Center for American Progress

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Introduction and Summary

The severe financial squeeze faced by America's families today is evident in stagnant income growth amid mounting job losses and in the spiraling costs of gas, energy, food, and healthcare amid record family debt levels. The results of this squeeze, such as rising home foreclosures, credit card defaults, and automobile and other personal loan defaults, now include the ultimate financial disaster—personal bankruptcies, which are the broadest measure of economic distress and are once again on the rise.

The bankruptcy rate has risen sharply for two years in a row, already reaching levels as high as those seen in the early 1990s. This jump in the bankruptcy rate should probably come as no surprise given the perilous economic terrain bequeathed to American families by the Bush administration and the conservative Congress in power for the first six years of Bush's presidency. Yet conservatives had other plans for financially strapped families when they passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. BAPCPA, as the act is inelegantly known in the world of personal bankruptcy, was designed to make it harder for people to declare bankruptcy.

That bankruptcy rates are back on the wrong track despite a conscious legislative effort by conservatives to force families to struggle longer with unsustainable debt obligations than they can afford speaks volumes about today's enveloping financial squeeze. And chances are high that personal bankruptcies will increase even further given current economic trends of weak income growth, high levels of debt, and rising prices. Should bankruptcy rates—measured by filings per 1,000 people—continue to increase at the rate registered between early 2006 and the end of 2007, bankruptcy rates will again reach the relatively high levels that were maintained before BAPCPA was enacted in April 2005. In particular, we find from the available data that:

- The bankruptcy rate is again comparatively high. The national annualized bankruptcy rate reached 2.7 filings per 1,000 people in the fourth quarter of 2007.[12] This is a marked increase from the 1.5 rate in the first quarter of 2006 (right after the new law was passed), exceeds the bankruptcy rates of the 1980s, and is only slightly below the bankruptcy rates of the early 1990s.

- Bankruptcy rates have doubled in 16 states over the past two years and many states are rapidly catching up to pre-BAPCPA levels. In the fourth quarter of 2007, seven states were less than one-third below the bankruptcy rate in their state before the enactment of BAPCPA, and seven states remained more than two-thirds below their pre-BAPCPA levels.

- Since passage of the new law, bankruptcy rates have diverged across states. States that had higher bankruptcy rates to begin with also tended to see faster growth in their bankruptcy rates. In the end, bankruptcy rates varied more two years after the passage of the law than immediately after BAPCPA was enacted.

- State-by-state data for the past two years show that bankruptcy filings are connected to economic hardships. States and quarters with higher unemployment rates are associated with higher bankruptcy rates, as are observations associated with lower real per capita incomes, and higher shares of people without health insurance.

- A larger share of bankruptcy filers fall under rules that are more beneficial to creditors than to debtors. Since the changes to the bankruptcy code, the average share of Chapter 7 filings—which give debtors a clean slate—has, out of total filings, dropped by 11.4 percentage points.

Contrary to conservative claims, families enter bankruptcy because of external economic factors, such as a spell of unemployment, a medical emergency—particularly when health insurance is not available—and mounting debt levels.[3] This was apparent in the data before the enactment of BAPCPA in 2005 and remains apparent in the data after 2005. These facts run counter to the intent of Bush's bankruptcy bill, the largest overhaul to the federal bankruptcy code since its enactment in 1978,[4] and one of the signature legislative "accomplishments" of his presidency and the last conservative-led Congress. Instead of eliminating presumably widespread "bankruptcies of convenience,"[5] bankruptcy rates remain high because of fundamental economic pressures on America's families.

Opponents of these changes to the U.S. bankruptcy code in 2005 contended at the time that the increased costs and complexity of filing could make bankruptcy an impractical option for some families, or at least cause them to delay filing, while also closing an important pressure valve for financially struggling families.[6] They were right.

To truly address the bankruptcy rate in the United States, legislators must be willing to recognize the real reasons why families file for bankruptcy and address them accordingly. This will require an overhaul of the bankruptcy code to ensure families have access to the long-standing American tradition of debtors being able to start over after financial disaster. In addition, a number of other economic policy steps are needed to address the underlying causes of rising personal bankruptcies, especially very weak income growth, lack of health insurance, and lack of personal saving.

The Unexpected Legacy of the Bankruptcy Abuse and Consumer Protection Act of 2005

Proponents of changing the bankruptcy code three years ago, among them Sen. Chuck Grassley (R-IA) and George Mason University law professor Todd Zywicki, wanted to reduce the total number of bankruptcy filers because they erroneously believed that personal irresponsibility caused many families to abuse the system.[7] They argued that due to a declining stigma toward bankruptcy it was "becoming a first stop for some, rather than a last resort, as debtors treat bankruptcy as merely another financial planning tool and file for bankruptcy for simple convenience."[8]

Opponents, though, contended—correctly as the data later showed—that the changes in the code would have little effect on separating debtors who were filing because of circumstances like a medical catastrophe from the few who were filing because they spent irresponsibly.[9]

A second goal of the legal changes was to get more people to file under more onerous rules, which would also mean more debt repayment. The U.S. bankruptcy code distinguishes between two types of bankruptcies. A Chapter 7 bankruptcy gives debtors a limited "fresh start." Even though all of a debtor's assets, except those that his or her state exempts, are liquidated and distributed among his or her creditors, most of a debtor's remaining debts are cancelled, except for child support, taxes, and student loans.

