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Committee on the Judiciary
Subcommittee on Commercial and Administrative Law
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The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Mr. Chairman and Distinguished Members;

Thank you for inviting me to testify before the Committee on the Medical Bankruptcy Fairness Act (2009). The Act is intended to introduce certain amendments to the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005 to make the bankruptcy process easier for medical debtors. While most would agree that there are obvious benefits to this proposal, my testimony will caution against the not-so-obvious but nonetheless tremendous costs that such a proposal could impose on the bankruptcy system. Before we move forward with this proposal, we need to clearly weigh both the benefits and the costs of doing so.

The role of the bankruptcy system is critical in today's economic environment. The U.S. economy is in the midst of a fragile recovery from the Great Recession. Millions of families are struggling to make ends meet. In a recent speech, Janet Yellen of the Federal Reserve Bank of San Francisco remarked that of those officially counted as unemployed, nearly 44 percent have been jobless for at least six months, a far bigger share than in any previous postwar recession. If instead we look at a broader measure of underemployment-those who are discouraged from seeking work and who are working part-time-the unemployment rate jumps to 16.9 percent.[1] This represents a real tragedy for our society. The loss of a job is a catalyst for economic hardships for families, since low incomes erode their ability to meet basic expenses, leading to unsustainable debts and often a bankruptcy filing.

The Medical Bankruptcy Fairness Act focuses on medical debtors. Given the current economic climate, the focus on medical debtors to the exclusion of other debtors is somewhat surprising. I believe that the urgency to tackle the issue of medical bankruptcies is being largely justified through the use of studies claiming that more than 60 percent of all personal bankruptcy

[1] http://www.frbsf.org/news/speeches/2010/janet_yellen0415.html

filings are caused by medical debt. I hope that through my testimony I will be able to dispel the belief that medical bankruptcies are such a large fraction of all bankruptcies today. Having said that, the attempt here is not to belittle the hardship suffered by families struggling with medical bills. The question we are concerned with today is whether a reform of the bankruptcy code, as put forward in the Medical Bankruptcy Fairness Act, would provide a solution to the problem of medical bankruptcies.

My testimony will first focus on whether evidence supports the essential premise underlying the introduction of the Medical Bills Fairness Act which appears to be the much debated surge in medical bankruptcies in recent times. Second, it will explain how the bankruptcy code currently affects medical debtors. Third, it will provide details on the proposed reform and its practical applicability. Finally, it will explore the possible abuse of the Act based on a literature review of the effect of bankruptcy laws on debtor behavior.

I. Medical Debts and Bankruptcies

The Medical Bankruptcy Fairness Act is intended as a solution to the problem of rising medical bankruptcies. While I applaud the goals underlying the Act, I also believe that it results from a mis-diagnosis of the problem. The essential premise of the Medical Bankruptcy Fairness Act of 2009 is that today medical debts are the leading cause of consumer bankruptcy filings in the U.S. and therefore medical debts need to be addressed differently from other debts. How valid is this supposition?

The American Bankruptcy Institute provides statistics on consumer bankruptcy filings for the U.S. since 1980.[2] The data show a rise in filings from about 1.2 million in 2000 to 2.0 million in 2005. In 2006, filings dipped to 617,600 presumably due to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 which instituted a means-test provision by which only low income filers could file for bankruptcy and discharge their (unsecured) debts. More importantly, since the start of the recession, filings have risen from about 850,000 in 2007 to nearly 1.5 million in 2009. What fraction of this is due to medical debts?

Household level data on medical debts is available from the Survey of Consumer Finances (SCF).[3] The SCF survey samples approximately 4500 households every three years to assess families' financial situations and provides a picture of their debt and asset levels. The households are randomly selected to avoid biased results. A look at the latest SCF data (2007) shows that medical indebtedness has not changed significantly over the past decade or so. The SCF includes medical debts with other debts incurred for "goods and services", including credit card debt. These debts have risen marginally from 5.5 percent of all debt in 2001 to 5.8 percent in 2007, and have in fact, declined over a 10 year period by 0.2 percentage points.[4] The SCF shows that this change is mainly being driven by rising credit card debts where the average value has increased from $4800 to $7300 (Medical debts are excluded from the credit card debt category). Even if all credit card debt were medical debt, it is still hard to conclude that medical debts are responsible for an increasingly large fraction of bankruptcy filings. A paper by Bucks (2008) analyzing the SCF data for 1989-2004 shows, in fact, that the number of families

[2] http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=57826

[3] http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html

[4] The largest categories of debt are mortgages and vehicle loans.

reporting any medical debt has declined from 3.6 percent in 2001 to 2.8 percent in 2004. [5] The same paper also shows that medical debts as a fraction of all debts have remained steady at 0.3 percent between 2001 and 2004.[6] My own analysis of the 2007 data shows that only 2.4 percent of families reported any medical debt, and only 2.8 percent of families reported that they would save for future medical expenses.

