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R. Jervis

Bankruptcy

Bankruptcy procedures are intended to provide an efficient and fair mechanism for the reorganization or liquidation of the assets of insolvent debtors. Debtors include both individuals and business entities. A second important objective of some bankruptcy procedures is the financial rehabilitation of overindebted individuals. Rehabilitation sometimes includes discharge of indebtedness.

1. Fair and Efficient Administration of Insolvent Estates

1.1 The Need for Bankruptcy

Reliance on the usual legal procedures to collect debts from non-paying debtors can lead to inefficient and unfair results when applied to an insolvent debtor. When there are not enough assets to pay all creditors, non-bankruptcy law commonly favors the creditor who seizes and sells assets before other creditors do. The resulting race to seize the debtor's assets can lead to inefficient dispositions of debtor's assets. For example, if a business is making a profit even while insolvent, it may be more efficient to allow it to continue to operate and pay debts from future profits, yet competition between creditors can lead to sale of assets that makes continued operation of the business impossible (Jackson 1985). Competition between creditors also leads to unnecessarily duplicative collection activities. Many people also believe it is unfair to give priority in the distribution of the limited assets of an insolvent estate to the creditors who are the first to initiate formal collection actions.

Bankruptcy procedures address each of these difficulties. Once a bankruptcy proceeding is initiated, unsecured creditors are automatically enjoined from using non-bankruptcy collection procedures. In some countries, secured creditors are similarly enjoined. These injunctions eliminate duplicative collection efforts and permit an orderly disposition of the debtor's assets. In bankruptcy, the debtor's assets constitute a bankruptcy estate, to be managed in the interests of the estate's beneficiaries, the creditors. When the bankruptcy estate makes distributions, creditors with similar contractual priorities are usually paid pro rata according to the amount they are owed. Contractual promises to subordinate or to privilege particular creditors in the distribution of debtor's assets (including security agreements) are normally respected, and a few creditors (e.g., tax creditors) receive priority payments by statutory mandate. However, priorities are not usually given to creditors who have initiated collection activities before the bankruptcy filing.

1.2 Liquidation vs. Reorganization in Business Bankruptcy

The assets of an insolvent business estate may be sold, either as a unit or in separate parts, to the highest bidder(s), which is called a liquidation. Alternatively, the assets may be retained by an entity and operated as a continuing business, which is called a reorganization. In a liquidation, creditors are paid the proceeds of the sale(s). In a reorganization, creditors are given securities (debt instruments and/or shares) in the new reorganized entity, which represent rights in the future income of the continuing business. Bankruptcy creditors often have conflicting interests in the decision whether to liquidate or reorganize an insolvent business estate.

Creditors with contractual priority over other creditors (including, most importantly, secured creditors) usually prefer rapid liquidation if the anticipated proceeds will pay them in full. Reorganization both delays repayment and introduces an element of risk, because the continuing business might lose money, thus depriving these senior creditors of full payment. This preference for liquidation exists even when reorganization seems the better option from the

perspective of creditors generally, because a reorganized business is more likely than not to make profits, yet in an immediate sale a buyer is not likely to pay for those prospective gains.

Contractually subordinated creditors, on the other hand, may favor reorganization, even when it seems more likely than not that a reorganized business will suffer losses. Immediate liquidation of the assets may not yield any payments to subordinated creditors, and there is always a possibility of payments from the future profits of a continuing business. Three other groups may also favor reorganization, even when immediate liquidation seems a better prospect for maximizing payments to creditors. Trade creditors may prefer to continue the business under the former management because of the prospect of making future sales. Management of the business is often identified as a separate interest group favoring reorganization, both to preserve their jobs and to provide an opportunity to rehabilitate professional reputations harmed by business insolvency. Finally, the owners of the insolvent business will normally favor reorganization. They will receive nothing if the business is liquidated while insolvent, but in a reorganization future profits of the continuing business may be sufficient to return the entity to solvency.

1.3 Governance Issues in Business Bankruptcy

Conflicts in interest between creditors can generate controversy about control over decision-making within a bankruptcy. In most countries, senior creditor interests control the appointment of the effective decision makers. Often, secured creditors are not even enjoined from foreclosing on their collateral by the initiation of bankruptcy, and they may be able to force liquidation simply by doing so. In these circumstances, reorganization within bankruptcy may seem unlikely. In response, management and owners of insolvent businesses may take desperate steps in order to avoid a bankruptcy filing. For example, a business might sell non-essential assets quickly at lower prices than could be obtained if more time were taken, in order to pay off a senior creditor who is threatening to seize assets (Baird 1991). Junior creditor interests may also purchase the claims of senior creditor interests, even after a bankruptcy filing, in order to forestall an immediate liquidation.

In the United States, bankruptcy procedures often allow management of the insolvent business to exert substantial control over decision-making within bankruptcy. It is widely believed that this system leads to decisions to reorganize an insolvent business when immediate liquidation would be in the overall interests of creditors as a whole. Furthermore, it causes senior-creditor interests to agree to compromise their contractual priority rights, in favor of junior interests, in order to facilitate a quicker liquidation or a reorganization in which senior interests receive debt instruments with a high likelihood of ultimate payment. There has been considerable academic criticism of the governance of business bankruptcy in the United States, describing it as inefficient for allowing insolvent businesses to continue without sufficient prospects of returning to profitability, and as unfair in failing to protect fully contractual priority rights (Bradley and Rosenzweig 1992). Its defenders point out that there are many non-creditors with an interest in reorganization—most importantly, the employees of the insolvent business (Warren 1993).