In addition, if someone wants to keep a home or a car, any outstanding mortgage or loan must be paid. Many people who file for a Chapter 7 bankruptcy tend to have assets that are exempt from liquidation, such as the equity in a vehicle up to a certain value, the filer's home up to a certain value, and the public benefits that have accumulated in a bank account (e.g. social security and unemployment compensation). Chapter 7 enables debtors to limit debt repayment,[10] though what can be exempted from liquidation varies by state. Many states have taken advantage of a provision in the bankruptcy code that allows states to either use the federal exemption law or adopt its own exemption law.

In a Chapter 13 bankruptcy, debtors are instead put on a repayment plan that lasts up to five years. Not until the end of the repayment plan are any remaining unpaid debts canceled, again except for child support, taxes, and student loans. Keeping a home or a car in Chapter 13 requires the loan to be paid. Because debtors are held to stringent budgets in Chapter 13, but may encounter unexpected unforeseen expenses, only about one in three of those who file for Chapter 13 ever complete their payments according to plan. The remaining filers convert to Chapter 7 or are pushed out of the system altogether, receiving no relief from their debts.

BAPCPA was also partially intended to increase repayments to credit card companies, payday lenders, and similarly situated unsecured creditors. Besides making it harder to enter Chapter 7 bankruptcy, the new law made bankruptcy filings more costly, thus preventing or delaying bankruptcy filings. Prior to BAPCPA, a debtor had to pay $209 when filing for a Chapter 7 bankruptcy, and $194 for a Chapter 13 bankruptcy. Today, a debtor must pay $299 at the time of filing for a Chapter 7 bankruptcy, and $274 for a Chapter 13 bankruptcy. And these figures don't include the costs of hiring a bankruptcy attorney.[11]

These cost increases are proportionately much larger, relative to income, for low-income families than for higher-income ones.[12] This disproportionate effect by income is particularly relevant since lower-income families tend to depend more heavily on more costly, unsecured forms of credit.[13]

Several additional changes raised costs to attorneys that are passed through to clients in the form of higher filing fees. An attorney representing someone filing for bankruptcy can be fined and subject to fees if any information included in their client's case is found to be inaccurate.

Additionally, bankruptcy law firms must now call themselves "a Debt Relief Agency," and there are a number of restrictions, disclosures, and requirements pertaining to everything from advertising to contracts that must be complied with. The DRA requirements, when combined with other additional new tasks that bankruptcy lawyers must prepare, have "approximately doubled the attorney and staff time necessary to shepherd a case from the initial client contact through discharge with no comparable gains in preventing abuse or benefit to debtors."[14]

Aside from the higher costs, the code's amendments made the bankruptcy filing process more burdensome.[15] The effect of the additional requirements can be felt by debtors even before they file. They must now complete a credit counseling course some time in the six months immediately before filing for a Chapter 7 or Chapter 13 bankruptcy with a credit counselor that has been approved by the U.S. Trustee. The course usually lasts 45 to 90 minutes and most often consists only of online or telephone contact with a credit counselor.

If the session results in the production of a debt-management plan, it must be filed with the bankruptcy court. Additionally, at the end of the process, the debtor must also complete a credit education course or money management classes at his expense before his debts can be discharged. The value of the credit counseling requirement remains unclear at this point, though a recent Government Accountability Office study found anecdotal evidence that, "by the time most clients receive the counseling, their financial situations are dire, leaving them with no viable alternative to bankruptcy."[16] This suggests that the counseling requirement serves more often "as an administrative obstacle than as a timely presentation of meaningful options."[17]

In addition, debtors have to pass a new means test.[18] Before October 2005, the bankruptcy law gave the judge who found "substantial abuse" the discretion to send a Chapter 7 filer to Chapter 13 or dismiss the case altogether. Now, a filer's income is subject to a more rigid two-part means test. The debtor's net household income is first compared to his state's median family income. If the debtor's income is lower than the state median, which is the case in the majority of Chapter 7 filings,[19] then only the court has the power to challenge whether the filer should qualify for a Chapter 7 bankruptcy. Creditors cannot exert the same challenge.

But if the filer's income exceeds that amount, then the trustee or a creditor can charge that the filer is abusing the law. If the filer is not found to be abusing the system, the amount that a debtor is supposed to pay toward debt repayment is determined next. This amount is based on a formula that uses living standards guidelines derived by the Internal Revenue Service, thereby reducing the court's discretion. This formula determines what is reasonable to pay for necessary expenses, such as food and rent, in order to calculate how much of the debtor's income is available to pay his creditors.

If it is determined that the debtor can afford to pay more than $10,950, or 25 percent, but at least $6,575 of their non-priority unsecured debt (such as credit card debt) over five years, then they have to move forward with a Chapter 13 filing instead of a Chapter 7 filing. If it is ultimately determined by the means test that a debtor is abusing the system, then it would be possible for the filer to request a hearing to change their filing status by arguing that their case has "special circumstances that justify additional expenses or adjustments of current monthly income."[20] Very few filers request such a hearing, however, because of the high costs for legal fees and the limited likelihood of success.

Moreover, bankruptcy filers are now also required to produce more documents in support of their case, and their case is subject to automatic dismissal if they do not. Besides providing a list of their income, expenses, creditors, and schedules of assets and liabilities, a filer must now provide proof of their credit counseling, pay stubs from the 60 days prior to their filing, a statement of their monthly income, and any anticipated increases in both income and expenses after filing their most recent tax returns. They must also present any tax returns filed during their case, including those for years that may have not been filed when their case began, and a picture ID.[21]

Furthermore, the change in the homestead exemptions likely affected the chance of bankruptcy filing. Before October 2005, the state in which a petitioner filed for bankruptcy determined the amount of home equity that was protected. Now, a federal standard more strictly defines which state home equity amount can be used in the debtor's case. For example, if debtors have not lived in the state that they are filing in for at least 730 days, then they are required to use the exemption amount of the state they resided for the majority of time in the 180 days prior to the 730 days that are examined.