At an aggregate level, national health expenditures data show that out-of-pocket medical payments as a fraction of total health expenditures have, in fact, been declining since 2000 from 14.4 percent of all expenditures to 11.8 percent in 2008 (Figure 1).[7] (Figure 2 shows how this compares to out-of-pocket spending in other countries)

To summarize, while bankruptcy filings have increased by 25 percent since the start of this decade, medical debts (or even credit card debts in total) have not changed significantly as a share of total debt over this period. It seems obvious to me that medical debts could not be a significant factor in raising consumer bankruptcies.

The literature on bankruptcies and medical debts can methodologically be divided into two streams, one that has focused on survey data and the other on empirical regression analysis. For instance, relying on surveys of 1032 bankruptcy filers, Himmelstein et al. (2009) conclude that approximately 62 percent of all bankruptcies in 2007 were "medical."[8] Their earlier study (Himmelstein et al. (2005)), based on a 2001 survey of 1000 filers, concluded that approximately

[5] http://www.iariw.org/papers/2008/bucks.pdf
[6] Data for 2007 are not available from the paper.
[7] https://www.cms.gov/NationalHealthExpendData/01_Overview.asp
[8] Himmelstein, David, Warren, Elizabeth, Thorne, Deborah and Woolhandler, Steffie (2009), "Medical Bankruptcy in the United States, 2007: Results of a National Study", The American Journal of Medicine, available at: http://pnhp.org/new_bankruptcy_study/Bankruptcy-2009.pdf

46 percent of all bankruptcies had medical causes.[9] Note that in both studies, "medical" refers to all sorts of medical reasons for a bankruptcy filing, not just medical debts. These include lost weeks of work due to own illness or spouse's illness, as well as when the debtor said that a medical problem of a family member caused the bankruptcy filing. The idea that medical bankruptcies are on the rise comes essentially from these two studies. In the Appendix to this testimony I discuss methodological problems with these studies that may lead to biased results. However, even if we take their estimates at face value to calculate the fraction of medical bankruptcies in total bankruptcies, the number of medical bankruptcies has in fact declined from 667,933 (46 percent of 1,452,030) in 2001 to 510,005 (62 percent of 822,590) in 2007. Hence there is little to suggest that there has been a surge in medical bankruptcies that warrants a big change in the bankruptcy code.

Further, the survey results shown in Table 2 (Page 3) of the study clearly state that only *29* percent of the respondents believed that their bankruptcy was actually *caused* by medical bills. However, the authors chose to add to this number the percent of people who lost weeks of work due to illness, the percent of people with more than $5000 in medical bills, and the percent of people reporting any medical problems. This is clearly an overstatement of the problem. Since the respondents themselves do not believe that these other factors caused the bankruptcy filing, it is wrong to ascribe the additional bankruptcy filings to their medical costs. A related point is that the survey fails to provide information on other causes of the bankruptcy filing or how the respondents would rank different factors, as in the PSID. Therefore, it is unclear whether medical bills were the most important cause or just another cause.

[9] Himmelstein, David, Warren, Elizabeth, Thorne, Deborah and Woolhandler, Steffie (2005), "Illness and Injury as Contributors to Bankruptcy", *Health Affairs* (Web Exclusive), 2 February

This criticism was also raised by Dranove and Millenson in reference to the 2005 paper.[10] Exhibit 2 of that paper identified people who stated that illness or injury was a cause of bankruptcy (although not necessarily the most important cause). According to Himmelstein and colleagues, 28.3 percent of respondents stated that illness or injury was a cause of bankruptcy. They also reported that medical bills contributed to the bankruptcy of 60 percent of this group. Multiplying the two figures together, Dranove and Millenson conclude that 17 percent of their sample had medical expenditure bankruptcies. Even for that 17 percent, it cannot be stated with any degree of certainty whether medical spending was the most important cause of bankruptcy.

