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Consumer Bankruptcy and Household Debt

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Summary

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA, P.L. 109-8) included the most significant amendments to consumer bankruptcy procedures since the 1970s. The 110th Congress continues to monitor the impact of the new law on debtors and creditors. Bankruptcy reform was enacted in response to the high number of consumer bankruptcy filings, which in 2005 and 2006 reached five times the level of the early 1980s. Why did filings increase so dramatically during a period that included two of the longest economic expansions in U.S. history? Because bankruptcy is by definition a condition of excessive debt, many would expect to see a corresponding increase in the debt burden of U.S. households over the same period. However, while household debt has indeed grown, debt costs as a percentage of income have risen only moderately. What aggregate statistics do not show is that the debt burden does not fall equally on all families. Financial distress is common among lower-income households: in 2004, 27% of families in the bottom fifth of the income distribution spent more than 40% of their income to repay debt. This report presents statistics on bankruptcy filings, household debt, and families in financial distress, and it will be updated as new statistics become available.

This report presents data on bankruptcy filings, household debt, and families in financial distress. **Table 1** shows filings since 1980. Business filings peaked in 1987 and have since declined, but the number of consumer filings continued to grow through 2005. In 2005, the number of filings surpassed 2 million — there was a "rush to the courthouse" before the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) took effect in October 2005. In 2006, filings dropped sharply, suggesting that the new law caused many to accelerate their filings, and that many petitions that would have been filed in 2006 (or later) were pushed forward by bankruptcy reform.

Whether (or how much) BAPCPA will reduce filings in the long run is still unclear. Filings have risen steadily from the 2006 lows, and in the second quarter of 2008 reached 266,667, or over 1 million at an annual rate. Weakening credit market and macroeconomic conditions in could produce further increases.

Table 1. Bankruptcy Filings in the United States, 1980-2008

Year	Total Filings (number)	Business Filings (number)	Nonbusiness or Consumer Filings		
			Number	% Change from Previous Year	Filings Per 1,000 Population
1980	331,264	43,694	287,570	46.0	1.26
1981	363,943	48,125	315,818	9.8	1.37
1982	380,251	69,300	310,951	-1.5	1.34
1983	348,880	62,436	286,444	-7.9	1.22
1984	348,521	64,004	284,517	-0.7	1.20
1985	412,510	71,277	341,233	19.9	1.43
1986	530,438	81,235	449,203	31.6	1.87
1987	577,999	82,446	495,553	10.3	2.04
1988	613,465	63,853	549,612	10.9	2.24
1989	679,461	63,235	616,226	12.1	2.49
1990	782,960	64,853	718,107	16.5	2.87
1991	943,987	71,549	872,438	21.5	3.45
1992	971,517	70,643	900,874	3.3	3.53
1993	875,202	62,304	812,898	-9.8	3.15
1994	832,829	52,374	780,455	-4.0	2.99
1995	926,601	51,959	874,642	12.1	3.33
1996	1,178,555	53,549	1,125,006	28.6	4.24
1997	1,404,145	54,027	1,350,118	20.0	5.02
1998	1,442,549	44,367	1,398,182	3.6	5.17
1999	1,319,465	37,844	1,281,581	-8.3	4.68
2000	1,253,444	35,472	1,217,972	-5.0	4.54
2001	1,492,129	40,099	1,452,030	19.2	5.10
2002	1,577,651	38,540	1,539,111	6.0	5.33
2003	1,660,245	35,037	1,625,208	5.6	5.59
2004	1,597,462	34,317	1,563,145	-3.8	5.32
2005	2,078,415	39,201	2,039,214	30.5	6.92
2006	617,660	19,695	597,965	-70.6	1.98
2007	850,912	28,322	822,590	37.6	2.74
2008[a]	522,205	18,456	503,749	28.4	3.10

Source: Administrative Office of the U.S. Courts.

a. Figures for 2008 are first half; rates are for the 12-months ending June 30, 2008, compared with the previous 12-month period.