Another example would be the national limit of $125,000 that was set as the amount that the debtor can exempt as interest in a home purchased within 1,215 days before they filed for bankruptcy. Depending on the circumstances, the new bankruptcy rules may protect less of the bankrupt homeowner's residence than the previous law did.[22]

With higher costs and more hurdles for bankruptcy filings, it was expected that fewer people would file for bankruptcy, and that many people would delay filing, thus permitting creditors to earn interest for longer periods. The new law was also expected to result in a shift toward Chapter 13 filings, which would mean fewer protections for filers' assets.[23] Shifting the rules to better benefit creditors became more politically possible because bankruptcy rates rose considerably prior to BAPCPA,[24] lending credence to the idea that many beleaguered debtors were actually filing "bankruptcies of convenience."

Still, even with higher bankruptcy rates prior to passage of BAPCPA in 2005, lenders—and especially credit card companies—managed to increase their profitability considerably at the same time.[25] To buttress its claims for more stringent rules on debtors, the consumer credit industry also publicized the fictional claim that every American had to pay an extra $400 a year when they purchased goods and services "to cover the costs of debts discharged in bankruptcy."[26] This myth was conjured up by a lobbyist, yet the claim was repeated as a factual statement in the media and in Congress.[27]

In contrast, during the BAPCPA negotiations many bankruptcy experts who opposed BAPCPA were not included in the drafting process—even though similar experts had provided much of the technical expertise that previous revisions to bankruptcy law had required.[28] The result was a legal revision that primarily benefited creditors.

Bankruptcy Rates Rise Sharply After Legal Changes Take Effect

In anticipation of the changes coming into effect in October 2005, many people rushed to file for bankruptcy under the old rules. Bankruptcy rates thus rose dramatically between the first and fourth quarters of 2005 before sharply dropping in the first quarter of 2006 as the changes in the bankruptcy code took effect.

Since then, bankruptcy filings have risen sharply again, so that rates are comparatively high again by historical standards. The national annualized bankruptcy rate reached 2.7 filings per 1,000 people in the fourth quarter of 2007.[29] Although this remains below the fourth quarter of 2004 (pre-BAPCPA era) rate of 4.9 filings per 1,000 people, it is a marked increase from 1.5 in the first quarter of 2006. Indeed, this rate exceeds the bankruptcy rates of the 1980s, and is only slightly below the bankruptcy rates of the early 1990s.

If bankruptcy filings continue to rise at the rate of the past two years, then there will be close to 1 million filings in 2008. The upshot: Families find themselves once again in a position where declaring bankruptcy is their only option to handle the various economic pressure points, such as low income growth, spells of unemployment, medical emergencies, and high debt levels. This is true across the United States, and can be seen by comparing individual states' bankruptcy rates with their income levels, unemployment rates, and levels of health insurance coverage, as well as by comparing the national bankruptcy rate with the national level of credit over multiple quarters.

Even with Large Variations, Bankruptcy Rates Are Substantial in Most States

The national bankruptcy rate, however, masks large differences by state. In the fourth quarter of 2007, Tennessee had the highest annualized rate, with 6.4 filings per 1,000 people—a 50.4 percent increase from the first quarter of 2006. All in all, there were 16 states with bankruptcy rates above the national average in the fourth quarter of 2007.

Even among the 16 states with the lowest bankruptcy rates, one or two people out of 1,000, including children and the elderly, can expect to declare bankruptcy annually at the rate of the fourth quarter of 2007 (see table on page 8).

Bankruptcy Rates Doubled in 15 States Over the Past Two Years

Annualized Chapter 7 and Chapter 13 bankruptcy rates have risen rapidly for many states since the first quarter of 2006. The states with the fastest growth rates are California, Nevada, Rhode Island, and North Dakota, with increases of 212.5 percent, 185.5 percent, 159.8 percent, and 157.4 percent, respectively, between the first quarter of 2006 and the fourth quarter of 2007. Overall, there were 16 states where bankruptcy rates more than doubled from the first quarter of 2006 to the last quarter of 2007. In the end, all but the 10 states with the smallest increases saw bankruptcy rates rise by at least 50 percent during this period (see table on page 9).

The growth rate of the bankruptcy rate in many of the states over the past two years is relatively correlated with the initial levels in many of those states, which means that states with higher bankruptcy rates at the beginning of the period in the first quarter of 2006 also tended to have higher relative increases in bankruptcy rates. Similarly, states with lower bankruptcy rates did not catch up with states that had higher bankruptcy rates to begin with. Thus there was a divergence between the states in terms of their bankruptcy experience. This divergence, though, was in large part a result of underlying economic trends, as we show further below. States' experiences with respect to income growth, health insurance coverage, unemployment, and debt growth differed over the past two years and bankruptcy rates with them. As the economy weakened more in some places than in others, bankruptcy rates rose faster in those places, where eco-

STATE BANKRUPTCY RANKINGS

Bankruptcy ratings of the 50 states and the Distinct of Columbia in the fourth quarter of 2007