Most other studies in fact suggest a minimal role for medical debts in bankruptcy. The closest comparable survey to the Himmelstein et al. studies is a study of bankruptcy filers by the Department of Justice's Executive Office of the United States Trustee (USTP). The USTP examined the records of 5,203 bankruptcy cases filed between 2000 and 2002, the most thorough study of the problem to date of those who actually filed bankruptcy. It reported that 54 percent of the cases in the sample listed no medical debt, meaning that the median amount of medical debt in the study was zero. Medical debt accounted for 5.5 percent of total general unsecured debt and 90.1 percent of filers reported medical debts less than $5,000.

A more nationally representative survey is the Panel Study of Income Dynamics (PSID), which is a longitudinal survey tracking households since 1968.[11] In 1996, the PSID asked respondents whether they had ever filed for bankruptcy between 1996 and 1984, and if so, what were the primary, secondary and tertiary reasons for filing from a given a list of possible reasons, which included medical bills, job loss, injury or illness, etc. This is the most definitive survey so

[10] Dranove, David and Millenson, Michael, L. (2006), "Medical Bankruptcy: Myth vs Fact" HEALTH AFFAIRS 74 (2006)
[11] http://psidonline.isr.umich.edu/

far in terms of determining the proximate cause of a bankruptcy filing. The largest contributor to bankruptcy filings was high credit card debt. Nearly 42 percent of respondents reported high credit card bills as the primary reason for filing, while an additional 9 percent claimed it as the secondary reason for filing. Other big reasons were job loss (13 percent) and divorce or separation from spouse (12 percent). Only 9 percent of the sample claimed medical bills as the primary reason for filing, and 7 percent claimed it as a secondary reason.

By their very nature, survey data are unable to account for a host of other factors that might help explain why households file for bankruptcy. For instance, factors like average household wealth and income, state-level factors such as bankruptcy exemptions and unemployment rates, and household expenditures such as rent and taxes could each play a significant role in a household's decision to file for bankruptcy. The standard methodology in the economics literature for accounting for all of these factors is multivariate regression analysis. With regression analysis, it is possible to study the effect that each factor has on the probability of filing for bankruptcy while holding the effect of all other variables constant. This is the only way that one can establish causation, rather than correlation. In other words, only when we use regression analysis to control for the effect that each of the other factors has on a bankruptcy filing can we be sure that medical debts are significant determinants of bankruptcy filings.

Fay, Hurst, and White (2002) study PSID (Panel Study of Income Dynamics) data from 1996. Their data included 254 filers. They compared that sample of filers to a much larger sample of non-filers to identify determinants of bankruptcy demand. Consistent with the strategic model, they find that differences in the *net benefit* of filing, computed based on individual debt, income, assets, and exemptions (as determined by residence), played a major role in the decision to file. By contrast, medical problems were not significant determinants of a bankruptcy filing.

A 1999 study by Ian Domowitz and Robert Sartain in the *Journal of Finance* uses exactly this approach. The authors examined 827 households who filed for bankruptcy in 1980 matched against 1,862 households not in bankruptcy. Accounting for prevalence of various sources of debt, Domowitz and Sartain found that "the largest single contribution to bankruptcy at the margin is credit card debt." Medical debt does matter, but only when combined with other forms of unsecured debt.

In an AEI Working paper that I wrote, I estimated a model of the household bankruptcy filing decision, using PSID data for the period 1994-1996 and a three year panel covering the years 1984, 1989 and 1994 respectively.[12] The main aim in the paper was to test whether medical debts can be ascribed as the leading cause of bankruptcy filings. The results from my paper do not support the view that medical debts are the *leading* cause of bankruptcy filings. In fact, households who are most likely to file are those with *primarily* other forms of debt, such as credit card or car debts, who *also* incur medical debts.

To summarize this section, most data using simple sample averages, including the Himmelstein et al. studies, suggests that medical debts could be the immediate cause for between 9 to 17 percent of all bankruptcies. Further, most empirical studies find either no role or a marginal role for medical debts in explaining consumer bankruptcies. Therefore, if that is the essential premise of the Medical Bankruptcy Fairness Act, then the foundations of the Act are built on shaky grounds.

