement from a moral point of view.

It is reasonable to impose some costs on students for future private benefits they will acquire as graduates. The economics of student lending informs us that student loans are a financial means by which a person transfers wealth from a future life period of relative prosperity to the present when times are lean (Akers & Chingos 2016). Student debt generates the opportunity for future prosperity.[10] It is well understood in economics that student lending finances an investment in human capital. This investment pays private as well as public benefits. Some personal investment is morally acceptable so long as its terms comply with the standards of egalitarian justice discussed above. To comply with the first principle, that of avoiding the financing of public goods primarily through private debt, we want our moral convictions to be respected while still maintaining some level of personal investment when goods are a mix of the public and private.

2.2. *Do Not Unreasonably Restrict Equality-Sensitive Access to Credit*

As discussed in part 1, access to credit and wealth are positively correlated. The lower a person's net worth, the more they rely on debt. Generally, access to credit is a more important institution for distributing resources for the poor than for the rich. We can say with some certainty that a good number (but certainly not all) of low-net worth persons in a society are in their disadvantaged position as a result of bad brute luck. For these persons, we would want the balancing of responsibility and justice in our luck egalitarian framework to put more weight on justice, to remediate the effects of bad brute luck. The question then becomes how to pick out which forms of credit are more or less sensitive to these egalitarian concerns. Under our luck egalitarian framework, some forms of credit will be more equality sensitive than others. If the kind of credit in issue is likely to neutralize bad brute luck inequalities and relates to distributing important resources in a society, then it is more apt for institutional design along egalitarian lines.

The home mortgage in societies in which substantial private home ownership is prevalent is an example of an equality sensitive form of credit. The regulation of mortgages took a turn after the global financial crisis of 2007-09 towards substantial restrictions of mortgage availability for low net worth households. These regulatory changes were designed around a single principle: financial stability. Reliance on the single variable of financial stability in designing mortgage credit allocation systems risks substantial restrictions on access to home mortgage credit for the less well off.

The UK's Turner Review, issued in March 2009, recommended a regulatory response to the crisis that included substantial reform of the regulation of mortgages towards actual product regulation and not simply disclosure – to what is known as regulation of the conduct of business of mortgage providers (Turner 2009).[11] The Review found: "Though not to the same extent as in the US subprime market, [UK] mortgage credit was extended to social categories which would not previously have enjoyed access . . . (Turner Review 2009). From an egalitarian perspective, the fallacy in the Turner Review's conclusions about mortgage credit is its evaluation of "credit-hungry families," "on the breadline," and "surviving singles." The Review characterizes "credit hungry families" as "less affluent families who rely on credit to fund lifestyles" and "on the breadline" as including only "singles" and "lone parents." These categories are flawed because they omit an important category of families who are "credit hungry" but because they actually need the funds to live a decent life in the societies in which they happen to be a member. These persons have no control over the fact that home ownership is one of the few means by which their society enables them to stay out of poverty, live in safe communities, save for their families, and have good schools for their children. Buying a house is not only about consumption of shelter. Society cannot both make particular resources essential for people to live a decent life and make them available only through private debt markets while depriving people with reasonable means by which to acquire these resources in those markets. These oversights result from focusing only on a single and incomplete policy aim of financial stability, a goal that just might be best achieved by making the unluckiest the worst off in the distribution of home mortgage credit.

Post-crisis, the United Kingdom and the United States have put in place a set of hard paternalistic laws governing the conduct of business by mortgage providers. These new rules regulate well beyond disclosure requirements (Johnston 2016). Regulation of the conduct of business of mortgage providers and actual mortgage terms and conditions is designed to deal with the fact that people choose poorly when it comes to financial products. These laws deal with problems of poor choice by mortgage borrowers, but they fail to deal with other factors of moral relevance in the design of debt regulation.

