The Rise in Personal Bankruptcy

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Outline of Presentation

- A Brief History of Bankruptcy Law in the United States
- The Bankruptcy Boom: Cited Culprits
  - Economic Factors
  - Legal and Institutional Factors
- The Bankruptcy Boom: National, Regional, and Local Statistics and Analyses
- Summary
- Solutions (?)

Bankruptcy Law in the United States

- The U.S. Constitution gives Congress the authority to legislate bankruptcy (Article I, Section 8).

- Despite Constitutional authority, no permanent bankruptcy legislation existed for the first 120 years of U.S. history -- a result of strong political divide between Democrats (pro-debtor) and Republicans (pro-creditor) during the 1800s.

- The 1898 Bankruptcy Act was the first permanent bankruptcy legislation in the U.S. The permanency of the Act resulted from the growth in special interest groups during the late 19th century.

  – The 1898 Act was designed to aid creditors in the liquidation of an individual's assets and reorganize insolvent corporations. Most bankruptcies were corporate.

Bankruptcy History, cont.

- The Great Depression revealed problems with 1898 Act:
  - Personal bankruptcies increased
  - Corruption associated with corporate receivership

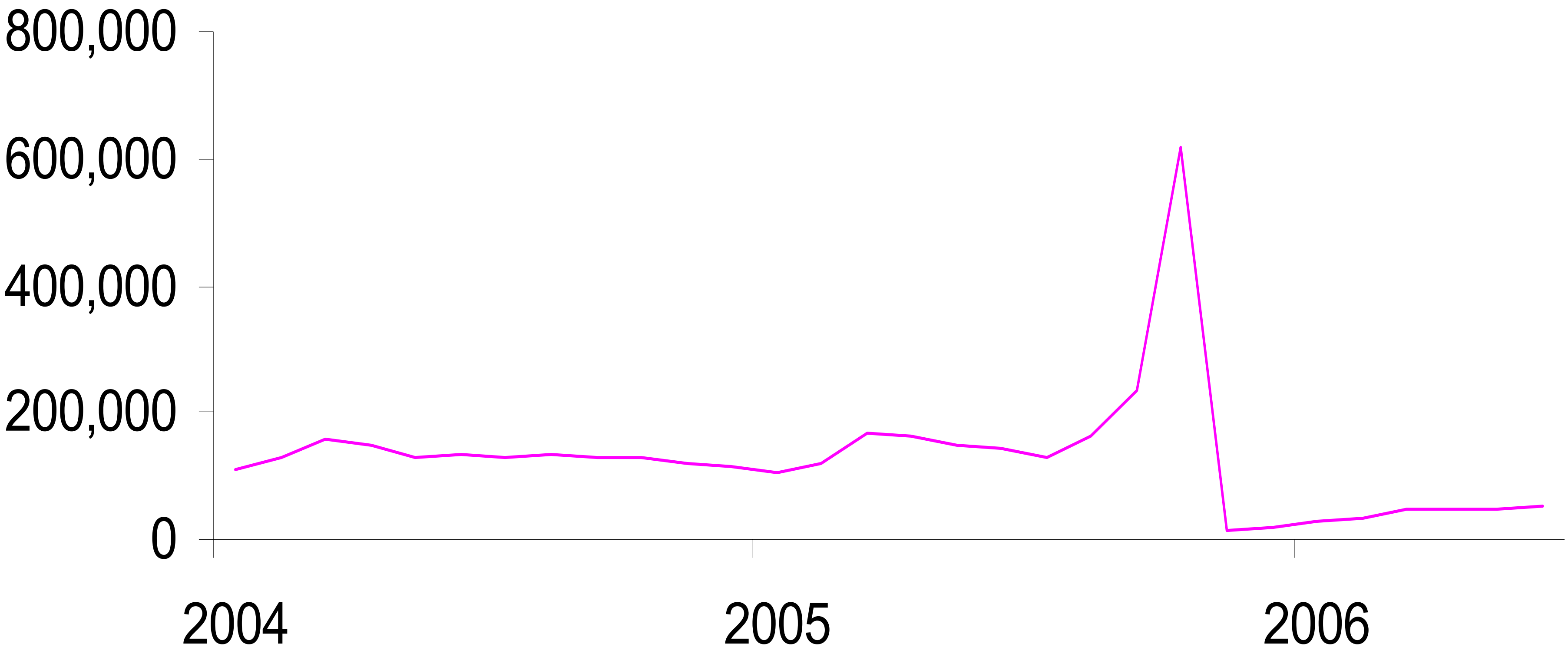
- The Chandler Act of 1938 provided more bankruptcy provisions for individuals and corporations. It allowed for voluntary and involuntary bankruptcies and a choice between liquidation or repayment. The Act focused mainly on corporate bankruptcies.

