

The Redistributive Effects of Debtor Protection Laws

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Abstract : We exploit state-level changes in the amount of personal wealth individuals can protect under Chapter 7 to analyze the causal effect of debtor protection on income inequality. We find that an increase in state exemptions significantly increases inequality by reducing income for low-income individuals and by increasing income for high-income individuals. The increase in inequality is four times larger among the self-employed than among wage earners, and it is due mainly to a growing income gap between skilled (i.e., individuals with a college degree) and unskilled entrepreneurs. We also find that the employment rate of skilled entrepreneurs significantly increases, while the employment rate of unskilled wage earners falls. Our results are consistent with a recent literature that shows that higher exemptions redistribute credit from low-wealth to high-wealth entrepreneurs, affecting the performance of their businesses.

Keywords : debtor protection, credit markets, income inequality, debtor protection laws

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