RANK	STATE	ANNUALIZED CHAPTER 7 AND CHAPTER 13 BANKRUPTCY RATE (FILINGS PER 1,000 PEOPLE)
1	TN	6.4
2	AL	5.1
3	GA	4.8
4	IN	4.7
5	MI	4.6
6	OH	4.2
7	KY	3.9
8	AR	3.8
9	MS	3.8
10	NV	3.7
11	LA	3.7
12	MO	3.4
13	IL	3.2
14	CO	3.0
15	NE	2.8
16	RI	2.8
17	WI	2.7
18	KS	2.7
19	VA	2.5
20	MD	2.5
21	WV	2.3
22	MN	2.3
23	IA	2.2
24	OK	2.2
25	PA	2.2
26	WA	2.2
27	OR	2.2
28	NJ	2.2
29	FL	2.2
30	UT	2.1
31	CA	2.1
32	ID	2.1
33	MA	2.0
34	NH	2.0
35	ND	2.0
36	NY	1.9
37	NC	1.9
38	DE	1.8
39	NM	1.6
40	CT	1.6
41	SD	1.5
42	TX	1.5
43	SC	1.5
44	AZ	1.5
45	ME	1.5
46	MT	1.5
47	VT	1.4
48	DC	1.3
49	WY	1.2
50	HI	1.0
51	AK	0.8

Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; and U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC. Notes: Ranked from highest to lowest Chapter 7 and Chapter 13 annualized bankruptcy rate (filings per 1,000 people).

nomic troubles were brewing. In short, a decline in "bankruptcies of convenience" after enactment of BAPCPA cannot be discerned in the data, but economic factors are clear.

States Are Rapidly Catching Up to Pre-BAPCPA Bankruptcy Levels

The rapid increase in bankruptcy rates has meant that for many states the gap between the pre-BAPCPA bankruptcy rates has sharply declined. The last year that bankruptcy cases were clearly not influenced by the changes in the law was 2004. Comparing the bankruptcy rate in the fourth quarter of 2007 to that of the fourth quarter of 2004, then, gives us a sense of how far states are from the pre-BAPCPA bankruptcy levels.

In the fourth quarter of 2007, seven states—Rhode Island, Michigan, Minnesota, California, Massachusetts, Nevada, and Tennessee—were less than one-third below the bankruptcy rate in their state before the enactment of BAPCPA (see table on page 10), meaning that these seven states today are already nearing their pre-BABCPA levels. To some degree the economic woes in many of these states are also reflected in rapidly rising foreclosure rates, following the fallout from the bursting real estate bubble. The majority of states were between one-third and 50 percent below their pre-BAPCPA levels by the fourth quarter of 2006, while just seven states—Iowa, Wyoming, Utah, Arizona, Alaska, Idaho, and Oklahoma—remain more than two-thirds below their pre-BAPCPA levels.

Nationally, the bankruptcy rate in the fourth quarter of 2007 was 45.1 percent below that at the end of 2004, meaning

STATE BANKRUPTCY GROWTH RANKINGS

The growth rate of the bankruptcy rate in the 50 states and the Distinct of Columbia from the first quarter of 2006 to the fourth quarter of 2007

RANK	STATE	2006-I TO 2007-IV GROWTH RATE IN CHAPTER 7 AND CHAPTER 13 ANNUALIZED BANKRUPTCY RATE (FILINGS PER 1,000 PEOPLE)
1	CA	212.6%
2	NV	185.5%
3	RI	159.8%
4	ND	157.4%
5	CO	155.5%
6	MA	145.0%
7	ME	144.9%
8	MN	143.3%
9	NH	134.0%
10	FL	115.7%
11	OH	111.4%
12	IA	109.1%
13	DC	108.3%
14	SD	104.3%
15	LA	102.5%
16	WV	102.4%
17	WI	98.6%
18	IN	98.6%
19	VA	93.9%
20	NY	90.9%
21	MD	87.2%
22	KY	85.4%
23	CT	83.1%
24	HI	82.7%
25	KS	79.4%
26	MS	78.6%
27	NJ	77.5%
28	MI	77.2%
29	NE	76.6%
30	VT	72.5%
31	IL	71.7%
32	OK	70.2%
33	AZ	69.4%
34	MO	66.5%
35	AL	62.5%
36	NM	59.8%
37	AK	57.8%
38	WA	57.7%
39	DE	57.3%
40	AR	57.0%
41	TN	50.4%
42	ID	49.1%
43	PA	48.4%
44	WY	37.4%
45	OR	37.2%
46	TX	37.1%
47	GA	35.7%
48	UT	32.3%
49	SC	24.6%
50	NC	16.6%
51	MT	-10.9%

Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; and U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico."

that bankruptcies had on average climbed to more than half their levels before the legal changes brought on by BAPCPA in 2005, and in some states bankruptcies had climbed to more than two-thirds their 2004 levels.[30] If the national annualized bankruptcy rate continues to grow at the average quarterly rate of change it has grown at over the past two years—or 0.2 cases per 1,000 people—then it would take another three years and one quarter before it reached the pre-BAPCPA levels at the end of 2004.

Given the worsening economic conditions since the end of 2007, however, chances are relatively high that the bankruptcy rate will accelerate in the coming years. Despite BAPCPA, the time it takes for the "new" post-2005 bankruptcy rate catches up to the "old" pre-2005 rate may be shorter than anyone anticipated—not least the conservatives who promised bankruptcy rates would decline, and presumably stay at low levels, due to tougher bankruptcy laws.