In the United Kingdom, the Turner Review led to a Mortgage Market Review and to the Financial Services Act 2012, all of which fed into the Mortgage Conduct of Business Regulations now found in the UK's Financial Conduct Authority Handbook.[12] The Mortgage Conduct of Business (MCOB) chapter in the Handbook deals with the "regulated mortgage contract."[13] It requires mortgage providers to assess mortgage affordability. It requires stress testing of borrowers by mortgage providers for some additional risks such as interest rate risk. It substantially restricts interest-only mortgages to borrowers with a repayment strategy independent of selling the property. It requires advice only mortgages and offers fewer protections for high net worth borrowers (Nield 2015)(Mak 2015)(Nield 2010).[14]

In the United States, housing stock is valued at $26 trillion, which makes it the largest asset class in the world, worth a modest amount more than capital in the American stock exchanges.[15] On mortgage affordability, US law is similar to UK law. The Dodd Frank Wall Street Reform and Consumer Protection Act of 2012 Section 1411 (b) amends the Truth in Lending Act[16] by inserting a new section 129C. Title XIV of Dodd-Frank is subtitled the Mortgage Reform and Antipredatory Lending Act. Section 1411, entitled "Minimum Standards for Residential Mortgage Loans," obligates both mortgage originators and brokers to refrain from making a residential mortgage loan unless they make "a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments."[17] Dodd Frank further provides that such a determination "shall include consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling."[18] Dodd Frank further requires that a mortgage lender "determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan."[19] The US Consumer Financial Protection Bureau specifies safe harbor or rebuttable presumption requirements in its Regulation Z for a "qualified mortgage" meeting these requirements. Regulation Z also prohibits interest-only periods in mortgages, negative amortization, balloon payments, loans for more than thirty years, and excess points of fees. It specifies permissible debt-to-income ratios for borrowing.[20]

Financial stability is indisputably an important policy goal for any financial system. Mortgage lenders certainly should evaluate the credit risk of borrowers. The UK and US mortgage affordability and ability to pay rules go further, however, to impose legal responsibility and potential liability on mortgage lenders for the creditworthiness of their borrowers. Substantive regulation of mortgages in the form of affordability requirements do not only shift costs to the lenders. A rational lender will in turn shift them back to borrowers. The borrowers who suffer the most are those least able to bear the loss, low net worth homeowners, who have the most to lose. In some cases, mortgage debt is a feasible way to distribute resources. It has historically been a significant way to distribute wealth to non-saving households in some societies.

An equality-sensitive set of regulatory institutions would not unduly restrict access to credit to those who need it most. The regulatory aim would not be to return to pre-crisis bad practices of toxic lending based on unverified income, assets, and credit histories but to develop a regulatory toolkit that is sensitive to the fact that restrictions alone can inflict serious degradations on people who need credit the most. It is a matter of supplementing the financial stability principle with an equality principle. One solution might be in soft paternalist approaches to nudge mortgage lenders to offer more innovative and less rigid loans. Mian and Sufi advocate a "shared responsibility mortgage," a hybrid concept with features of both debt and what are usually found in equity ownership (Mian & Sufi 2014). Equality sensitive regulatory incentives to promote product innovation might temper the morally problematic aggregation effects of the financial stability principle. Government homebuyer assistance for selected categories of low net worth borrowers also may be coupled with innovative mortgage products. Governments could tailor homebuyer assistance around concepts of luck. Additional solutions would be in policy innovations to mitigate foreclosure or repossession externalities.[21]

Yet another solution would be to shift the burdens of regulation onto banks that can more readily bear the risk, such as in requiring them to hold more equity in their capital structure. The current rules on capital adequacy are far from adequate and allow banks to maintain dangerous levels of debt on their books (Admati & Hellwig 2014). This solution has the advantage of imposing relatively fewer burdens on those less able to bear them (low net worth households) and relatively more on those more able to bear them (large banks). Still, by itself, capital adequacy rules may result in less lending to low net worth borrowers and so should be coupled with policy innovations to incentivize lending.

The basic insights about equality sensitivity in the design of debt regulation and contracts apply beyond the example of home mortgages. Sovereign debt is an example of an equality-sensitive form of debt. It can be salubrious and effective as a way to support economic and social policy or it could be predatory or odious.[22] Sovereign debt restructuring is equality sensitive to the extent that the debtor-government would have to use resources otherwise used to neutralize inequality or otherwise provide basic services to their citizens to service debt to external creditors (Goldmann 2014).