II. Current Bankruptcy Code and Proposed Reforms

[12] "Mathur, Aparna (2006), "Medical Bills and Bankruptcy Filings," AEI Working Paper http://www.aei.org/paper/24680

How does current bankruptcy law affect medical debtors? Under current law, debts incurred for medical treatments are completely dischargeable under Chapter 7 of the bankruptcy code. This includes services provided by doctors, hospitals, dentists, chiropractors, physical therapists and other medical providers. In addition to medical debts, Chapter 7 also eliminates other unsecured debts such as credit card debts and personal loans. Therefore individuals who have piled up high medical debts on their credit cards can get that debt discharged as well. The advantage of a Chapter 7 bankruptcy is that debtors can retain some or all of their property and shield it from being used to repay creditors at the time of a bankruptcy filing. The value of assets that they can protect depends upon the exemption level in the state of filing. Exemption levels can range from a few thousand dollars to more than $100,000.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 instituted a means-test provision by which only filers with incomes below the median income in their state could file for bankruptcy and discharge their (unsecured) debts under Chapter 7. In most cases, the payments will be based upon what the individuals can afford, rather than what they owe. High-income debtors who can repay a substantial portion of their debts without significant hardship are required to enter a Chapter 13 plan and repay as much as they can of their unsecured debts as a condition for filing bankruptcy, whether 40%, 60%, or 80% of their outstanding unsecured debt. Moreover, in calculating the debtor's income available to repay debts in Chapter 13, the law permits a deduction for health insurance and other health expenses. Finally, a judge retains discretion to permit an otherwise-ineligible debtor to file in Chapter 7 if she can show special circumstances, such as "a serious medical condition."

In short, current law adequately accommodates the claims of those debtor laid low by medical problems and expenses and other innocent parties who are affected by bankruptcy including health care professionals and other consumers.

The Medical Bankruptcy Fairness Act of 2009 will reform the current system in the following ways. First, the Act would amend Section 101 of the Bankruptcy Code, which is more commonly known as the definitions section. Section 101 would be amended to add the definition of a "medically distressed debtor" as a debtor, or a dependent of the debtor, who has in excess of the lesser of 25 percent of the household income or $10,000.00 of medical debt (which was not covered by insurance) in a twelve month period in the last three years or lives in a household with a person who was out of work for four weeks in the last twelve months due to medical reasons.

Second, it would allow these medically distressed individuals to claim an exemption against their home of $250,000. This would override any state homestead exemptions that would typically vary from a low value of $5000 to more than $100,000.

Finally, it would also remove the means-testing requirement for medically distressed debtors. In other words, all individuals defined as being medically distressed debtors could file under Chapter 7, even if their mean income was above the median income in their state.

While the purpose of the Act is to make the bankruptcy process easier and more efficient for medical debtors, there are several unintended consequences and problems with the proposed reforms to the bankruptcy code that I outline below.

(1) Definition of medically distressed debtor

The definition of a medically distressed debtor is open to abuse and fraud. By definition, a medically distressed debtor is anyone who incurred debts of the lesser of $10,000 or 25 percent of income at any time within a twelve month period in the three years prior to the filing. To see what this implies for the actual level of medical debts, it is helpful to look at a typical distribution of bankruptcy filers by income level. A study of the distribution of bankruptcy filers by income in 2000-2002 showed that more than 85 percent of filers had annual incomes less than or equal to $48,000, with almost 60 percent earning between $12,000-$36,000.[13] This means that if the average filer spent about $3000-$9000 on medicines or medical care in any year, then they would qualify for a medical bankruptcy. The same study shows that credit card debts average approximately $15,000 for this group of low-income borrowers. In the worst case scenario, this could create perverse incentives for households since by accumulating medical debts, they could take advantage of the high exemptions and the debt discharge provisions of Chapter 7 to get rid of their high credit card debts. In fact, it might even tempt households to accumulate other types of debt prior to the filing, since they are eligible for debt discharge under Chapter 7. Therefore, by allowing debtors to file as medical debtors irrespective of whether medical debts are actually driving the household to bankruptcy, the Medical Bankruptcy Fairness Act would essentially be providing relief from credit card debt rather than medical debts.[14]

A second problem with this definition is that it imposes huge informational requirements for a bankruptcy filing. For an attorney to establish a debtor as a medically distressed debtor, they would have to go back three years in either their, or one of their dependent's, medical history and determine that at any one time during that three year period, was there a specific time

[13] Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 37–38 (1999); Ed Flynn & Gordon Bermant, *Bankruptcy by the Numbers: Chapter 7 Asset Cases*, AM. BANKR. INST. J., Dec. 2002–Jan. 2003
[14] http://weber.ucsd.edu/~miwhite/UIll-law-review--final.pdf

when the debtor or one of their dependents had more than $10,000.00 outstanding in medical debt which was confined to a twelve month period. Then, they would have to determine whether the debtor had insurance, and what bills, if any, were either paid by insurance or not. It is extremely hard to imagine that debtors would be able to provide such detailed medical bills for themselves as well as their family, along with all the insurance documentation.