STATE RANKINGS OF PERCENT CHANGE IN BANKRUPTCY RATES

Percent difference in the bankruptcy rate in the 50 states and the Distinct of Columbia between the fourth quarter of 2004 and the fourth quarter of 2007

RANK	STATE	PERCENT DIFFERENCE IN ANNUALIZED BANKRUPTCY RATE, 2004-IV TO 2007-IV
1	RI	–17.3%
2	MI	–24.8%
3	MN	–26.1%
4	CA	–28.3%
5	MA	–28.9%
6	NV	–31.3%
7	TN	–31.5%
8	KY	–35.9%
9	VT	–36.2%
10	WI	–36.6%
11	LA	–37.9%
12	NH	–38.7%
13	ND	–39.0%
14	IN	–39.3%
15	NE	–40.7%
16	GA	–41.5%
17	OH	–42.5%
18	AL	–42.8%
19	MS	–43.7%
20	MO	–44.0%
21	NY	–44.4%
22	CO	–45.7%
23	CT	–46.2%
24	NJ	–46.4%
25	IL	–46.4%
26	VA	–47.1%
27	MD	–48.5%
28	KS	–48.5%
29	PA	–48.6%
30	SD	–48.8%
31	ME	–49.6%
32	FL	–50.4%
33	NC	–52.0%
34	DE	–53.5%
35	AR	–54.4%
36	DC	–55.3%
37	SC	–56.8%
38	HI	–57.6%
39	WA	–58.4%
40	MT	–59.9%
41	WV	–60.1%
42	TX	–61.1%
43	NM	–63.0%
44	OR	–63.4%
45	OK	–66.3%
46	ID	–66.5%
47	AK	–66.8%
48	AZ	–67.2%
49	UT	–71.5%
50	WY	–71.7%
51	IA	–76.2%

Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; and U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC. Notes: Ranked from highest to lowest percent change in the Chapter 7 and Chapter 13 annualized bankruptcy rate (filings per 1,000 people).

People Are Less Able to Protect Their Assets, Get Clean Start

Proponents of BAPCPA had argued the bankruptcy code needed to be amended because many people were abusing the system by filing for a Chapter 7 bankruptcy when they really should be filing for Chapter 13 bankruptcy. This would mean that after BAPCPA was enacted, in addition to seeing both the Chapter 7 and Chapter 13 bankruptcy rates decline, the share of Chapter 13 filings would increase relative to the share of Chapter 7 filings.

Between the first quarter of 1980 and the fourth quarter of 2004, Chapter 7 filings accounted for an average of 70.8 percent of the total number of Chapter 7 and Chapter 13 filings combined. Since the passage of BAPCPA, the share of Chapter 7 filings has decreased, although only by 11.4 percentage points, averaging 59.4 percent between the first quarter of 2006 and the fourth quarter of 2007. In the end, more debtors are probably falling into Chapter 7 bankruptcy after going through the Chapter 13 process. This added financial stress to debtors seeking bankruptcy protection clearly prolongs their ability to get a fresh start.

Bankruptcy Filings Related to Fundamental Economic Stress

Bankruptcy scholars Teresa Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook found in their 2006 article, "Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings" that "middle-class families who filed for bankruptcy in 2001 are in even worse financial trouble than their counterparts who filed during the prior twenty years." This analysis contradicts the claim by BAPCPA proponents that increasing numbers of bankruptcy filers were actually able to afford to pay part or even all of their debts but were instead choosing to take advantage of the system.[31]

Survey and macroeconomic data suggest that fundamental economic problems, not frivolous spending, account for the vast majority of bankruptcies. For instance, the National Association of Consumer Bankruptcy Attorneys found in their October 2006 survey of bankruptcy attorneys that only 8.1 percent of attorneys found that discretionary spending was one of the top two reasons their clients were forced to file for bankruptcy.[32] Further, the NACBA found in a separate survey that credit counseling firms reported an overwhelming majority of their clients were filing for bankruptcy because of circumstances beyond their control. The average response among the firms that responded in this manner was 79 percent, and ranged from 65 percent to 95 percent.[33]

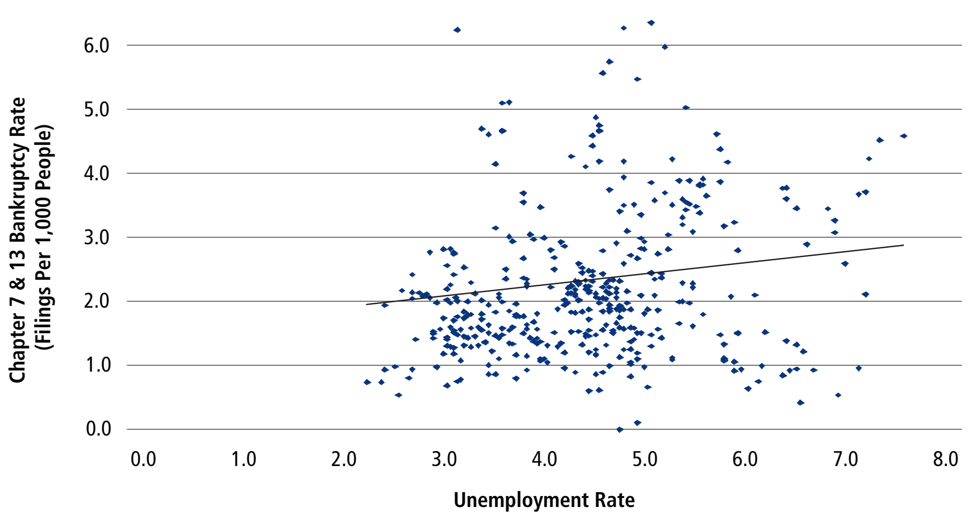
With relatively few exceptions, the majority of academic research and analysis on bankruptcy—both pre-BAPCPA and post-BAPCPA—finds that long-term macroeconomic trends and a filer's ability to pay have considerably more to do with bankruptcy rates than legal regulation.[34] Researchers have consistently found that the majority of bankruptcy filings occur following an unfortunate unplanned event that a family is unable to bounce back from because of limited savings or low income, rather than the frequently touted tales of a bankruptcy filer going on shopping spree after shopping spree and racking up purchases financed with credit card debt that they never intended to pay.

