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Consumer Bankruptcy and Household Debt

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Summary

The 107th Congress considered, but did not pass, legislation (H.R. 333) that would have required some consumer bankruptcy petitioners to repay certain debts rather than have them discharged, or erased, by the bankruptcy court. The issue is likely to be taken up again in the 108th Congress. The principal impetus behind bankruptcy reform is the high number of consumer bankruptcy filings, which in recent years have been running at over four times the levels of the early 1980s. It is not clear why bankruptcy filings have increased so dramatically during a period that has included two of the longest economic expansions in U.S. history. Since bankruptcy is almost by definition a condition of excessive debt, many would expect to observe 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 been fairly constant over the past two decades. What these aggregate statistics do not show is that the debt burden does not fall equally on all families. Financial distress is most common among lower-income households: in 2001, 27% of families in the bottom fifth of the income distribution had debt service payments that exceeded 40% of their incomes. This suggests that explanations for the rise in consumer bankruptcy filings are more likely to be found in micro-analysis of individuals and groups of debtors than in macroeconomic indicators. This report presents statistics on bankruptcy filings, household debt, and families in financial distress, and will be updated as new statistics become available. For discussion of bankruptcy reform proposals, see CRS Report RL31706, *Bankruptcy Reform: A Recap*.

The tables below present data on bankruptcy filings, household debt, and families in financial distress. Table 1 shows bankruptcy filings since 1980. Both business and non-business bankruptcies showed increases in the early 1980s, but business filings peaked in 1987 and have since declined, while the number of consumer filings has continued to grow. Consumer bankruptcies exhibit a pattern of rapid annual growth for several years, a 2- or 3-year pause, and a resumption of growth. The most recent pause began in 1999 and continued through the end of 2000: there were 13% fewer filings in 2000 than in 1998. In 2001, and again in 2002, however, consumer bankruptcy filings surpassed the previous record.

Table 1. Bankruptcy Filings in the United States, 1980-2002

Year	Total	Business	Nonbusiness or Consumer Filings		
	Number	Number	Number	% Change from Previous Year	Rate 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

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

Table 2. Household Debt Levels and Debt Burden, 1990 – 2002

(At end of year, except as noted for 2002)

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	Consumer Debt	Mortgage Debt	Total	
1990	250.9	554.2	805.1	235.9	2,532.3	7.10	6.31	13.41	80.0
1991	277.1	517.4	794.5	256.4	2,708.7	6.51	6.26	12.77	80.7
1992	292.2	508.3	800.6	255.6	2,865.1	5.97	5.88	11.85	79.6
1993	325.0	534.0	859.0	248.2	3,001.4	6.09	5.67	11.76	80.6
1994	383.2	600.7	983.9	264.4	3,178.2	6.48	5.69	12.17	82.9
1995	464.1	658.7	1,122.8	289.3	3,367.6	7.04	5.85	12.89	85.1
1996	494.4	683.1	1,182.6	338.1	3,577.7	7.43	5.83	13.26	86.0
1997	531.0	712.0	1,243.0	416.2	3,818.1	7.44	5.90	13.35	87.3
1998	562.5	755.0	1,317.5	476.7	4,157.2	7.51	5.89	13.40	86.1
1999	597.7	818.6	1,416.3	532.8	4,531.1	7.56	6.09	13.65	89.7
2000	666.5	894.0	1,560.6	630.6	4,901.8	7.82	6.44	14.26	90.8
2001	699.4	968.0	1,667.5	699.4	5,379.8	8.00	6.32	14.32	95.3
2002	711.2	1,011.1	1,722.3	799.6	5,849.7	7.76	6.24	14.00	96.0

Note: 2002 consumer credit figures are for year-end; all other 2002 figures for the end of the third quarter.

Source: Federal Reserve. Release G. 19 (consumer credit) and Flow of Funds Accounts, Table L. 218 (household mortgage debt).

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 revolving credit, or credit card debt, and 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 rapidly growing category 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 estimates of the burden of debt service, that is, the percentage of household disposable income that goes to repay loans. It is noteworthy that consumer credit is more expensive in terms of debt costs than is mortgage debt, even though the principal outstanding on mortgage debt is three times as great. This reflects the higher interest rates charged and the shorter maturities in consumer lending, as well as the fact that mortgage and home equity debt receive favorable tax treatment.

The total debt burden figures in table 2 fluctuate within a fairly narrow range: from 11.8% to 14.3%. (During the 1980s, the range was similar: from 12.3% to 14.2 %.) However, it should be kept in mind that interest rates – particularly mortgage rates – have declined in recent years and are now at the lowest levels in decades. Therefore, the relative stability of the debt burden in the face of falling interest rates implies that the ratio of debt to income has been rising. This ratio – total household debt as a percentage of disposable personal income – is shown in the right hand column of table 2. The increases in this figure, particularly in the last few years, suggest that further increases in bankruptcy filings (and perhaps problems for lenders) may lie ahead if mortgage and other interest rates rise significantly. For the present, however, falling rates have permitted households to take on more debt without a corresponding increase in the debt burden.

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 below, 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 1992 through 2001.

Table 3. Percentage of Families in Financial Distress* by Income Level, 1992-2001

Percentile of Income	1992	1995	1998	2001
All Families	10.8	10.6	12.8	11.0
Less than 20	26.4	26.2	28.2	27.0
20 – 39.9	15.1	16.0	17.2	16.0
40 – 59.9	10.1	8.1	15.3	11.7
60 – 79.9	7.6	7.1	8.6	5.6
80 – 89.9	2.9	4.6	3.4	3.5
90 – 100	2.5	2.0	2.6	2.0

* "Financial distress" means that debt service payments consume over 40% of the family's income.

Source: Federal Reserve. Survey of Consumer Finances. In: *Federal Reserve Bulletin*, January 2003.

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.[1] Second, like the debt burden figures shown in Table 2 above, there is no sharply rising trend that would explain the dramatic increase in personal bankruptcy filings. Between 1998 and 2001, the incidence of financial distress fell, even for those in the bottom income quintile. As a result of the 1998-2001 decline, for which falling interest rates may be primarily responsible, the percentage of all families in distress in 2001 is little changed from the 1992 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, the divorced, or residents of states without mandatory uninsured motorist coverage. Supporters of bankruptcy reform maintain that the current bankruptcy code is too debtor-friendly and creates an incentive to borrow beyond the ability to repay, or in some cases without the intention of repaying. Opponents of reform claim that financial distress is often a by-product of the high-pressure marketing campaigns of credit card issuers and other consumer lenders. Lack of a consensus explanation for the rise in consumer bankruptcy filings ensures that reform efforts will be controversial.

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[1] Several studies in the mid-to-late 1990s reported that the median income of bankruptcy petitioners was about $22,000. See: U.S. General Accounting Office. *Personal Bankruptcy: Analysis of Four Studies on Chapter 7 Debtors' Ability to Pay*. GAO/GGD-99-103. June 1999. p. 23.