Some debt is less equality sensitive or not equality sensitive at all. Most forms of corporate and commercial debt, for example, are best left to be governed solely or primarily by the financial stability principle and principles of economics and finance. For example, corporate bonds are probably best understood using standard tools of economics and finance because a range of persons in different situations need to be able to rely on efficient capital markets to support their pensions, for insurance, for savings, and so on. Corporate finance in this sense plays an important social function. In many of these contexts, inequality is very purposefully built into the hierarchical structure of the finance. Mezzanine finance is an example. Dual class capitalizations offer another example. The inequality between debt and equity in corporate finance is uncontroversial.

Finally, another way to develop an equality-sensitive account of access to credit is to through a right to access to credit. There indeed may be such a right as Meyer argues (Meyer 2017). Meyer argues for two claim rights: one placing a duty on lenders to lend to creditworthy applicants and another on the state to provide educational and other forms of assistance to prospective borrowers. The focus in this article is on regulatory design – on how debt is regulated. The end result just might be, however, that the luck egalitarian framework applied here results or settles on rights to access to credit. Exploring whether that might be so is beyond our scope here.

2.3 *Relax the Rigidity of Debt in Appropriate Cases*

As we have seen, debt is often referred to with the metaphor of rigidity. Debt is rigid because one of its central features is that it is a fixed claim for repayment regardless of the value of the underlying asset it might be financing or the debtor's circumstances. Rigidity can be understood using any number of debt instruments. Corporations typically have a capital structure comprised of bonds, which are debt, and stock, which is equity. Bonds have by their terms a fixed payment structure and pay on the basis of their interest rates regardless of the success of failure of the corporation. Bond holders are entitled to the same fixed payment until the bond matures, regardless of firm performance. Shareholders, however, are known as residual claimants. Dividends are generally subject to legal standards prohibiting their payment when the corporation is insolvent.[23] Shareholder claims are subordinated to those of the bondholders both during the life of the corporation and at its death, during liquidation. Sovereign debt is also rigid: sovereign bond holders are entitled to payment regardless of the state of the finances or the economy of the sovereign debtor. Residential home mortgages, a classic form of household debt in many societies, is rigid: if the homeowner-borrower loses her job, she cannot go to the bank and ask for forbearance while unemployed. If the house is underwater because of massive housing price declines and the homeowner-borrower has negative equity in the house, she still must pay the mortgage on time and for the fixed and scheduled amount of principal and interest. These are but a few examples of debt rigidity.

Debt's rigidity makes it entirely insensitive to circumstances and brute luck. This circumstance/brute luck-insensitivity makes debt prone to produce social outcomes offending egalitarian justice. As explained previously, a positive relationship exists between reliance on debt and net worth – the poorer a person is, the more likely she relies on debt to secure resources necessary to live a decent life. Lower net worth persons must use costlier means to secure basic resources than higher net worth persons. Debt can be an extremely potent driver of inequality.

Affordability and ability to pay requirements and subsidies for debtors improperly focus only on at the point of formation of the debt contract and not on the terms and conditions of the contract. Policies focusing only or primarily on affordability or subsidy means that policies are focused on the most harmful and restrictive legal means to regulate debt from an equality standpoint. If ability to pay or affordability were the only policies in play to control debt for financial stability purposes, then governments could promulgate regulation that, for example, prohibits home mortgages for all households, with annual income, say, below $200,000. Financial stability might result from such a draconian policy, but such a policy would surely offend our notions of egalitarian justice. Methods exist to both promote financial stability and that do the least amount of harm from an egalitarian point of view.

Student loans are an example of an area in which debt rigidity has been somewhat relaxed through income-based repayments and loan duration limits. There are no affordability checks or risk assessments of student loans (Simkovic 2013)(Note 2012). In the United States, the financial need of the student determines the amount of the government subsidy and in the United Kingdom all student loans are subsidized, though the subsidies as between the two countries are different and what is most important is the overall cost of the loan to the borrower. While the student loan situation is far from ideal, it does show modest movement towards policies to balance subsidies, approval requirements, and rigidity relaxation.

For many years in the United States, student loans did the opposite of neutralizing bad brute luck. Rather, they aggravated the effects of bad brute luck because of their extreme rigidity. There was no option for loan forgiveness or income contingent repayment for many years and there still is not for loans entered before October 1, 2007. Some loans were and continued to be subsidized based on financial need, but these subsidies have nothing to do with loan terms on repayment but only with interest rates and deferral of interest accumulations until after graduation for subsidized loans. These loans were rigid in terms of their repayment obligations and operated like a standard debt contract but only with lower costs to the borrower if subsidized.