The bottom line: Personal bankruptcies both before and after the passage of BAPCPA in 2005 were repeatedly found to be a function of unemployment, income growth, debt levels—especially credit card debt—and medical expenditures, particularly those due to a lack of health insurance coverage.[35] And these leading indicators of financial stress continue to trend the wrong way for debtors.

For the past two years, the United States has experienced a weak labor market with rising unemployment. By December 2007, the national unemployment rate had risen to 5.0 percent from 4.7 percent in March 2006. To examine this relationship since the change in the bankruptcy code, we graphed states' unemployment rates and bankruptcy rates together between the first quarter of 2006 and the fourth quarter of 2007. When unemployment rates rose between the first quarter of 2006 and the fourth quarter of 2007, the bankruptcy rate tended to rise as well.

THE CONNECTION BETWEEN BANKRUPTCY AND UNEMPLOYMENT

Bankruptcy rates and unemployment rates are correlated between the first quarter of 2006 and the fourth quarter of 2007. Each data point represents one quarter in each state. The line represents the linear relationship between the two variables.



Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC; and Bureau of Labor Statistics. 2006. "Unemployment Rate." Washington, DC. Bankruptcy rates expressed in annualized terms.

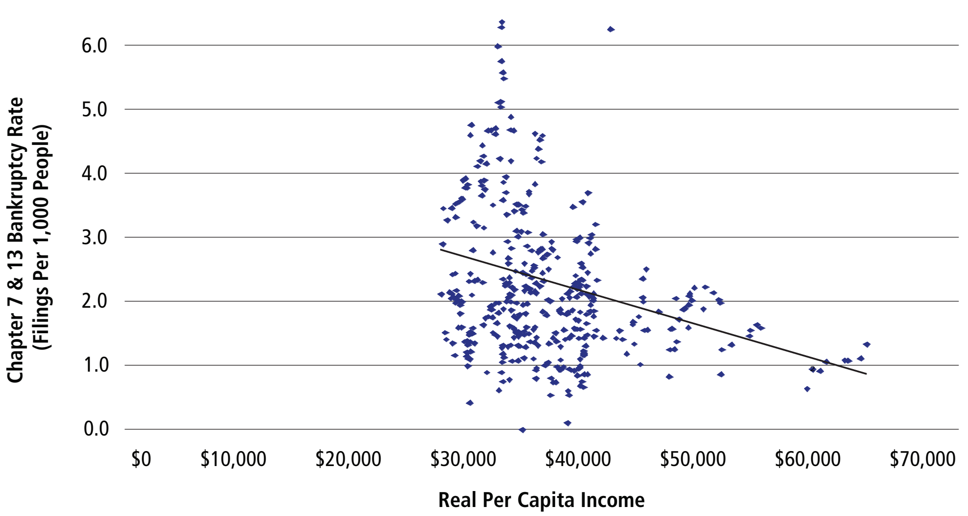
Generally, states and quarters with higher unemployment rates are associated with higher bankruptcy rates (see chart on page 12). Importantly, families have also become more vulnerable to unemployment than in the past, perhaps because the chance of re-entry into the labor market after a lost job has been substantially lessened as measures of long-term unemployment continue to persist.[36]

Another factor contributing to personal bankruptcies is personal income. Weak income growth is often cited as being related to the bankruptcy rate. In recent years, personal income growth has been relatively weak. For instance, factoring in inflation, hourly wages were only 2.0 percent higher, and weekly wages were only 0.8 percent higher, in December 2007 than in March 2006. To examine this relationship since the change in the bankruptcy code, we graphed average real per capita disposable income and bankruptcy rates together, again between the first quarter of 2006 and the fourth quarter of 2007. We found a negative relationship, such that states and quarters with lower real per-capita income also had higher bankruptcy rates (see chart below).

Prices for big ticket items, such as housing, energy, food, and health care, also continue to grow rapidly. For instance, prices for medical care grew by 8.4 percent from the first quarter of 2006 through the end of 2007, while prices for all goods and services rose by only 6.2 percent. Additionally, the share of private-sector workers with employer-provided health insurance continues to decline, dropping to 59.7 percent in 2006 from 64.2 percent in 2000. These trends mean that a medical emergency can translate more quickly than in the past into a financial disaster.[37] Again, states and quarters with a larger share of the popu-

