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. Bankruptcy reform was enacted in response to the high number of consumer bankruptcy filings, which in 2004 and 2005 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 evenly on all families. Financial distress is common among lower-income households: in 2007, 27% of families in the bottom fifth of the income distribution spent more than 40% of their income to repay debt.

Following the effective date of BAPCPA, in October 2005, there was a sharp reduction in the number of bankruptcy filings, reflecting the "rush to the courthouse" in the months before the new law took effect. Since the 2006 lows, the number of filings has risen steadily. In 2010, personal bankruptcy filings reached 1.5 million, roughly equal to the pre-BAPCPA level. It appears that BAPCPA has not produced the effect its supporters hoped for—a substantial and permanent reduction in the rate of consumer bankruptcy.

With the recession that began in December 2007, the long-term upward trend in consumer indebtedness was interrupted. Beginning in the middle of 2008, the amount of debt held by U.S. households declined for 11 consecutive quarters. Through the third quarter of 2011, households reduced their debt burden by $853 billion, or 6.5%. Causes and implications of this trend are discussed in CRS Report R41623, *U.S. Household Debt Reduction*, by (name redacted).

This report presents statistics on bankruptcy filings, household debt, and families in financial distress. It will be updated as new statistics become available.

Contents

Figures

Tables

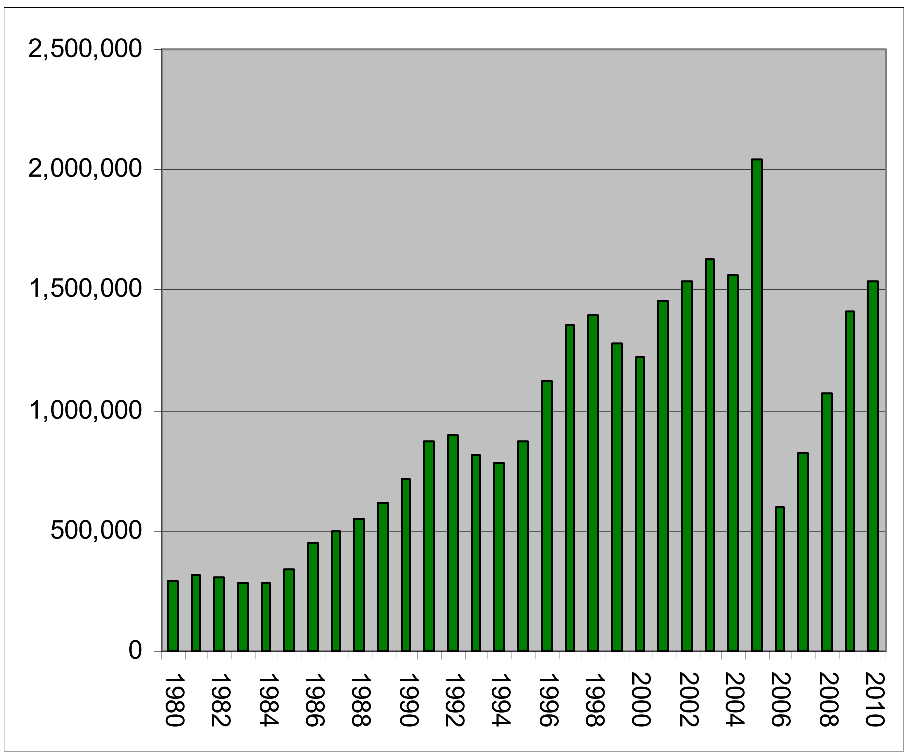
Contacts

Bankruptcy Filings

Figure 1 and **Table 1** show bankruptcy filings since 1980. Business filings peaked in 1987, but the number of consumer filings continued to grow through 2005. In that year, 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; P.L. 109-8) 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 BAPCPA will reduce filings in the long run is still unclear. Filings rose steadily from the 2006 lows until 2010, when they exceeded 1.5 million, which was approximately the level during the four years before BAPCPA. Over the first three quarters of 2011, there was a slight decline from the year-earlier numbers.

Figure 1. Consumer Bankruptcies, 1980-2010



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

Table 1. Bankruptcy Filings in the United States, 1980-2011

			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	1,117,711	43,546	1,074,225	30.6	3.48
2009	1,473,675	60,837	1,412,838	31.5	4.53
2010	1,593,091	56,282	1,536,799	8.8	4.98
2011	1,094,603	36,385	1,058,218	-7.8	4.69

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

Notes: The 2011 filing figures are for January through September. The 2011 percentage change and per capita figures compare the 12 months ending September 30, 2011, with the year ending September 30, 2010.