For loans issued after October 1, 2007, former President Obama put in place through Executive Order a pay-as-you-earn (PAYE) or income-contingent system capping monthly loan payments at ten percent of a graduate's monthly income.[24] These new rules somewhat relax the rigidity of student loans in the United States. Under this system, remaining balances are forgiven after twenty years of payment or ten years in public service. In the United States, private lenders no longer make government-guaranteed loans; the government is now lender. The Obama program is similar to the program the Browne Report in the United Kingdom recommended, an income contingent repayment scheme. The British government has adopted the principal aspects of these recommendations (Bolton 2012)(Bolton 2016). Starting in financial year 2012/13, UK graduates pay their loans back only when their income reaches or exceeds £21,000. An automatic repayment of nine percent above the income threshold is netted from the borrower's pay. A real interest rate will start to be charged when income reaches the income threshold, at a maximum of three percent above inflation when income reaches a second threshold of £41,000. Both earnings thresholds are increased annually. UK student loan debt is forgiven after thirty years.

Income-based repayment programs implement a limited form of luck neutralization. Distributive justice comes in at the back end, not at the front end, as it does with allocations of loans based on financial need. A more progressive form of distribution comes in at the contingent repayment level. Payment based on how much a borrower earns should result in a more progressive distribution of repayments, in which higher earning graduates repay more than lower earning graduates. But they still maintain substantial costs for unlucky borrowers because of their limited loan forgiveness provisions. Loan rigidity is relaxed but costs over the life of the loan can be high. As explained in the context of the UK program: "The impact of these changes on graduates is expected to be larger average loans, lower *monthly* repayments, a large increase in the average duration of long, increased average repayments across the lifetime of the loan (with the largest increases coming from the highest earners) and an increase in the proportion of graduates who have some of their loan written off from around 15% for pre-2012 borrowers to around 60%" (Bolton 2016).

Extreme rigidity remains in the United States for a large inventory of loans issued before October 1, 2007. This extreme rigidity also results from the fact that unless a debtor in personal bankruptcy proves "undue hardship" in an adversarial proceeding in federal bankruptcy court, section 523(a)(8) of the US Bankruptcy Code prohibits the debtor from discharging student debt.[25] The U.S. Court of Appeals for the Second Circuit in *Brunner v. New York State Higher Education Services Corp.* states the standard test for undue hardship. Debtors must prove that (i) if forced to pay the debt, she cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents; (ii) additional circumstances inform the court that this state of affairs will likely persist for a significant portion of the repayment period; and (iii) the debtor has made good faith efforts to repay the student debt.[26] This standard is very strict and results in relatively few discharges of student loan debt.[27]

British personal bankruptcy law contains a provision like that of Section 523(a)(8), making student loans "non-provable" in bankruptcy proceedings generally after September 1, 2004, which means they are not discharged in bankruptcy.[28] British law does not contain any undue hardship relief, but the effects of the provision may be less than expected, given that income contingency has been a feature of student loans in the United Kingdom since their inception.

Section 523(a)(8) and provisions like it reflect a contract model of bankruptcy. In this contract perspective, the statutory provision effectively mandates a term imposed on debtors in favor of creditors, ostensibly designed to prevent opportunism by graduates with no assets and supposedly little to lose by declaring bankruptcy soon after graduation (Jackson 1986). These rational choice arguments are now suspect for reasons having to do with problems of choice and compelling normative arguments also exist against the exemption.

The bankruptcy discharge exemption cannot meet the basic requirements for egalitarian justice. It very likely violates the fresh start policy fundamental to personal bankruptcy law in the United States (Howard 1987)(Porter & Thorne 2006). The undue hardship exemption in Section 523(a)(8) only partly relieves bad brute luck because it deals only with a very limited set of circumstances having to do with repayment of the particular obligation at hand and not more generally with bad brute luck and how not putting graduates in these precarious situations in the first place is the preferable position from the standpoint of equality. The provision has substantial and perverse redistributive effects on the worse off and those with bad brute luck. Student debt is unsecured debt, but the exemption gives it even better protection than secured credit, where the issue is whether secured creditors have "adequate protection" under US bankruptcy law.[29] The private lenders protected by section 523(a)(8) enjoy government guarantees for their loans and so the US federal government has already provided insurance against risk of discharge by opportunistic graduates. A mandatory term to protect sophisticated institutional creditors from insolvent individual debtors seems unwarranted.

