Ideal Bankruptcy Law and the 2005 BAPCPA

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IDEAL BANKRUPTCY LAW AND THE 2005 BAPCPA
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by

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Submitted to The Department of Economics

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Date:

I hereby recognize and pledge to fulfill my responsibilities as defined in the Honor Code and to maintain the integrity of both myself and the College as a whole.

Daniel Santos
<table>
<thead>
<tr>
<th>Table of Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>List of Tables &amp; Figures</td>
</tr>
<tr>
<td>Abstract</td>
</tr>
<tr>
<td>1. Chapter 1: Introduction</td>
</tr>
<tr>
<td>2. Chapter 2: History</td>
</tr>
<tr>
<td>3. Chapter 3: Theory</td>
</tr>
<tr>
<td>4. Chapter 4: Empirical Analysis</td>
</tr>
<tr>
<td>5. Chapter 5 Conclusion</td>
</tr>
</tbody>
</table>
List of Tables:

Table 2.1
Comparison of Chapter 7 and Chapter 13 Bankruptcy Protection
(Information from the American Bar Association)

Table 4.1
1993 to Present: Filing Rates and Debt per Household
(Data from the U.S. Department of Justice, the Board of Governors of the Federal Reserve System, and the U.S. Census Bureau)

Table 4.2
1994 to Present: Share of Chapter 7 and Credit Card Collected Interest
(Data from the U.S. Department of Justice and the Board of Governors of the Federal Reserve System)

Table 4.3
2000 to Present: Outcomes of Bankruptcy Enquiries
(Information from the United States Courts System)

List of Figures:

Figure 3.1
Consumer Saving and Consumption Functions
Abstract

In 2005, the U.S. legislature passed the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), generating the most significant changes to the U.S. bankruptcy code in decades. In this essay, I find that a decade after its passage as law, the evidence still supports that the BAPCPA was only able to decrease filing rates and did not deal with factors, especially credit card debt, that lead to the increased rates of bankruptcy filing. Instead, the BAPCPA increased the cost of filing for bankruptcy and decreased its availability as an option for people in debt. The changes to the bankruptcy code directly benefited credit card companies while it hurt debtors. Thus, it is important that, in the future, the U.S. affords more protection to debtors that file for bankruptcy protection out of necessity.
Chapter 1: Introduction

When the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was signed into law in 2005, it was evident that the U.S. bankruptcy code moved away from being consumer friendly. Overall, this could have been a good change for the bankruptcy code, as ideal bankruptcy law lies somewhere between protecting consumers and allowing for debts to be repaid. And the years leading up to 2005 certainly gave the impression that a change in bankruptcy code would have to be made. The number of bankruptcies filed had increased into the millions of cases per year, a six-fold increase over two decades prior. Many people including consumers, attorneys, and credit card companies were worried that the growth in bankruptcy filings was due to individuals abusing the system. The public sentiment that bankruptcies were too prevalent allowed for the U.S. government to first increase scrutiny on bankruptcy cases and later on enact the BAPCPA.

The instant reaction to the law change from economists was that the new provisions went too far to benefit the credit card companies that lobbied for changing the law. Upon revisiting the subject over 10 years after the law was enacted, the BAPCPA has been successful at decreasing bankruptcy filing rates, but it has done this through discouraging necessary filers instead of cracking down on abuse of the system. Instead of focusing on decreasing fraud in the bankruptcy system, the BAPCPA increased expenses for debtors filing for bankruptcy, a move that would equally harm opportunistic bankruptcy filers as well as necessary filers. All of the major provisions of the law increased expenses for people attempting to file for bankruptcy.
As a first step to evaluate the law’s changes, the third chapter will begin by outlining the reasons that bankruptcy laws exist as well as defining a way to optimize the law such that it offers protection for any person that has lost the ability to repay debts. Meanwhile, it is also important that bankruptcy laws are only available to those in need of debt relief and does not allow for people to abuse the system. The finding from this section is that while U.S. bankruptcy law was flawed prior to 2005 due to people that abused the system, the law changes would discourage both abusers as well as necessary filers from going through with bankruptcy protection. Further, due to the financial circumstances of debtors looking to file for bankruptcy, the increased upfront costs of filing for bankruptcy would only target the necessary bankruptcy filers.