Table 2. Household Debt Levels and Debt Burden, 1990-2008

Year	Consumer Credit ($ billions)			Home Mortgage Debt ($ billions)		Debt Burden (% of Income Used for Debt Payments)	Debt as % of Disposable Personal Income
	Revolving	Non-revolving	Total	Home Equity Loans	Total		
1990	238.6	569.6	808.2	214.7	2,502.5	11.98	76.1
1991	263.8	534.3	798.1	222.0	2,681.2	11.53	76.6
1992	278.4	527.7	806.1	217.1	2,852.9	10.80	75.1
1993	309.9	555.7	865.6	210.4	3,007.8	10.80	77.1
1994	365.6	631.6	997.2	221.8	3,173.7	11.17	78.8
1995	443.5	697.5	1,141.0	237.5	3,327.9	11.86	81.6
1996	499.6	743.2	1,242.8	262.6	3,534.8	12.12	84.0
1997	536.7	783.3	1,320.0	297.0	3,752.8	12.11	84.7
1998	576.5	839.3	1,415.8	309.9	4,054.0	12.07	85.5
1999	604.5	923.6	1,528.1	334.3	4,431.0	12.41	89.0
2000	675.7	1,028.9	1,704.6	407.3	4,808.3	12.89	90.5
2001	741.7	1,127.3	1,869.0	439.0	5,292.9	13.39	95.7
2002	762.8	1,189.9	1,952.7	500.7	6,036.2	13.57	102.0
2003	781.6	1,252.8	2,034.4	593.4	6,887.1	13.55	109.2
2004	810.1	1,310.4	2,120.5	775.6	7,845.4	13.57	115.0
2005	829.2	1,348.0	2,177.2	914.9	8,875.7	14.10	120.0
2006	880.1	1,520.0	2,400.1	1,065.8	9,872.9	14.42	124.8
2007	940.6	1,583.0	2,523.6	1,129.2	10,542.7	14.39	128.1
2008[a]	965.6	1,614.4	2,580.0	1,128.0	10,639.9	13.85	122.0

Sources: (1) Federal Reserve, Release G. 19, Consumer Credit; Release Z.1, Flow of Funds Accounts, Table L. 218, Household Mortgage Debt; Household Debt Service Obligation Ratios, DSR. (2) Bureau of Economic Analysis, Personal Income & Outlays, Table 2.

a. Figures for 2008 are for the end of the second quarter.

Table 2 shows figures on household debt. The major categories of household debt are mortgage debt and consumer credit, which together comprise about 97% of all household indebtedness. Consumer credit consists of (1) revolving credit, or credit card debt, and (2) non-revolving debt, which is dominated by auto loans (though it also includes loans for boats, mobile homes, vacations, and so on). Mortgage debt is borrowing secured by real estate. A subcategory within mortgage debt, home equity lending, is broken out in the table because it may substitute for consumer credit in many cases.

Table 2 also includes Federal Reserve estimates of the burden of debt service, that is, the percentage of household disposable income that goes to repay loans. Over the past decade, the rise in this measure has been steady, but not dramatic. The debt burden figures in **Table 2** fluctuate within a fairly narrow range: from 10.80% to 14.42%. (During the

1980s, the range was similar: from 10.6% to12.5%.) Although the burden of debt has risen since the 1980s, particularly since 2001, the increase has been gradual and would not appear to explain much of the fivefold increase in personal bankruptcy filings over the past two decades.