Beyond student lending, there has been little movement towards rigidity relaxation but there have been several proposals for innovation on residential home mortgages, such as the above-discussed shared responsibility mortgage. Unlike in the United States, mortgages in the United Kingdom are overwhelmingly adjustable rate, which soften the blow to borrowers in economic declines because interest rates decline as well in such periods, but a shared responsibility mortgage goes further. A shared responsibility mortgage would be linked to a local house price index. If house prices rise or remain the same as when the mortgage was entered, the monthly mortgage payment stays the same as does the mortgage amortization schedule. If the house price index falls below the level it was when the borrower entered into the mortgage, the monthly mortgage payment reduces but the mortgage amortization schedule remains the same. This results in an automatic but temporary reduction of the mortgage principal. It is temporary because house prices tend to increase the longer the time period in which they are considered. So, when the local house price index increases, the mortgage payment and principal will revert to its initial state. To eliminate or reduce the possibility that the lender will increase mortgage interest rates to compensate for its risk in sharing the downside potential of the housing market, the shared responsibility mortgage could give the lender, say, a five percent share of the capital gain when the home is sold or refinanced. Others have similar advocated alternative mortgage products (Campbell 2013)(Cocco 2013). A continuous workout mortgage adjusts payments in response to trigger events such as recession or job loss (Shiller, Wojakowski, Ebrahim & Shackleton 2013); Shiller, Wojakowski, Ebrahim & Shackleton 2011). Governments also could require or incentivize home owners to buy home equity insurance to cover mortgage payments in the event of job loss or other developments that hinder ability to pay (Shiller 2012).

Sovereign debt is another area in which there have been some proposals for debt flexibility but no action by governments, creditors, or international organizations.[30] One such proposal would be for contingent repayment based on the ability of the sovereign debtor to finance basic minimums for their population. Another might be to treat debt that is invested for future generations differently than debt intended for short-term consumption (Reddy 2007). Other examples are in linking payments or interest rates to GDP growth (Shiller 2012). These terms would of course be priced into the debt.

Finally, yet another area is in health care finance in states that lack public provision of health care. Assume that access to health care in some form constitutes a resource or basic social good subject to the demands of equality. This has been the subject of a good deal of research (Daniels 1985)(Segall 2009). Health care in countries like the United States rely on a mix of private and social insurance and deductibles to pay for health care. It has been the case, with some variation, that some less advantaged persons cannot afford any health care insurance, and some cannot bear the cost of deductibles associated with insurance policies. Some less advantaged persons have no choice but to self-insure. The number of personal bankruptcies annually in the United States associated with health care expenses is debated but the consensus is that it is significant number (Dobkin *et al*. 2018). Medical debt afflicts a particularly egregious form of misery as persons can be critically ill while having to face down medical bill collectors. A significant number of these persons afflicted by medical debt are the victims of bad brute luck. In situations such as this, some form of equality-sensitive structuring of regulation and policy is required to mitigate the harshness of bad brute luck, which can include government engagement in the insurance market, as in the US Affordable Care Act. Yet to be innovated would be hybrid debt products linking payment of medical expenses to some income-contingency conditions similar to the structure of student debt. These are complex products yet to be explored.