Empirical evidence furthers the point that the BAPCPA did nothing to remedy the problem that it was supposed to fix. In short, the changes to the law were able to decrease the total number of bankruptcy filers, but it did nothing to remedy the growing credit card debt in the U.S. Instead, over the past few years, credit card debt has decreased along with other factors that show the U.S. is moving away from credit card debt for the first time since it was introduced as a quick and easy way to get credit. Specifically, with these factors already decreasing, now is a perfect opportunity to prevent people from having to deal with substantial debts through credit counseling and restrictions on the operation of credit card companies.
Chapter 2: History

From the 1980s until the early 2000s, personal bankruptcy filings rose at levels that conflicted with what many thought should be expected (White, 2007). From 1980 to 2005, U.S. population grew by around 30 percent, but bankruptcy filings rose by over 600 percent (White, 2007). This startling rise in bankruptcy would lead to substantial law changes that were a part of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. The first areas to explore are the parties and factors that most influenced the new law. Prior to 2005, the sentiment of some was that the U.S. bankruptcy code would have to change to combat abuse of the system (Zywicki, 2005; Weller, et al. 2008). Due to abuses of the system, creditors were hurt by the ability of many to get debts forgiven, while the abuse hurt consumers and debtors that filed for bankruptcy protection out of necessity. The most influential group was the lobby of credit card companies that was able to put money and campaign contributions behind new legislation. Then, to set up the eventual passing of the BAPCPA, it is important to note the smaller step that the government took prior to the law, specifically the National Civil Enforcement Initiative, undertaken by the U.S. Trustee Program. Most important will then be a look at the major changes that the 2005 BAPCPA brought about in regards to the bankruptcy code.

I Push for Bankruptcy Reform

Bankruptcy proceedings are broken down into three parties: debtors, creditors, and government. The debtors and creditors have oppositional views on bankruptcy protection and it is up to the government to enact laws that are deemed equitable for both sides. In regards to the 2005 BAPCPA, the government wanted to fix a problem in the
law that allowed people to exploit filing for bankruptcy. Creditor’s heavily supported attempts to change the law to decrease exploitation, but they lobbied more heavily for laws that would decrease consumer protection during bankruptcy. Examined here are these two sides and how they pushed for bankruptcy reform.

A. Bankruptcy Exploitation

As many writers, such as Benton (2005), Edmiston (2006), and Weller, et al. (2008), observe, bankruptcy reform was spurred by rising filing rates that were caused by consumers that abused the bankruptcy code. It was with this knowledge that the U.S. government began to draft changes to the bankruptcy code. From their view, the laws should make bankruptcy more expensive to diminish the incentive for people to exploit the system. Optimally, changes in the law would only target people exploiting the system and keep incentivizing insolvent people to file for bankruptcy protection.

B. Lobbying from Creditors

Credit card companies pushed for decreasing the amount of exploitation in bankruptcy filings, but they also would benefit from any increase in the consumer price of bankruptcy. This included increasing prices for debtors that could still pay off debts but filed due to lax laws, but also to people that are insolvent and are in need of bankruptcy protection. The credit card companies had huge incentives for increasing the price to consumers filing for bankruptcy and thus ensured that they had sway in creating the changes to the code.

As Robert Scott (2007) states, increasing bankruptcies were a direct result of the credit card companies and the willingness of the industry to allow consumers a line of
unsecured debt. Credit card companies made money off of consumer debt, but
bankruptcies cost the credit card companies $4 billion in lost revenue per year (Scott,
2007). Thus, the industry spent more than $100 million to lobby for greater costs, and
they would be successful in increasing the cost of bankruptcy for consumers.

II Actions Taken Prior to 2005

As a division of the U.S. Justice Department, the U.S. Trustee Program operates
as a supervisor over bankruptcy cases and ensuring the integrity of the bankruptcy
system. As the program explains, “one of the U.S. Trustee Program’s most critical
responsibilities is to combat fraud and abuse in the bankruptcy system (U.S. Trustee
Program, 2002).” With concern over people abusing the bankruptcy protection system,
the burden fell on the Trustee Program to further scrutinize bankruptcy filers. Beginning
in 2002, the Trustee Program launched the National Civil Enforcement Initiative, the
most substantial action taken prior to 2005. The Initiative was focused on enhancing the
Trustee Program’s ability to prosecute abusers by increasing the resources dedicated to
criminal enforcement. The Trustee Program had two courses available to deny abusers
from completing bankruptcy, dismissal of a bankruptcy case for “substantial abuse” and
denial of discharge for actions meant to defraud a creditor or trustee. These two aspects
will be looked at as a measure of how effectively the Trustee Program was able to combat
fraudulent use of the bankruptcy code.