1.4 Law and Practice in Business Bankruptcy

Although frequently subject to the same formal rules, there are often important practical differences between the administration of bankruptcy estates of large and small businesses. In the case of large businesses, there are likely to be substantial assets and many creditors. Creditors with different priorities are organized into groups and represented by lawyers. Cases tend to be litigious and lengthy, but most interests are represented vigorously. Because of the influence of management, there may be a slight favoritism towards reorganization, but it is not great (LoPucki and Whitford 1993). In small-business bankruptcies, however, apart from possibly one large creditor which is likely to be secured, creditors are more likely to believe that the combination of the amount of debt at stake and the prospect of a substantial ultimate payment is insufficient to justify investment in legal fees. As a result, governance in small-business cases often is left to management and perhaps the one large creditor, and they may agree to a reorganization or to delay liquidation, to the substantial detriment of creditor interests (LoPucki 1983). There have been calls for greater judicial or administrative oversight of the governance of small cases to insure more appropriate representation of smaller creditor interests.

2. Rehabilitation of Individual Debtors

The automatic injunction upon bankruptcy filing against non-bankruptcy collection actions can help the financial rehabilitation of individual debtors. By protecting the debtor's paychecks and bank accounts from judicial attachment during the course of the bankruptcy proceedings, the automatic injunction gives the debtor time to work out financial problems. Most countries allow the debtor to extend the duration of the automatic injunction for several years by proposing and then carrying out a plan for the repayment of some or all of the debt through periodic payments.

A few countries, most notably the United States, allow an individual debtor to obtain a discharge of

many unsecured debts in a bankruptcy proceeding. Before getting the discharge, the debtor must turn over for the benefit of unsecured creditors all property that is not encumbered by a security interest, or considered exempt from this requirement because it is essential to the debtor's everyday life. In practice, individual debtors usually enter bankruptcy with little or no property that is neither exempt nor unencumbered, so unsecured creditors usually receive nothing in these bankruptcy proceedings.

The availability of discharge has been justified historically as a means of providing individuals with a 'fresh start,' so that they might again become productive economic participants in society. An overindebted debtor without realistic hope of repaying all debts in the foreseeable future has little incentive to seek new economic opportunities, because the primary beneficiary of increased income will be the creditors (Whitford 1997). Relief of individual hardship is another rationale sometimes offered for the discharge.

The majority of countries that allow for the discharge of individual debt make the availability of this relief conditional upon completion of a plan for payment of debts over a three- to ten-year period (Huls 1994). Conditional discharge availability in this manner is justified as discouraging the incurring of debt in anticipation of discharge. It is also believed that payment plans can provide debtors with the opportunity to learn the disciplined living and household budget skills that will contribute to the overall financial rehabilitation objective, but there is little information available about how well payment plans achieve that objective. It is known that in the United States, where debtors have certain incentives to enter a payment plan voluntarily rather than seek an immediate discharge, more than two-thirds of payment plans are not completed successfully. Countries vary in whether they will grant a discharge to a debtor who has attempted, but not completed, a payment plan. Where discharge is denied, the result is a significant restriction of the availability of a fresh start to individual debtors.

The use of credit cards and unsecured indebtedness by individuals has increased dramatically throughout the world since the 1980s. Probably as a result of this, many countries are now reconsidering their laws concerning individual bankruptcy. Many countries that have not previously permitted discharge of consumer indebtedness now allow an individual to gain a fresh start, provided the debtor makes an attempt in good faith to complete a payment plan (Niemi-Kiesilainen 1997). In the United States, where traditionally debtors have been able to obtain a discharge without first attempting a payment plan, there has been a rapid increase in the bankruptcy filing rate. As a response, there is a significant political effort to limit the availability of the discharge for debtors whose income exceeds certain standards. These debtors would be required to complete a five-year payment plan before receiving a discharge of any amount not paid under the plan. If adopted, the result is likely to be a significant decrease in the bankruptcy filing rate, and, because most payment plans will not be completed satisfactorily, an even greater decrease in the number of discharges in bankruptcy.

See also: Business Law; Consumer Economics; Ethical Codes, Professional: Business Codes

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Basal Ganglia

1. Basal Ganglia Anatomy and Neurochemistry

As an anatomical entity, the basal ganglia have undergone significant revision. In 1664 anatomist Thomas Willis originally termed this subcortical region of the telencephalon 'corpus striatum.' The development of neuronal tracing techniques by Nauta and colleagues in the mid-1950s (e.g., silver degeneration) allowed for elucidation of efferent connections within the broadly defined corpus striatal region, and the term 'basal ganglia' was eventually adopted to refer to a relatively restricted group of subcortical structures that originally included the caudate nucleus and putamen, the globus pallidus, the claustrum, and the amygdala. As the amygdala became more closely identified as a component of the limbic system, its inclusion as a basal ganglia structure was dropped.

International Encyclopedia of the Social & Behavioral Sciences ISBN: 0-08-043076-7