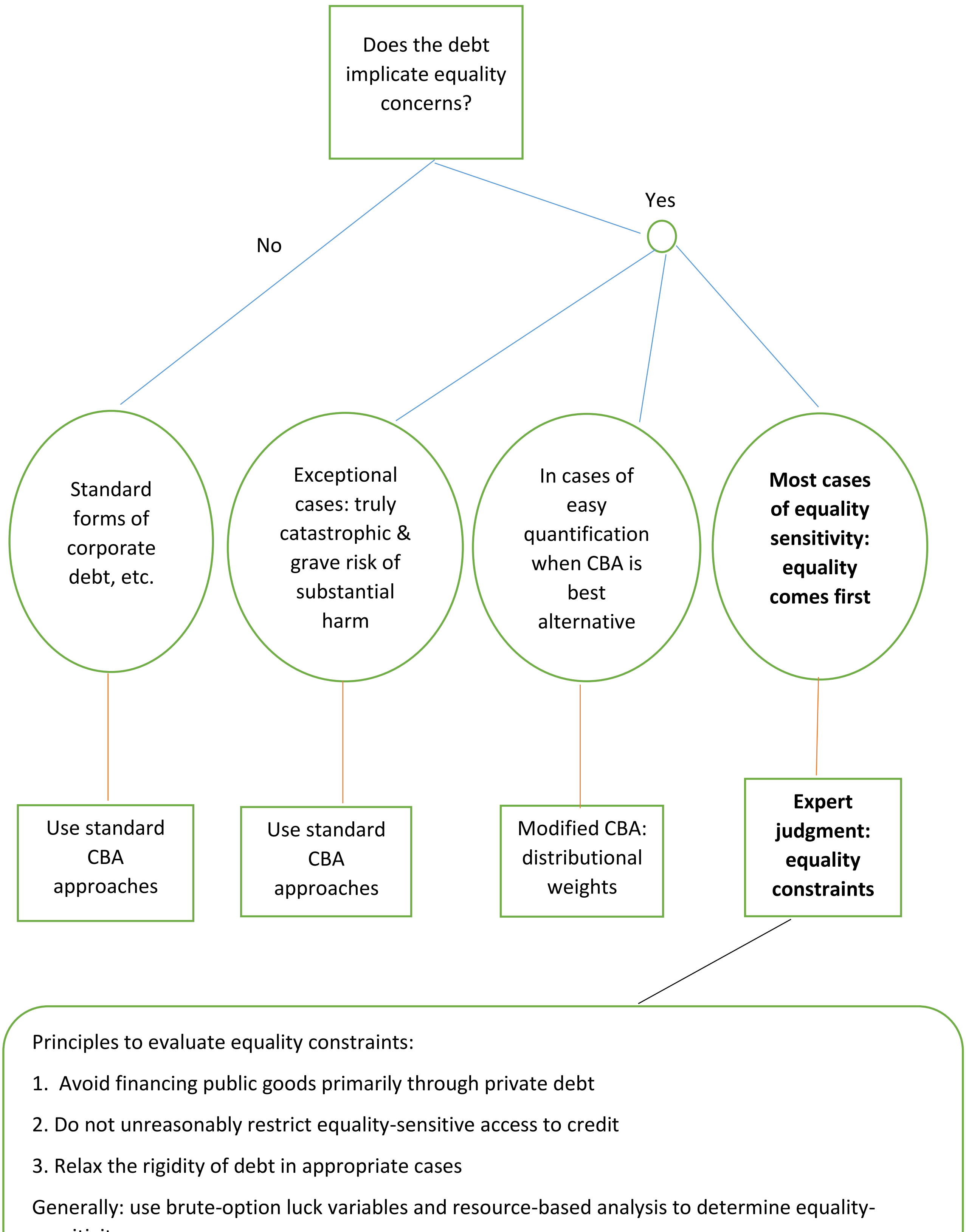
The corollary to the above points on relaxing affordability and rigidity is that any debt subsidies would have to be managed so as not to create unsustainable increases in asset values, high default rates, and externalities associated with defaults on debt obligations. An example of a harmful set of debt subsidies not accompanied by relaxation of debt rigidity can be found in the law and financial practices leading up to the most recent global economic crisis, with featured easy credit policies and government subsidies for mortgage securitization in the United States.[31] Governments should do both together – subsidize and relax – or neither.

3. *Regulatory Implications*

Current practices in regulatory agencies have not yet brought the equality concerns raised in this article to bear on regulatory design. Most of the advances to date have either focused on equality as it relates to protected categories or characteristics (race, gender, sexual orientation, etc.) or on trying to add distributive weights to some form of cost benefit analysis (CBA). Given CBA's influential role in regulatory design, the recommendations here will interact with specific elements of CBA, where appropriate. I assume that financial stability can be reliably evaluated using CBA, though this finding is contested (Coates 2015).