- Personal bankruptcies grew during 1960s - impetus behind the Bankruptcy Reform Act of 1978. Changes made filing more attractive to debtors. Bankruptcies increased after Act.

Bankruptcy History, cont.

- The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 took effect October 17, 2005. The Act was designed to reduce the rapid rise in personal bankruptcy filings by raising filing costs.
  - Needs-based tests (based on income) for Chapter 7 (liquidation) filings.
  - Credit counseling
  - Longer wait period to re-file.
  - Lenders must better disclose late payment deadlines, interest rates, etc.

Monthly U.S. Personal Bankruptcies - Jan 2004 to June 2006



The Bankruptcy Boom: Cited Culprits

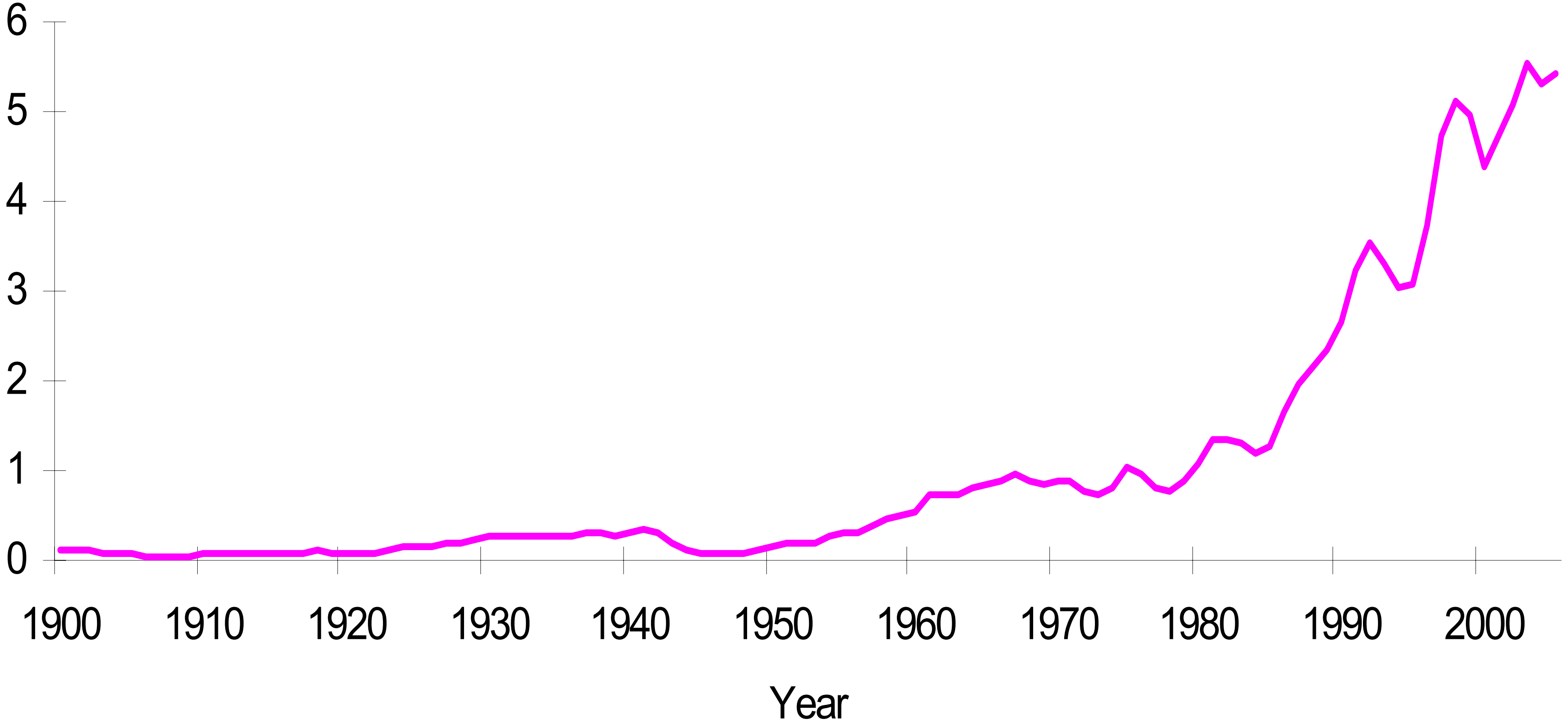
- Personal bankruptcy filings in the U.S. have increased from 1.2 per 1,000 people in 1980 to 5.4 per 1,000 in 2004. This is an increase of 350 percent.

