Congressional Research Service

Consumer Bankruptcy and Household Debt

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February 26, 2009

Congressional Research Service
7-5700
www.crs.gov
RS20777

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. 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 every quarter from the 2006 lows, and for the 12 months ending September 30, 2008, exceeded the 1-million mark. The recession that began in December 2007 could extend this rising trend.

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.

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

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

			Nonbusiness or Consumer Filings		
Year	Total Filings (number)	Business Filings (number)	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]	814, 496	29,960	784,534	30.2	3.26

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

a. 2008 filing figures are for Jan.-Sept.; rate figures are for the 12-months ending Sept. 30, 2008, compared with the previous 12-month period.

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

	Consumer Credit ($ billions)			Home Mortgage Debt ($ billions)			
Year	Revolving	Non-revolving	Total	Home Equity Loans	Total	Debt Burden (% of Income Used for Debt Payments)	Debt as % of Disposable Personal Income
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]	976.3	1,605.4	2,581.7	1,114.5	10,570.7	14.01	125.0

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 third quarter.

In December 2007, the U.S. economy went into recession. During the first half of 2008, household debt levels continued to grow, albeit at a slower rate than in recent years. Third quarter figures, however, show an absolute decline from the second quarter in household debt outstanding, in both consumer credit and mortgage debt. Monthly figures for consumer credit show continued contraction in both revolving and non-revolving credit outstanding: preliminary figures show that consumer credit shrunk at an annual rate of 3.4% in November 2008.[2]

The fall in debt balances does not represent an improvement in household balance sheets, because disposable personal income is also falling. Increased job losses naturally trigger financial hardship and are likely to raise bankruptcy filings. **Table 1** shows that the last four recessions

[2] Federal Reserve, Release G. 19, *Consumer Credit*, Jan. 8, 2009.

(1980, 1981-2, 1990-91, and 2001) were accompanied by increases in the numbers of filings, although many non-recession years since 1980 also recorded increases.

Table 3. Percentage of Families in Financial Distress by Income Level, 1995-2007

Percentile of Income Distribution	1995	1998	2001	2004	2007
All families	11.7	13.6	11.8	12.2	14.7
Below 20	27.5	29.9	29.3	27.0	26.9
20-39.9	18.0	18.3	16.6	18.6	19.5
40-59.9	9.9	15.8	12.3	13.7	14.5
60-79.9	7.7	9.8	6.5	7.1	12.7
80-89.9	4.7	3.5	3.5	2.4	8.1
90-100	2.3	2.8	2.0	1.8	3.8

Source: Federal Reserve, Survey of Consumer Finances, in: *Federal Reserve Bulletin*, February 2009.

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 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 2007. 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.[3] 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 2007 was little changed from the 1998 level. The 2007 figures do show a notable increase among families in the upper income percentiles; this may be attributable to increased mortgage debt taken on during the housing boom that ended in that year.

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.

[3] 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 U.S. 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.

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.[4] 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 whether 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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[4] Timothy Egan, "Newly Bankrupt Raking In Piles Of Credit Offers," *New York Times*, December 11, 2005, p. A1.