The disciplinary approach of this article shares with other philosophical theories about equality, at least implicitly, a feature known as a lexical priority: the order in which principles of justice, equality, and other normative principles are to be satisfied in any public policy. This article identifies a continuum of forms of debt, some of which should be sensitive to concerns of equality and others less so or not at all. We can use these features to develop a decision tree to guide regulators, as set forth in figure 1. The decision tree is constructed around a threshold decision about whether the form of debt to be regulated implicates concerns about equality. If not, then standard CBA techniques can be employed in decision making about regulation. If concerns about equality are implicated, then the regulator has three choices. First, the regulator can still refuse to take equality concerns into account in the very rare case in which concerns about financial stability are so serious as to be overriding. This would be the highly unusual case in which, first, equality concerns are implicated, and second, to take them into account in regulation would likely cause substantial collective harm. Moral theory should not be employed to support a rule or action that would be absurd or dangerous. Second, the regulator can try to develop distributional weights for CBA in cases in which quantification and inclusion of such weights is plausible and reliable. There is great interest in this approach (Deighton-Smith, Erbacci & Kauffman 2016). It, however, does not comply with the demands of equality developed in this article. It is insensitive to the principles elucidated in Part 2. It is included here because there may be cases in which it offers a superior alternative from a pragmatic point of view in taking some equality concerns into account. There are many problems with this approach, not the least of which it can be unreliable and threatens the integrity of CBA, and perhaps more importantly for the analysis here, it is not sufficiently sensitive to the luck egalitarian considerations elucidated in this article. Lastly, in many cases in which the threshold determination is that the equality concerns implicated in this article are in issue, the approach to evaluating regulatory options will be in expert judgment as a separate and distinct exercise from CBA, the finding of which will trump or override the CBA if CBA outcomes conflict with equality concerns. The use of expert judgment to evaluate distributive considerations is in evidence in Canada and to a more limited extent in other countries (Deighton-Smith, Erbacci & Kauffman 2016). There is a great deal of distance, however, between the findings and recommendations of this article and current practice. This article offers a novel set of concrete principles to put this expert judgment in new territory grounded in a philosophical theory about equality. To date, moral philosophy has had very little if any impact in this area and this article attempts a shift in direction.

Figure 1


Does the debt implicate equality concerns?
No
Yes
Standard forms of corporate debt, etc.
Exceptional cases: truly catastrophic & grave risk of substantial harm
In cases of easy quantification when CBA is best alternative
Most cases of equality sensitivity: equality comes first
Use standard CBA approaches
Use standard CBA approaches
Modified CBA: distributional weights
Expert judgment: equality constraints
Principles to evaluate equality constraints:
1. Avoid financing public goods primarily through private debt
2. Do not unreasonably restrict equality-sensitive access to credit
3. Relax the rigidity of debt in appropriate cases
Generally: use brute-option luck variables and resource-based analysis to determine equality-

Conclusion

This article seeks to promote the development of methodologies to regulate debt and access to credit from the standpoint of luck egalitarianism. Normative principles currently predominating legal and policy discussions about debt and access to credit come primarily from economics and finance. These disciplines offer a substantial set of tools to measure and evaluate distribution and inequality. Political philosophy offers complementary insights on the situations in which inequality relating to access to credit are morally objectionable. Political philosophy is not empirical but can assist governments in evaluating legal and policy options. Law, economics, and political philosophy can be used in combination to develop debt regulation that aims for fairness, efficiency, and justice. This article is an early step in bringing these disciplines together to show how governments can undertake this important work.

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[1] The first sentence of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Public Law No 111–203 (21 July 2010), 124 Stat 1376 (2010), provides: "To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ''too big to fail'', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes. . . ." The Financial Stability Board, established in April 2009 and located at the Bank for International Settlements, forms a pillar of the current global financial order, succeeding the Financial Stability Forum. Financial stability has been the subject of attention of the Bank for International Settlements and the Basel Committee on Banking Supervision for some time. The Bank of England's definition of financial stability is available at http://www.bankofengland.co.uk/financialstability/Pages/default.aspx.

[2] An alternative approach may have relied more directly on Rawls, but the aim here is to focus on an account taking responsibility directly into account, given the transactional qualifies of the debt contract. Reliance on luck eqalitarianism also allows us to avoid debates about whether Rawls actually did take the concept of luck into consideration (Freeman 2007)(Hurley 2003). The application of other theories of equality might produce similar conclusions to those reached in this article, in particular G.A. Cohen's equal access to advantage and Richard Arneson's equality of initial opportunities approaches (Arneson 1989)(Cohen 1989). Dworkin's account has some special features in its division between option and brute luck that are amenable to evaluating equality concerns about debt. Alternatively, we can simply take the application of Dworkin's approach as a given and save the discussion of competing approaches for another day.