- The 2004 filing rate of 5.4 per 1,000 is nearly 80 times greater than the 1920 filing rate of 0.06 per 1,000.

- The causes of bankruptcy filing are known – high levels of debt often accompanied by a negative income shock. Lower-middle income individuals are the most likely to file.

- However, the important question is why have personal bankruptcies soared over the past several decades?

U.S Personal Bankruptcies 1900-2005
(per 1,000 population)



Cited Culprits, cont.

- Economic Factors:

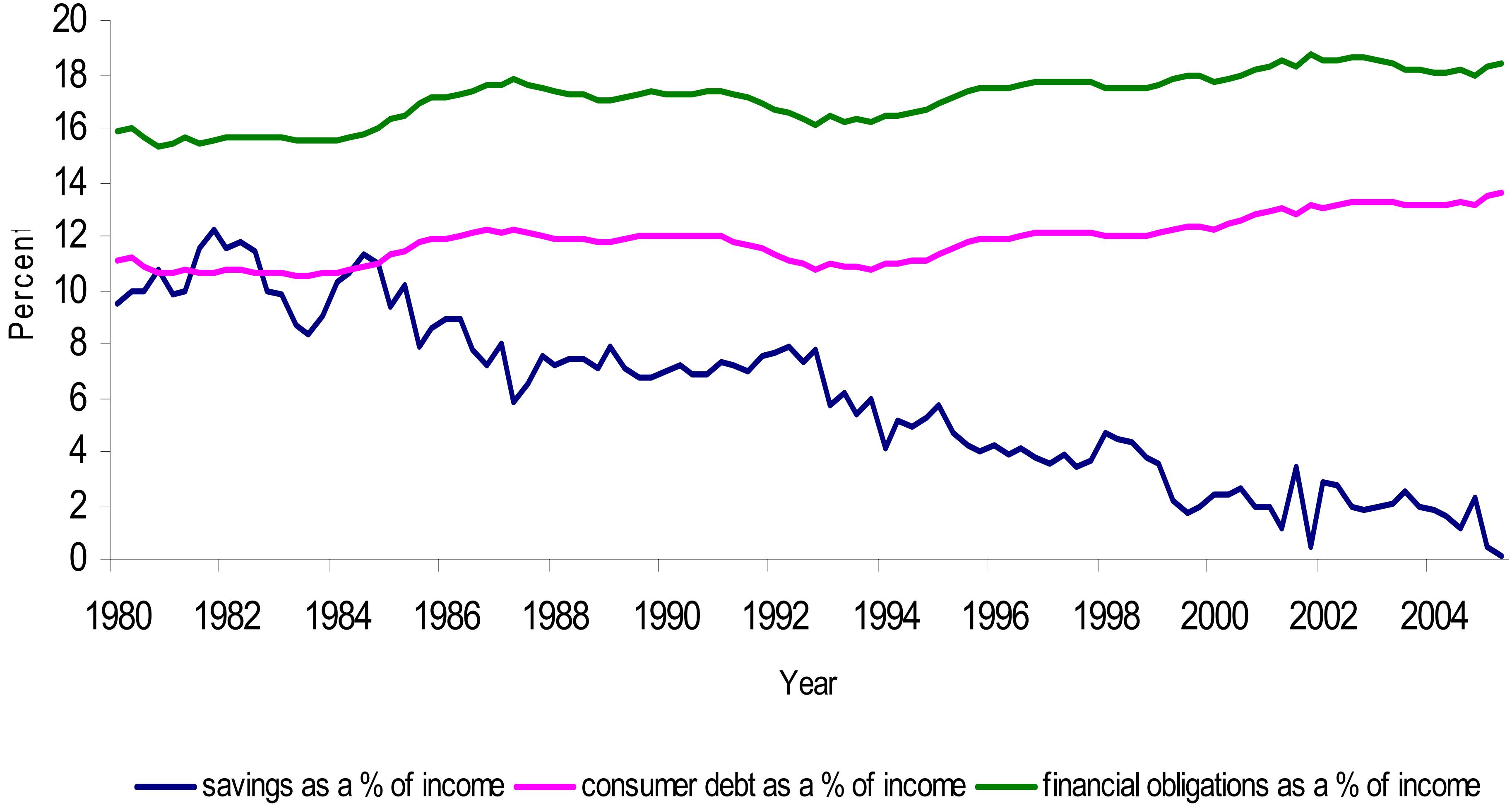
  1) Growth in the size of state and local government transfer payments during the 1960s and 1970s. Safety net discourages personal responsibility?