Household 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 (1) revolving credit, or credit card debt, and (2) non-revolving debt, which is dominated by auto and college 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. Household Debt Levels and Debt Burden, 1990-2011

(all figures at year-end)

	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	53.3	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	12.59	90.5
2001	741.7	1,127.3	1,869.0	439.0	5,292.9	13.10	95.7
2002	762.8	1,189.9	1,952.7	500.7	6,036.2	13.24	102.0
2003	781.6	1,252.8	2,034.4	593.4	6,887.1	13.16	109.2
2004	799.8	1,391.8	2,196.6	775.6	7,838.6	13.25	115.0
2005	824.5	1,460.7	2,285.2	915.0	8,879.3	13.77	120.0
2006	874.6	1,513.1	2,387.7	1,065.5	9,843.4	13.88	124.8
2007	942.9	1,579.9	2,522.8	1,129.8	10,484.2	13.93	128.1
2008	958.1	1,602.9	2,561.1	1,113.5	10,426.9	13.62	122.2
2009	866.1	1,585.3	2,451.3	1,032.4	10,262.3	12.70	116.3
2010	799.7	1,607.6	2,407.3	948.9	10,069.6	11.75	108.0
2011	792.0	1657.9	2,445.0	888.0	9,882.2	11.09	106.6

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

Note: The 2011 figures are for third quarter, except for debt burden, which is mid-year.

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, this measure rose steadily (but not dramatically), until the recession and financial crisis that began in 2007. The debt burden figures in **Table 2** fluctuate within a fairly narrow range: from 10.80% to 13.93%. (During the 1980s, the range was similar: from 10.6% to 12.5%.) Although the burden of debt has risen since the 1980s, 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. Moreover, the decline in the debt service ration since 2007 has not been accompanied by a significant reduction in bankruptcy rates.

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 expressed as a percentage of disposable personal income—is shown in the far right column of **Table 2**. The increases in this figure, which between 1990 and 2007 rose 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. Since 1980, however, declining interest rates have permitted households to take on more debt without a comparable increase in the interest payments required to service that debt.

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 percentages of families at various income levels that devote more than 40% of their income to debt service, for selected years from 1995 through 2007.

Two noteworthy facts emerge from the data in **Table 3**. The 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**, 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.

[1] In 2010, the median annual income reported by Chapter 7 bankruptcy petitioners (based on average monthly income for the six months prior to filing) was $33,600, or 67% of the U.S. median household income as reported by the Census. See Administrative Office of the U.S. Courts, "2010 Report of Statistics Required by [BAPCPA]," p. 12, and U.S. Bureau of the Census, *Household Income for States: 2009 and 2010*, September 2011, p. 2.

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 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 suggests that the issue will remain controversial.

Household Deleveraging

In December 2007, the U.S. economy went into recession, in the midst of global financial panic. Household debt levels began to fall in three of the four categories shown in **Table 2**. The decline in debt balances continued for 11 calendar quarters, until debt outstanding rose slightly in the second quarter of 2011. In the third quarter, debt levels fell again. On a percentage basis, home equity and credit card debt led the decline, as shown in **Table 4**. In dollar terms, however, mortgage debt (other than home equity loans) accounted for most of the drop.

Table 4. Change in Household Debt Outstanding: 2nd Quarter 2008 Through 3rd Quarter 2011

Type of Debt	Change in Debt Owed ($ Billions)	Percentage Change
Revolving Credit	-$178	-18.3
Non-Revolving Credit	+$52	+3.2
Mortgage Debt	-$726	-6.8
—Home Equity Loans	-$239	-21.2
Total	-$852	-6.5

Source: Federal Reserve, Release G. 19, *Consumer Credit*; Release Z.1, *Flow of Funds Accounts*, Table L. 218.

Several factors appear to have contributed to the fall in debt balances. Some households may be paying down their debt, others may be borrowing less, and the amount of debt written off by lenders as uncollectible has increased. Some lenders have tightened their credit standards for new loans. Mortgage balances have fallen because of mortgage modifications or other negotiations that reduce principal outstanding, and because foreclosed homes are often sold for less than the amount of the old mortgage. Causes and implications of deleveraging are discussed in CRS Report R41623, *U.S. Household Debt Reduction*, by (name redacted).

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