THE CONNECTION BETWEEN BANKRUPTCIES AND PERSONAL INCOME

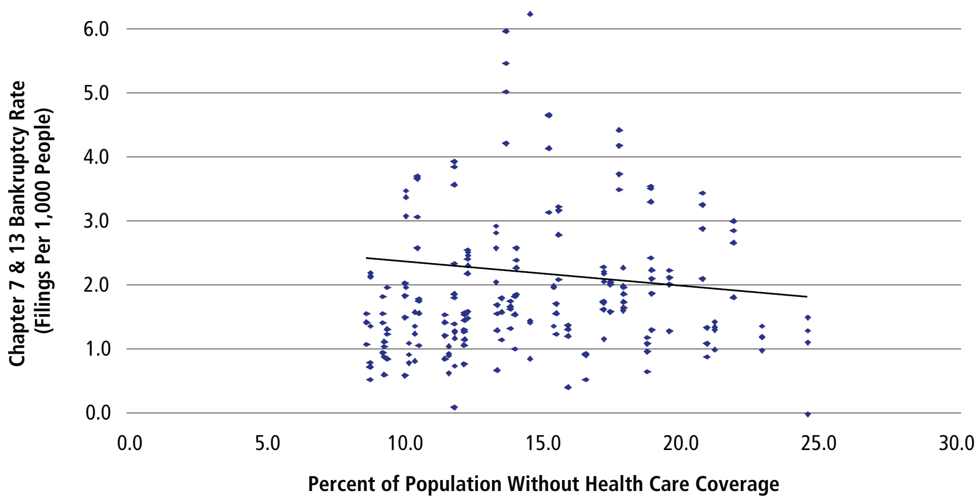
Bankruptcy rates and real personal income are correlated between the first quarter of 2006 and the fourth quarter of 2007. Each data point represents one quarter in each state. The line represents the linear relationship between the two variables.



Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC; and Bureau of Economic Analysis. 2007. State and Local Area Personal Income." Washington, DC. Bankruptcy rates expressed in annualized terms.

THE CONNECTION BETWEEN BANKRUPTCY AND HEALTH INSURANCE

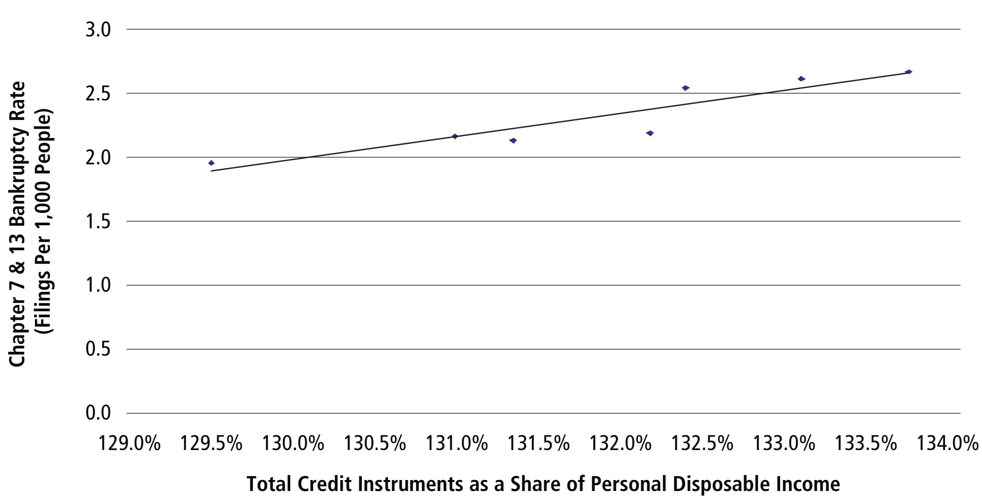
Bankruptcy rates and health insurance coverage are correlated between the first quarter of 2006 and the fourth quarter of 2007. Each data point represents one quarter in each state. The line represents the linear relationship between the two variables.



Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC; and DeNavas-Walt, Carmen, Bernadette D. Proctor, and Jessica Smith. 2006. "Income, Poverty, and Health Insurance Coverage in the United States." Washington, DC: US Census Bureau. Bankruptcy rates expressed in annualized terms.

THE CONNECTION BETWEEN BANKRUPTCY AND CREDIT CARD DEBT

Bankruptcy rates and total credit instruments as a share of personal disposable income between the second quarter of 2006 and the fourth quarter of 2007. Each data point represents one quarter. The line represents the linear relationship between the two variables.



Source: Authors' calculations based U.S. Courts. 2007. "Bankruptcy Statistics: Quarterly Filings: 3 month by Chapter and District." Washington, DC; U.S. Census Bureau. 2006. "Annual Estimates of the Population for the United States, Regions and States, and Puerto Rico." Washington, DC; Bureau of Economic Analysis. 2007. "State and Local Area Personal Income." Washington, DC; and Board of Governors of the Federal Reserve System. 2008. "Flow of Funds Accounts of the United States." Washington, DC: Board of Governors. Bankruptcy rates expressed in annualized terms.

lation without health insurance are also associated with higher bankruptcy rates (see first chart on page 14).

Additionally, Sullivan, Warren, and Westbrook found in their 2006 study examining 2001 data that approximately half of nonmortgage debt of bankruptcy filers was identifiable as credit card debt. What's worse, more than half of debtors owed over $10,000 in credit card debt, and over 20 percent of debtors owed over a year's worth of income in credit card debt alone.[38] Although the most current household level data on mortgages and other consumer debt are not readily available, the recent historical data available shows that the record amounts of debt families have accumulated has contributed to the rise in bankruptcies (see second chart on page 14). In fact, at the national level, the vast majority of the variation in bankruptcy rates over the past two years (more than 85 percent) is explained by the variation in debt levels.[39]

Families have been making do with incomes that are rising more slowly than the cost of necessities for several years now. To try to maintain their consumption, families have been borrowing increasing amounts of money. Household debt averaged a record 133.7 percent of disposable income in the fourth quarter of 2007. In the fourth quarter of 2007, families spent 14.3 percent of their disposable income to service their debt, which is up from 13.0 percent in the first quarter of 2001.