  2) A decrease in personal savings (10 percent of income in 1980, currently negative).

  3) Growing consumer debt (15 percent of income in 1980, 20 percent of income in 2005).

  4) Growth in casino gaming in the early to mid 1990s?

Consumer Saving and Debt as a Percentage of Income: U.S. Quarterly 1980-2005



Credit Card Balance by Family Income

Mean Credit Card Balance (2004 dollars)			
	Lowest	Middle	Highest
1970	$1,038	$950	$882
1989	909	2,502	3,960
1998	2,596	4,785	6,063
2003	2,938	6,077	14,713

Mean Balance as a Percent of Family Income			
	Lowest	Middle	Highest
1970	4.8	2.0	0.9
1989	3.9	4.2	2.7
1998	10.4	7.4	3.6
2003	11.9	9.1	8.4

Cited Culprits, cont.

- Legal and Institutional Factors:

1) Increased availability of credit cards (revolving credit) in 1960s

2) The Bankruptcy Reform Act of 1978

3) *Marquette* decision by Supreme Court in 1978 – allowed interstate credit card solicitation

4) Community Reinvestment Act of 1977 – encouraged depository institutions to help meet the credit needs of lower income individuals

5) A decrease in the social stigma associated with bankruptcy

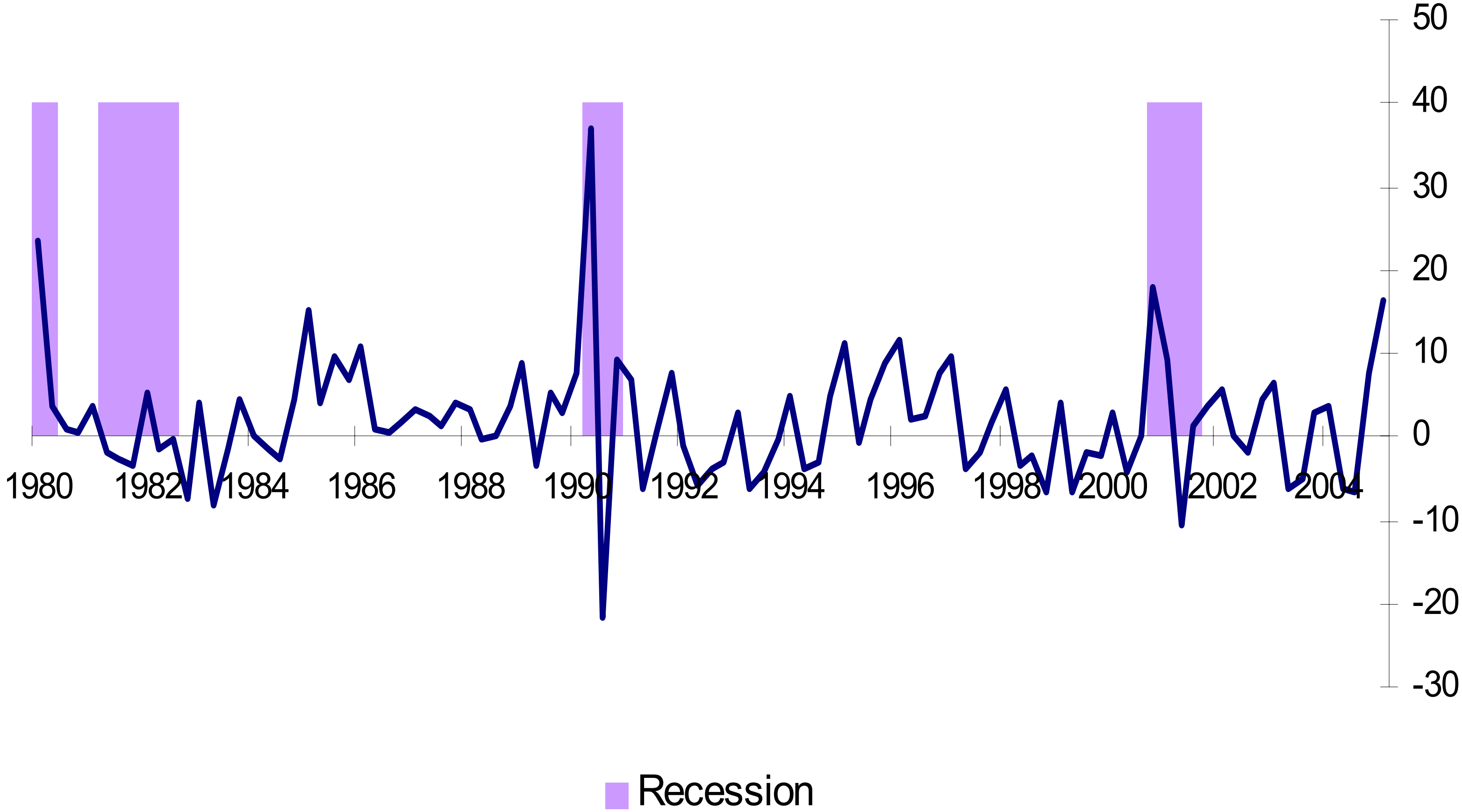
- The rise in bankruptcy over the past several decades can be attributed to:

  1) individuals have more debt, less savings
  2) the cost of filing for bankruptcy was relatively low (compared to 2005 Act)
  3) the social stigma associated with bankruptcy is less
  4) increased availability of credit

  Thus, individuals have become less financially secure than in the past. This has increased their susceptibility to negative income shocks, thus making bankruptcy more likely.

National Analysis

U.S. Personal Bankruptcies: Quarterly Percent Changes
1980 to 2005



National Analysis, cont.

- Explaining the variation in bankruptcy filings:

  - Key variables, such as changes in employment, income, savings rates, and debt to income ratio *do not* explain changes in bankruptcy filings.

  - Recessions (a proxy for a negative income shock) do have a statistically significant effect:

    1) first quarter of a recession: filings are 14.9 percentage points higher than non-recession quarters

    2) second quarter of a recession: filings are 9.2 percentage points lower than non-recession quarters

  Opposing effects are not statistically different – no *overall* difference in filings during recessions compared to booms.

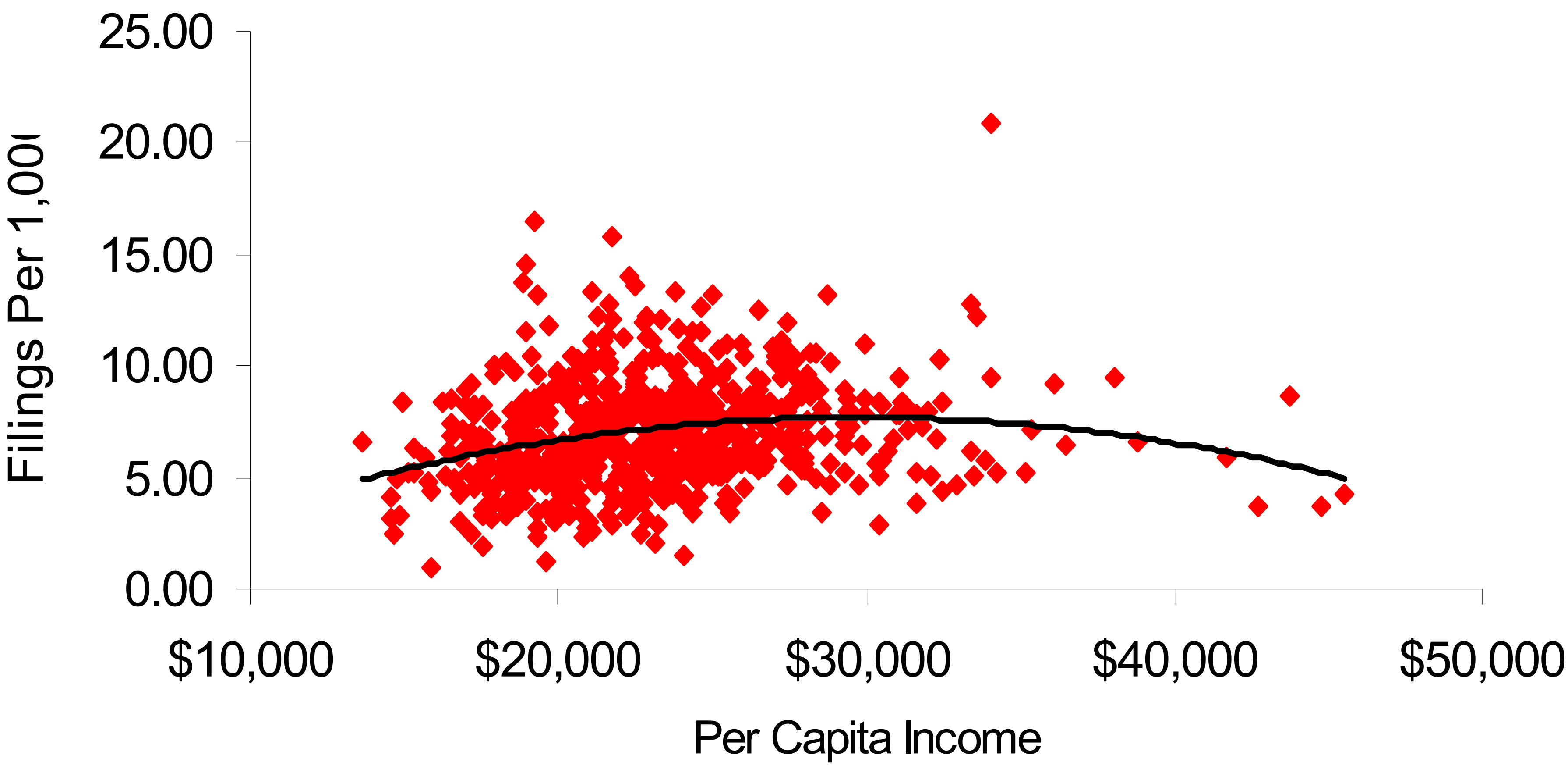
Bankruptcy in 8th District States

STATE	1980 rank	2004 rank	2005 rank	1980 bankruptcies per 1,000	2004 bankruptcies per 1,000	2005 bankruptcies per 1,000	Average Annual Growth (%) 1980-2004
Arkansas	27	4	5	0.99	8.69	10.85	31.17
Illinois	6	17	16	2.14	6.24	8.30	7.69
Indiana	5	5	1	2.18	8.66	12.47	11.87
Kentucky	7	11	9	1.95	6.71	9.55	9.74
Missouri	21	15	11	1.31	6.47	8.98	15.77
Mississippi	10	9	19	1.75	7.24	8.04	12.52
Tennessee	1	1	3	2.60	10.28	10.96	11.82
State Average	-----	-----	-----	1.18	5.34	6.93	16.72

County Data