[3] [1975] QB 326, [1974] All ER 757.

[4] Dworkin explains that "option luck is a matter of how deliberate and calculated gambles turn out – whether someone gains or losses through accepting an isolated risk her or she should have anticipated and might have declined" (Dworkin 2000, p. 73).

[5] *See also* UK Mortgage Market Review, Feedback on CP11/31 and final rules (Oct 2012).

[6] Data can be found on the US Department of Education website. https://studentaid.ed.gov/sa/about/data-center/student/portfolio.

[7] For US consumer price index data, *see* http://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/.

[8] The UK Institute for Fiscal Studies recently reported that wage premiums remain high despite increasing numbers of A-level graduates enrolling in UK universities. (Blundell, Green, & Jin 2016).

[9] *See* (Friedman 2016(.

[10] Not addressed here is the misuse of student loans that result from the failure of governments to means test student lending. Research on student loans has uncovered that there can be two groups of students

taking out student loans: one that used the finance to pay tuition fees and for accommodation and another coming from wealthier families, who use student loans to finance a higher standard of living and to pay for holidays during university breaks. (Christie & Munro 2003).

[11] *See also* (Prouza 2013, p. 36)(discussion of available regulatory options with a focus on conduct of business).

[12] The UK Financial Conduct Authority Handbook, https://www.handbook.fca.org.uk/handbook.

[13] *Ibid.,* Rule xx.

[14] *Ibid.* Ch. 11.

[15] Comradely Capitalism, *The Economist*, 20-26 Aug. 2016, 16.

[16] Truth in Lending Act Chapter 2, 15 U.S.C. §1631 *et seq.* (2006). For a discussion of these statutory provisions, *see* Pottow (2011).

[17] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 §1411, 124 Stat. 1376, 2142 (2010).

[18] *Ibid.*

[19] *Ibid.*

[20] Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 12 CFR Part 1026.

[21] Beyond our scope is an evaluation of social or public housing. As this article is on debt, the focus is on mortgages and private home ownership. The social housing solution is only a stop gap unless the collective choice is to move the economy away from private home ownership. There are also concerns about what might be involuntary or forced renting in a society in which home ownership produces sharp class distinctions. (Williamson 2009, pp. 234-235).

[22] *See* (Shiller 2012, p. 158) on salubrious debt as "designed by the lender to have a salutary effect in terms of social welfare." This concept can be extended to the borrower's intention as well.

[23] *See, e.g.,* Delaware General Corporation Law §170.

[24] The White House, 'Factsheet: Making Student Loans Affordable', 9 June 2014; https://www.whitehouse.gov/the-press-office/2014/06/09/factsheet-making-student-loans-more-affordable; The White House, Presidential Memorandum -- Federal Student Loan Repayments, 9 June 2014, Memorandum for the Secretary of the Treasury and the Secretary of Education. As of the date of this writing the Trump Administration has not promulgated new student loan policies.

[25] 11 U.S.C. §523(a)(8).

[26] 831 F.2d 395, 396 (2d Cir. 1987)(per curiam).

[27] (Iuliano 2012, p. 495) ("Incredibly, only 0.1 percent of student loan debtors who have filed for bankruptcy attempt to discharge their student loans.").

[28] Insolvency Service Technical Manual (July 2015), sections 40.77; 40.92; Education (Student Loans Repayment) Regulations 2009, Regulation 80.

[29] 11 U.S.C. §361.

[30] According to Kenneth Rogoff: "If . . . governments stood back and asked themselves how to channel a much larger share of the imbalances into equity-like instruments, the global financial system that emerged might be a lot more robust than the crisis-prone system we have now." (Rogoff 2011).

[31] There are many explanations of the events leading to the most recent global economic crisis. Just a few accessible accounts are cited here: (Mian & Sufi 2014)(Calomiris & Haber 2014)(Financial Crisis Inquiry Commission 2011)(Rajan 2010)(Turner 2009).