Interest rates paid by consumers — particularly mortgage rates — declined in recent years to the lowest levels since the 1950s, and they remain low. The relative stability of the debt burden in the face of falling and historically low interest rates implies that the ratio of debt outstanding to income has been rising. This ratio — the sum of consumer and mortgage debt shown in the table expressed as a percentage of disposable personal income — is shown in the far right column of **Table 2**. The increases in this figure, which since 1990 has risen more than twice as fast as the debt burden, suggest that further increases in bankruptcy filings (and perhaps problems for lenders) may lie ahead if interest rates should rise suddenly or unexpectedly. Many homeowners face resets on their adjustable-rate mortgages, with possible increases in their mortgage payments, but the prevalence of fixed-rate mortgages may mitigate this effect at the national level.[1] For the present, however, historically low interest rates have permitted households to take on more debt without a major increase in the debt burden.

Table 3. Percentage of Families in Financial Distress by Income Level, 1995-2004

Percentile of Income Distribution	1995	1998	2001	2004
All families	11.7	13.6	11.8	12.2
Below 20	27.5	29.9	29.3	27.0
20-39.9	18.0	18.3	16.6	18.6
40-59.9	9.9	15.8	12.3	13.7
60-79.9	7.7	9.8	6.5	7.1
80-89.9	4.7	3.5	3.5	2.4
90-100	2.3	2.8	2.0	1.8

Source: Federal Reserve, Survey of Consumer Finances, in: *Federal Reserve Bulletin*, February 2006.

Note: Families in "financial distress" are those devoting over 40% of their incomes to debt repayment.

The aggregate household debt numbers mask important differences among families: some have done very well in the long booms of the 1980s and 1990s, while others have taken on debt that they have difficulty repaying. **Table 3** above, based on the Federal

[1] Since 1990, about three-quarters of mortgages have been fixed-rate loans. For information on the recent increase in mortgage foreclosures, see CRS Report RL34232, *Understanding Mortgage Foreclosure: Recent Events, the Process, and Costs*, by Darryl E. Getter.

Reserve's Survey of Consumer Finances, shows the percentage of families at various income levels who devote more than 40% of their incomes to debt service, for selected years from 1995 through 2004. Two noteworthy facts emerge from the data in **Table 3**. First is the high rate of distress among lower-income families, who are the most likely to file for bankruptcy.[2] Second, like the debt burden figures shown in **Table 2**, there is no sharply rising trend that would explain the dramatic increase in personal bankruptcy filings. The percentage of all families in distress in 2004 is little changed from the 1995 level. Consumer bankruptcies in 2004, on the other hand, were up 79% over the 1995 figure.

The question remains why so many families at or below the national median income take on high levels of debt and end up in bankruptcy court. Some explanations focus on particularly vulnerable populations: the sick and uninsured (or underinsured), the divorced, or residents of states without mandatory uninsured motorist coverage. Supporters of the bankruptcy reform measure finally enacted in 2005 argued that the bankruptcy code was too debtor-friendly and created an incentive to borrow beyond the ability to repay, or in some cases without the intention of repaying. Opponents of reform claimed that financial distress is often a by-product of the marketing strategies of credit card issuers and other consumer lenders. Lack of a consensus explanation for the rise in consumer bankruptcy filings ensures that the issue will remain controversial.

The argument that consumer behavior is affected by the legal regime was given some dramatic support by the rush to file before the new law took effect on October 17, 2005.[3] Although the number of filings during 2006 was the lowest in decades, it remains to be seen whether this decline represents the "front-loading" of filings that would otherwise have taken place in 2006 into the period before the new law's effective date. The steady increase in bankruptcy filings since the initial post-BAPCPA drop in 2006 raises questions about how much the Bankruptcy Abuse Prevention and Consumer Protection Act will significantly reduce the number of consumer bankruptcy filings in the long run.

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[2] In 2007, the median annual income reported by Chapter 7 bankruptcy petitioners (based on average monthly income for the six months prior to filing) was $25,800, just over half of the median household income as reported by the Census. See Administrative Office of the U.S. Courts, "2007 Report of Statistics Required by [BAPCPA]," Table 2A.

[3] Timothy Egan, "Newly Bankrupt Raking In Piles Of Credit Offers," *New York Times*, December 11, 2005, p. A1.