(2) No Means Testing

The means test incorporated into the bankruptcy code in 2005 was designed to limit the use of Chapter 7 bankruptcy to those who truly cannot pay their debts. In effect, it limits the ability of high income filers to walk away from their debts when they have the ability to pay for them by forcing them into Chapter 13 bankruptcy. This increases efficiency and ensures that creditors get at least a minimum return on their debt. Doing away with the means test under the Medical Bankruptcy Fairness Act would allow high income individuals to walk away from not only their medical debts, but also other debts such as credit card debts. For instance, it is typically the case that families incurring high medical debts, especially due to job loss or other adverse events, also incur other debts, such as car loans, unpaid utility bills, credit card debts etc. If medical filers are no longer subject to means testing, then high income debtors would have an easier time walking away from their other dischargeable debts. In the study of bankruptcy filers cited earlier, those with incomes higher than $70,000 had average credit card debts of $42,000. Allowing this group to take advantage of the debt discharge provisions under Chapter 7 would hit creditors particularly hard. This is the exact situation that the 2005 bankruptcy reform tried to address. One possibility to avoid such a situation could be to set higher percentage of income thresholds for medical debt for higher income households, to allow eligibility for a Chapter 7 bankruptcy.

(3) Effect on Creditors

The Act does little, if anything at all, for the creditors in these medical transactions. As discussed in the previous two paragraphs, there could be potentially serious consequences for medical service providers if we make it easier for debtors to file for medical bankruptcy involving the discharge of all medical debts. In fact, research has shown that between 1994 and 2000, unsecured creditors received nothing in about 96 percent of Chapter 7 bankruptcy filings, and in most Chapter 13 cases, only mortgage creditors received anything at all.[15] These higher costs of bad debts will ultimately be passed on to consumers in the form of higher prices for care or poor delivery of care.

(4) Exemption Limits Raised

There is now a fairly large volume of economics papers that discusses how high bankruptcy exemptions affect debtor behavior. Debtors value high exemptions because it provides them with consumption insurance by discharging some or all of their debts when a drop in income would otherwise have caused a drop in consumption. However, because higher exemptions for wealth and income make filing for bankruptcy more attractive, studies show that the number of filings increases when exemptions increase.[16] This adversely affects the market for credit. To insure against the probability of a bankruptcy filing, lenders raise interest rates or ration credit,[17] which

[15] Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1036 (2000).
[16] Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 45–46 (1987) (discussing data indicating that an increase in the bankruptcy exemption level corresponds with an increased bankruptcy filing rate).
[17] Reint Gropp, John Karl Scholz, & Michelle J. White, *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. ECON. 217 (1997) (showing that higher exemption levels result in higher interest rates).

harms debtors who repay as well as those who would like to borrow but are rejected.[18] Hence creditors alter behavior when faced with higher exemptions.

At the same time, the incentive for debtors under these high exemption limits is to reallocate all wealth from non-exempt assets to exempt assets. For instance, if the homestead exemption were raised to $250,000 the individual would have an incentive to convert all non-housing assets to housing (say by using all available bank accounts to pay off the mortgage), so as to protect more of their income and wealth from the creditors. Therefore, there are both costs and benefits to having higher exemption limits that need to be recognized.

To summarize this section, what the Medical Bankruptcy Fairness Act would do is make the financial benefit from filing for a *medical* bankruptcy higher than the financial benefit of filing for any other type of bankruptcy. The higher exemption levels, the lack of means testing and the potential to identify oneself as a medical debtor would clearly lead to strategic behavior on the part of some opportunistic debtors. Medically distressed debtors who are able to file under Chapter 7 would use this to get rid of their credit card debts. This would be especially advantageous for high income debtors who are unable to file for Chapter 7 bankruptcy under the current code. This large scale discharge of credit card debts, available even to debtors with the ability to repay some of their debts, is one aspect of the previous bankruptcy code that the 2005 reform sought to undo. We need to understand therefore, that the changes being considered under the Medical Bankruptcy Fairness Act could impose tremendous costs on the system while conferring benefits to a few.

