

Senate Banking, Housing and Urban Affairs Committee

Subcommittee on Financial Institutions & Regulatory Relief

Hearing on Bankruptcy Reform

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Personal bankruptcy filings for 1997 reached a record 1.33 million filings, almost 20% higher than the year before. This continuing trend is troublesome, since the economy has been enjoying healthy growth, relatively low levels of unemployment, modest personal income gains and high levels of consumer confidence. It appears that individuals may not be using bankruptcy as it was intended, as a method of getting back on one's feet after hard times. Instead, many individuals may be seeking bankruptcy protection to obtain a free ride, a method of having one's debt forgiven without having to demonstrate need. The economy as a whole incurs financial costs due to the personal bankruptcy system and these costs ultimately must be absorbed by all consumers, both through higher prices and more expensive credit. This study examines the size of these financial costs associated with today's personal bankruptcy system, and the potential savings or costs to the economy of a proposal to reform bankruptcy law.

The key findings of this study include:

- **Financial losses due to 1997 personal bankruptcies totaled more than \$44 billion.** More than 90 percent of the losses came from Chapter 7 filings, which represented more than 70 percent of total bankruptcy filings. These losses are incurred on an annual basis, and losses of similar size can be expected each year if bankruptcy filings remain historically high.
- **Even if the growth in personal bankruptcies slowed to a rate of only 15% a year over the next three years, the American economy would have to absorb a cumulative cost of \$221.2 billion.**
- **Unsecured nonpriority losses totaled almost \$35 billion in 1997.** Unsecured nonpriority debt is dischargeable in Chapter 7, and the majority of it is held by Chapter 7 filers.
- **Passing such financial losses on to consumers in terms of higher prices would cost the average household over \$400 annually.**
- **Passing such unsecured nonpriority losses on to consumers in the form of higher interest rates, would on average cause American households to pay an additional 300 basis points in interest rates for an unsecured loan.**¹
- **The Needs-Based Proposal of H.R. 3150 should decrease financial costs to the economy due to bankruptcy.** This proposal would create a system that would grant an individual the amount of debt relief he or she needs, but would require repayment from those who have the ability to repay. The decrease in financial costs should be expected to range from 8% to 17% annually.

These results quantify the financial costs of the bankruptcy system and the potential impacts of changes to this system. It is clear that limiting the availability of Chapter 7 to those who truly need it and requiring repayment of debts by those who are able, will minimize the losses due to bankruptcy while still providing the important benefits of bankruptcy relief

Thank you. I will be happy to answer any questions.

¹ A basis point is equivalent to 1/100th of a percentage point. For example, if an interest rate were to rise from 5.0% to 8.0%, the interest rate would have increased by 300 basis points.