County	State	Avg. Annual Growth (%) (1991-03)	Un. Rate (%)	Bankruptcy Rate Per 1,000	Per Capita Income
Clinton	IL	11.17	5.9	4.62	28,789
Madison	IL	10.42	6.2	8.96	28,415
Monroe	IL	3.71	4.6	3.87	31,603
Randolph	IL	8.99	6.2	5.98	21,169
St. Clair	IL	10.28	7.0	9.60	27,324
Washington	IL	17.52	5.4	6.40	27,347
Franklin	MO	3.01	5.50	6.16	27,728
Jefferson	MO	5.22	5.2	7.55	26,352
St. Charles	MO	2.59	4.1	5.17	31,587
St. Louis	MO	9.96	5.2	8.61	43,766
St. Louis City	MO	8.05	8.90	9.54	27,236
Warren	MO	3.60	5.4	5.71	25,656

8th District Counties: Per Capita Income and Personal Bankruptcy Filings, 2003



County Income and Bankruptcy

State	Level of Per Capita County Income that Maximizes Bankruptcy Filings	Number of Counties Below Maximizing Income Level	Number of Counties Above Maximizing Income Level	Average County Per Capita Income 2003
Arkansas	$31,692	74	1	$21,452
Illinois	$26,901	74	28	$25,335
Indiana	$28,726	72	20	$26,137
Kentucky	$27,327	104	16	$22,040
Missouri	$53,572	115	0	$22,846
Mississippi	$26,442	75	7	$20,870
Tennessee	$30,434	89	6	$23,330
8th District	$29,698	631	50	$23,197

Summary

- Various legal and institutional changes are likely contributors to the rise in bankruptcy filings

- Individuals are less financially secure today than in the past – less able to absorb negative income shocks

- National level: recessions have one-time effect on filing rates; debt, reduced savings, & institutions explain trend

- State Level: large differences across the states, levels and growth are inversely related

- County Level: bankruptcies increase with income to a certain level, then decrease with income.

Solutions?

- Increase the costs of filing for bankruptcy, as done in the 2005 Act.
- Regulate solicitations by credit card companies
- EDUCATION, EDUCATION, EDUCATION

Questions/Comments