[18] The optimal exemption levels in bankruptcy are determined by trading off debtors' gain from having additional consumption insurance and better work incentives when exemption levels are higher against their losses from higher interest rates and reduced access to credit. For a formal model and simulations, see Michelle J. White, Personal Bankruptcy: Insurance, Work Effort, Opportunism and the Efficiency of the "Fresh Start," (May 2005) (unpublished manuscript, on file with author), *available at* http://www.econ.ucsd.edu/~miwhite/bankruptcy-theory-white.pdf, and Hung-Jen Wang & Michelle J. White, *An Optimal Personal Bankruptcy Procedure and Proposed Reforms*, 29 J. LEGAL STUD. 255, 265 (2000).

We obviously cannot wish illness away. However, some solutions may help families deal with the situation better. For example, employers and employees could try to come up with work arrangements that would enable the employee to function effectively even in the midst of a medical crisis. Job loss should not be the inevitable result of a prolonged medical condition since this increases the financial pressure on families. Government initiatives such as the formation of high risk pools may also alleviate the burden to a certain extent, though they need to be designed such that they do not impose tremendous fiscal pressure on an already tight federal budget. Finally, the Act could be modified to allow debtors to obtain relief under Chapter 7 only on their medical debts, rather than all of their other debt as well. This may reduce misuse of the system by opportunistic debtors.

III. Conclusion

To summarize, the case for bankruptcy reform to help medically distressed debtors is built on somewhat shaky foundations. While the intentions are laudable, there is little to support such an intervention based purely on the incidence of medical debts in bankruptcy filings. Despite some recent survey evidence suggesting that medical debts account for more than 60 percent of all filings, more rigorous analysis finds a relatively smaller proportion of bankruptcies that can be attributed to medical debts.

Further, the Medical Bankruptcy Fairness Act could create perverse incentives for debtors to accumulate non-medical debts prior to a filing, as long as they can file as medically distressed debtors. The Act attempts to overturn several features of the bankruptcy reform enacted in 2005 by doing away with a means test for medical debtors and allowing medical debtors to claim a homestead exemption higher than that allowed under the current code in

several states. This could have adverse consequences on at least two fronts. One, high income filers with the ability to repay their debts can get complete debt relief under Chapter 7, while imposing losses on their creditors. Two, the high homestead exemptions could affect credit markets by causing creditors to raise the interest rate on loans provided and/or ration credit. In other words, the proposed reform could have unintended adverse consequences for debtors as well.

I believe that any situation that causes a household to file for bankruptcy is unfortunate. In these tough economic times, individuals who lose their job for no fault of theirs are as badly affected as families hit by illnesses or injuries. Individuals who lose their homes because of a painful divorce are no worse off than people who are unable to pay their mortgages due to an unexpected change in credit conditions. Therefore, there is little to justify amendments to BAPCPA based on this criterion. Looking for solutions outside the bankruptcy code may work better.

Figure 1: Out-of-Pocket Expenditures as a Percent of National Health Expenditures, US