Moreover, as borrowing in the mortgage market has slowed recently, credit card borrowing has accelerated, and so, too, have default rates.[40] Between April 2006 and December 2007, inflation-adjusted credit card debt increased at an alarming average annualized rate of 4.7 percent, which is more than four times the rate it increased at between March 2001 and March 2006, when credit card debt had already reached a record high.[41] Further, credit card debt as a percent of disposable income has also grown at a marked pace since April 2006, increasing at an average monthly rate of 0.2 percentage points between April 2006 and December 2007. December 2007's rate of 9.1 percent of personal disposable income was nearing the May 2001 record high of 9.6 percent.[42]

This is another worrisome element to America's debt and bankruptcy problems. It seems likely that some families are using their credit cards to stay ahead of macroeconomic trends that are decidedly not in their favor—only delaying filing for bankruptcy for the time being.[43] This is a recipe for more swiftly rising bankruptcy rates in the coming quarters.

Conclusion

Our findings suggest that people declare bankruptcy because they have to and not because they want to do so. This implies that recent legal changes have largely been successful in only causing consumers to defer their necessary filings rather than decide that they don't really "need" to file. As Maryland bankruptcy lawyer Brett Weiss stated his May 2007 *Maryland Bar Journal* article, "Congress cannot outlaw the medical problems, job loss or domestic issues that cause the vast majority of people to file for bankruptcy relief."[44]

Nor are these worrying economic trends facing the U. S. economy likely to dissipate any time soon. Weak employment growth, stagnant income growth, the costs of necessities rising far more quickly than families' incomes, the mortgage market crisis, and the looming credit crunch are likely to contribute to an increase in bankruptcy filings. In short order, a resurgence of bankruptcy rates to levels last recorded before the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 went into effect may not be too far over the horizon.

If lenders and legislators alike want to get serious about reducing the number of people filing for personal bankruptcies, then they must recognize that larger macroeconomic issues are at play and act accordingly. Policy solutions that help alleviate potential financial hardships from harming families' economic stability—such as better health care coverage, higher income growth for low- and middle-income earners, and the growth of good jobs—would likely lessen the bankruptcy rate on a sustained basis.

Until policymakers face up to the real causes of rising bankruptcies in our country, more and more Americans will face the prospect of filing for bankruptcy protection. And soon, another year with an increasing level of bankruptcy filings should persuade President Bush and those in Congress who pushed BAPCPA into law to realize that they failed at lowering the bankruptcy rate through changes to the bankruptcy code.

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About the Authors

Amanda Logan is a Research Associate with the Economic Policy Team at the Center for American Progress. Her work largely focuses on issues surrounding lower- and middle-income American families, including prices for necessities, wages and benefits, economic distress such as bankruptcies, and how these families view economic policy. Amanda has been with American Progress since 2006 where she first worked as Special Assistant for Economic Policy. Prior to joining American Progress, she worked at the Center for Economic and Policy Research, the European Parliament, the National Low Income Housing Coalition, and the Idaho National Laboratory. She has appeared on radio programs and her work has been referenced in national media outlets such as *The New York Times*, *The Nation*, *U.S. News and World Report,* CNN, and "NBC Nightly News." A native of Idaho Falls, ID, Amanda graduated summa cum laude from Moravian College in Bethlehem, PA with a bachelor's degree in economics and political science.

Dr. Christian E. Weller is a Senior Fellow at the Center for American Progress and an Associate Professor of Public Policy at the University of Massachusetts Boston. His expertise is in the area of retirement income security, macroeconomics, money and banking, and international finance. He is also a research scholar at the Political Economy Research Institute at the University of Massachusetts Amherst. Prior to joining the Center, he was on the research staff at the Economic Policy Institute, where he remains a research associate. Dr. Weller has also worked at the Center for European Integration Studies at the University of Bonn in Germany, under the Department of Public Policy of the AFL-CIO in Washington, D.C., and in banking in Germany, Belgium, and Poland. Dr. Weller is a respected academic with more than 100 academic and popular publications. His academic publications have appeared in the *Journal of Policy Analysis and Management*, the *Journal of Development Studies*, the *Cambridge Journal of Economics*, the *Journal of International Business Studies*, the *Journal of Aging and Social Policy*, and the *Journal of Economic Issues*, among others. His popular writings have been published *in The New York Times*, *USA Today*, and the *Atlanta Journal Constitution*. He is the co-author (with E. Wolff) of *Retirement Income: The Crucial Role of Social Security* (Washington: Economic Policy Institute, 2005) and co-editor (with T. Ghilarducci) of *Employee Pensions: Policies, Problems and Possibilities* (Ithaca, NY: Cornell University Press, 2007). In 2006, he was awarded the Outstanding Scholar-Practitioner Award from the Labor and Employment Relations Association. In 2007, he was elected to the board of the Labor and Employment Relations Association, one of the country's largest associations for professionals in the fields of labor and employment relations. His work is frequently cited in the press and he is often a guest on national TV and radio programs. Dr. Weller holds a Ph.D. in economics from the University of Massachusetts at Amherst.

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