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Consumer Bankruptcy and Household Debt

Mark Jickling
Specialist in Public Finance
Government and Finance Division

Summary

On March 10, 2005, the Senate passed bankruptcy reform legislation (S. 256) that would require some consumer bankruptcy petitioners to repay certain debts rather than have them discharged, or erased, by the bankruptcy court. The principal impetus behind bankruptcy reform is the high number of consumer bankruptcy filings, which in recent years has been running at five times the level 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 obligations 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 two- or three-year pause, and a resumption of growth. In each calendar year from 2001 through 2003, number of consumer bankruptcy filings set a new record. In 2004, however, the number of filings declined by 3.8% from the previous year.

Table 1. Bankruptcy Filings in the United States, 1980-2004

Year	Total Number	Business 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

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

Table 2. Household Debt Levels and Debt Burden, 1990 — 2004

(At end of year, except as noted for 2004)

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	250.9	554.2	805.1	233.9	2,504.1	11.99	86.2
1991	277.1	517.4	794.5	240.7	2,683.5	11.53	87.3
1992	292.2	508.3	800.6	236.7	2,857.5	10.80	86.4
1993	325.0	534.0	859.0	229.1	3,017.3	10.79	86.6
1994	383.2	600.7	983.9	241.9	3,186.6	11.17	87.9
1995	464.1	658.7	1,122.8	259.4	3,344.3	11.87	89.8
1996	494.4	683.1	1,182.6	290.8	3,555.4	12.10	90.1
1997	531.0	712.0	1,243.0	331.9	3,779.3	12.10	90.5
1998	562.5	755.0	1,317.5	361.2	4,090.8	12.10	92.0
1999	597.7	818.6	1,416.3	401.5	4,459.5	12.42	93.6
2000	666.5	894.0	1,560.6	492.0	4,821.2	12.84	94.9
2001	699.4	968.0	1,667.5	518.0	5,285.8	13.30	99.1
2002	711.2	1,011.1	1,722.3	583.3	5,909.5	13.36	103.9
2003	744.6	1,257.2	2,001.8	684.9	6,643.1	13.15	104.1
2004	748.3	1,305.0	2,053.3	881.3	7,542.8	13.26	105.1

Source: Federal Reserve. Release G. 19 (consumer credit) and Flow of Funds Accounts, Table L. 218 (household mortgage debt).
Note: 2004 figures represent end of 3rd quarter, except for debt burden, which is end of first half.

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 Federal Reserve estimates of the burden of debt service, that is, the percentage of household disposable income that goes to repay loans. The debt burden figures in **Table 2** fluctuate within a fairly narrow range: from 10.80% to 13.36%. (During the 1980s, the range was similar: from 10.6% to12.5%.) Although the burden of debt has risen since 1990, the rise has not been so dramatic as to account for the fivefold increase in personal bankruptcy filings over the past two decades.

It should be kept in mind that interest rates — particularly mortgage rates — declined in recent years to the lowest levels since the 1950s, and they remain low despite the Federal Reserve's actions to raise rates since mid-2004. Therefore, the relative stability of the debt burden in the face of falling 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 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 interest rates rise significantly, although the prevalence of fixed-rate mortgages would mitigate this effect. 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 Distribution	1992	1995	1998	2001
All Families	10.8	10.6	12.8	11.0
Below 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

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

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

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. Consumer bankruptcies in 2001, on the other hand, were up 61% over 1992 levels.

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 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. Government Accountability Office, *Personal Bankruptcy: Analysis of Four Studies on Chapter 7 Debtors' Ability to Pay*, GAO/GGD-99-103, June 1999, p. 23.