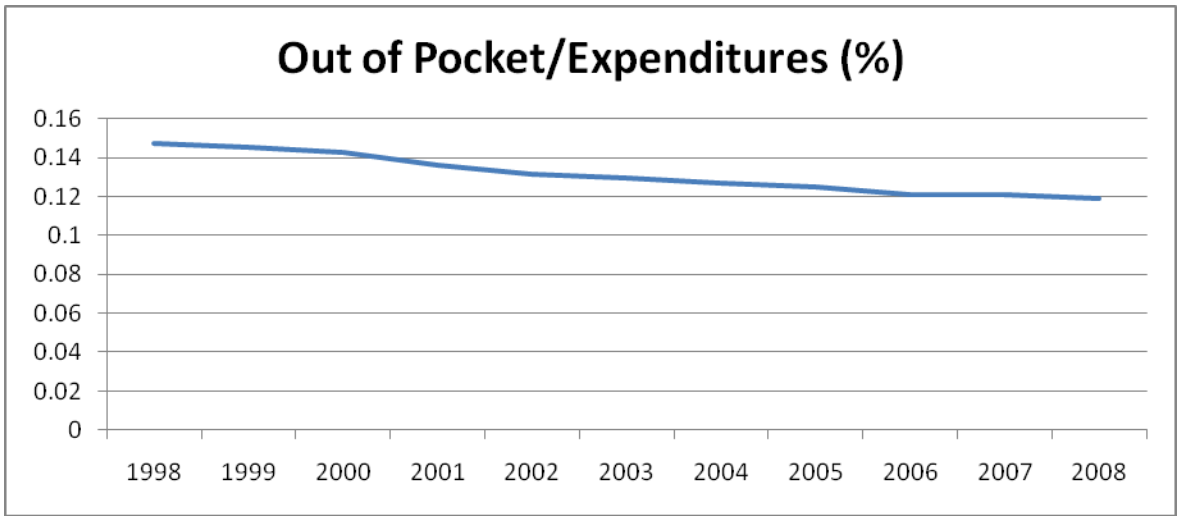
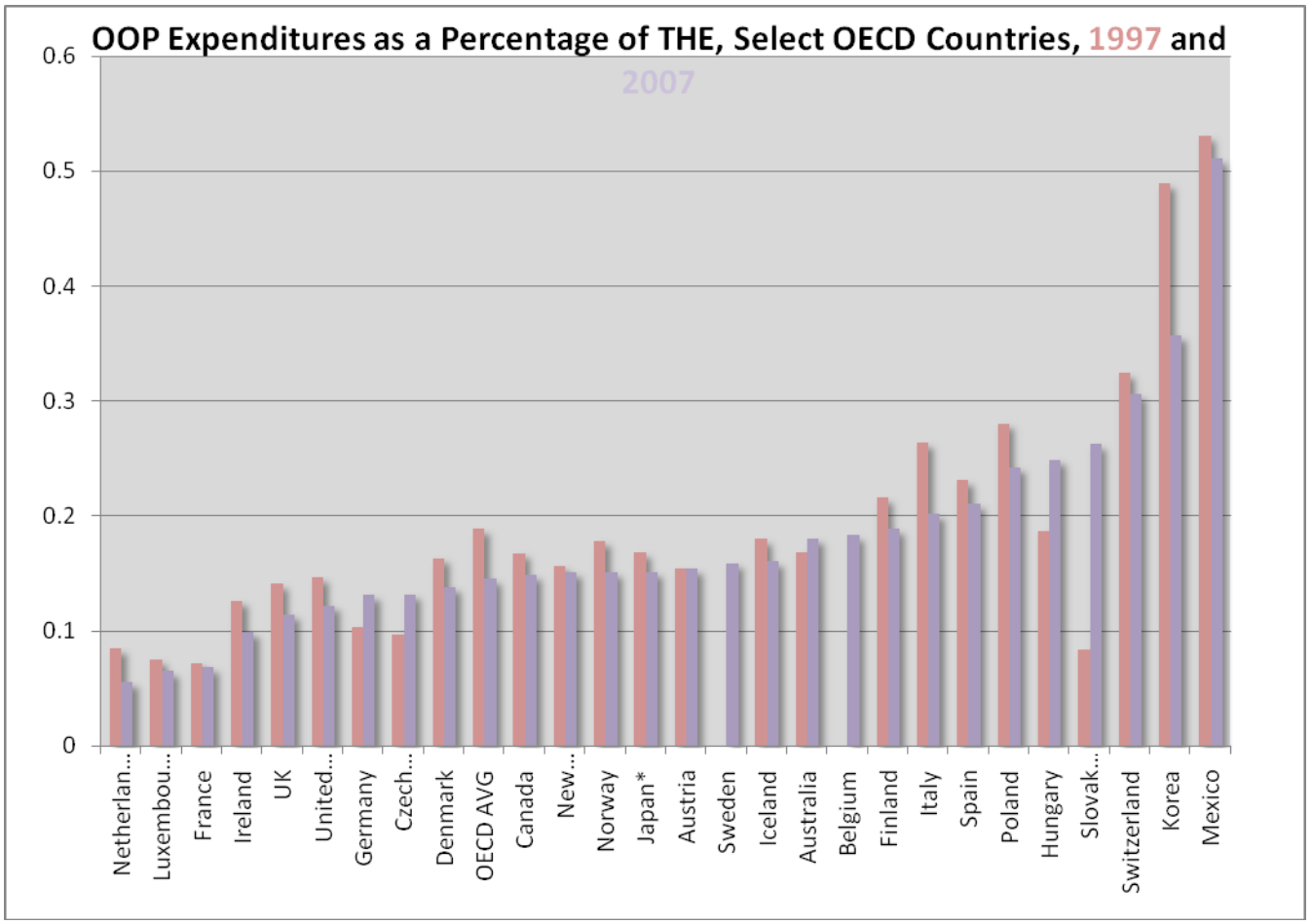


Figure 2: A Comparison of Out-of-Pocket Expenditures in the OECD countries



Appendix

Problems with the Himmelstein et al. (2005 and 2009) Studies

(1) Sample Selection Issues

A major shortcoming with both the Himmelstein et al. (2005 and 2009) studies is what economists dub the "sample selection issue". Himmelstein et al. (2005, 2009) conducted a survey of bankruptcy filers from public court records for the year 2001 and 2007. Based on a sample of 1000 debtors, they concluded that more than 50 percent of these had filed for bankruptcy due to a medical reason. By limiting the sample to those who had already filed for bankruptcy, the study overstated the incidence of medical debt. To account for causation, the study sample should have, at the very least, included a "control" group of medical debtors who did not file for bankruptcy. In other words, if the authors were trying to establish whether medical debts *cause* bankruptcy filings, the appropriate sample should have included households with and without medical debt, and households who filed or did not file for bankruptcy. In short, what the authors have established is some correlation, but not causation.

The sample also seems skewed towards debtors with high medical debt. The USTP report of bankruptcy filers, which included a much larger sample of 5203 filers, found that 90 percent of filers had medical debts less than $5000. The Himmelstein et al.(2009) study reports nearly 35 percent of filers with more than $5000 in medical debt. The authors make no attempt to reconcile or explain their findings or reveal the distribution of medical debts across filers in their sample.

(2) Regression Analysis

The study also should have allowed for the possibility that other household characteristics, such as the filer's work status, marital status, income, and other kinds of debts

could have influenced the filing. As explained earlier, this could be done through the use of appropriate regression techniques applied on a suitably large, random sample of filers and non-filers. Mainstream economics literature discussing the relationship between debts and bankruptcy amply outlines these standard considerations. The study does claim to have done multivariate analysis, but the analysis is done on an even more restricted sample than the original 1032 in 2007. The sample only includes people who reported having any medical bills. Therefore, it simply assumes that medical debts are important for bankruptcy filing, rather than testing for that hypothesis in the entire sample of bankruptcy filers.

(3) *Definition of Medical Bankruptcy*

The 2005 study used an overly broad definition of "medical filers," which included people with any sort of addiction or uncontrolled gambling problems. The 2009 study removed these clauses but still came up with a 62 percent number i.e nearly 62 percent of bankruptcy filings are due to medical reasons. The reason for the high number is puzzling, though as mentioned earlier, it is partly driven by the fact that the authors ascribe any remotely medical factor as causing the bankruptcy filing, not just medical debts. The survey results shown in Table 2 (Page 3) of the study clearly state that only *29* percent of the respondents believed that their bankruptcy was actually *caused* by medical bills. However, the authors chose to add to this number the percent of people who lost weeks of work due to illness, the percent of people with more than $5000 in medical bills, and the percent of people reporting any medical problems. This is clearly an overstatement of the problem. Since the respondents themselves do not believe that these other factors caused the bankruptcy filing, it is wrong to ascribe the additional bankruptcy filings to their medical costs. A related point is that the survey fails to provide information on other causes of the bankruptcy filing or how the respondents would rank different

factors, as in the PSID. Therefore, it is unclear whether medical bills were the most important cause or just another cause.

This criticism was also raised by Dranove and Millenson in reference to the 2005 paper.[19] Exhibit 2 of that paper identified people who stated that illness or injury was a cause of bankruptcy (although not necessarily the most important cause). According to Himmelstein and colleagues, 28.3 percent of respondents stated that illness or injury was a cause of bankruptcy. They also reported that medical bills contributed to the bankruptcy of 60 percent of this group. Multiplying the two figures together, Dranove and Millenson conclude that 17 percent of their sample had medical expenditure bankruptcies. Even for that 17 percent, it cannot be stated with any degree of certainty whether medical spending was the most important cause of bankruptcy.

[19] Dranove, David and Millenson, Michael, L. (2006), "Medical Bankruptcy: Myth vs Fact" HEALTH AFFAIRS 74 (2006)