While the National Civil Enforcement Initiative was able to specifically target
abusers of the bankruptcy code, it was insufficient in decreasing abuse due to limited
ability to review cases as well as the ambiguity of the law. Case dismissals rose by over
200 percent in the years following the Initiative while discharge denials rose by 300 percent from pre-2002 levels. However, this still meant that the Trustee Program would review around 30,000-50,000 cases per year, meaning that over 98 percent of bankruptcy cases were never reviewed for fraud or abuse. Overall, the Trustee Program pursued dismissal or denial actions in less than one percent of bankruptcy cases for each year after 2002 (Debtor Audits by the United States Trustee Program, 2004).

The problem with the Trustee Program reviewing such a small fraction of bankruptcy cases was the ambiguity of the laws that allowed them to dismiss cases. Specifically, under section 707 of the bankruptcy code, the Trustee Program could dismiss or deny bankruptcy for the reason of “substantial abuse.” Some abuse can easily be classified as substantial, particularly misrepresenting income or hiding assets from creditors. However, as the Trustee Program’s 2002 Annual Report stated the following:

The term “substantial abuse” is not defined, but under case law, it is generally determined based upon a consideration of the totality of a debtor’s circumstances including, most often, the debtor’s financial ability to repay creditors. For example, a high-income Chapter 7 debtor who spends large sums on luxury goods and services may be subject to a motion to dismiss for substantial abuse under Section 707(b) if the debtor can otherwise repay creditors outside of bankruptcy or through a Chapter 13 repayment plan.
Since only the Trustee Program could charge a bankruptcy filer with substantial abuse, it meant that the program had to first review a case to decide if it constituted an abuse of the system.

This initial step taken by the Justice Department to combat abuse was effective at increasing the ability of the Trustee Program to enforce bankruptcy abuse laws. However, the inability of the Initiative to decrease filing rates highlighted the need for more extensive action to combat fraud. The “substantial abuse” section of the code meant that determining abuse had to be done on a case-by-case basis, meaning that the vast majority of cases would be decided before they were reviewed for possible abuse.

### 2005 Bankruptcy Abuse Prevention and Consumer Protection Act

The pressure from lenders and the apparent shortfalls of the existing bankruptcy code were instrumental in gaining bipartisan support for the Bankruptcy Abuse Prevention and Consumer Protection Act. The Act brought sweeping changes to bankruptcy code and especially focused on individuals that exploited prior laws. One such change was to combat people who were called serial bankruptcy filers. In these cases, debtors would file for bankruptcy to prevent the execution of secured debt contracts. The bankruptcy filings would eventually be rejected, but this could be used to delay the relinquishing of collateral such as delaying foreclosure or repossession. The alterations were seen as necessary to the government to fix the problem of consumers exploiting bankruptcy protection code.

However, other changes were seen as diminishing the strength of protection, even for insolvent debtors that should be incentivized to file. The two aspects that follow, the
means test and associated bankruptcy fees were aspects pushed by credit card companies that were successful in partially diminishing consumer protection.

A. Means Test

The most substantial change enacted as part of the BAPCPA was the addition of financial requirements for people filing for chapter 7 bankruptcy. This provision put in place a restriction on the maximum amount of income that a person could have if filing for chapter 7 bankruptcy. If a person’s or a household’s income fell above this threshold, then that person cannot file for chapter 7 bankruptcy (Ashcraft, et al., 2007). Instead, the option for that person would be chapter 13 bankruptcy. Prior to the law, the consumer could choose either chapter 7 or chapter 13 and would choose the one that was most beneficial to their situation. Allowing debtors to choose between chapter 7 and chapter 13, the majority, 70 percent, of filings were for chapter 7 (Scott, 2007). The means test essentially replaced the “substantial abuse” clause of the bankruptcy code. Prior to the means test, the Trustee Program was the only authority able to force debtors to switch from Chapter 7 to Chapter 13. Instead of taking time on each case to decide what qualified as “substantial abuse,” the means test allowed for debtors to be automatically divided into people that qualified for Chapter 7 and those that did not. To understand what this means test changed, the important factor to look at is the difference between chapter 7 and chapter 13 bankruptcy.
Table 2.1. Comparison of Chapter 7 and Chapter 13 Bankruptcy Protection
(Information from the American Bar Association)

<table>
<thead>
<tr>
<th></th>
<th>Chapter 7</th>
<th>Chapter 13</th>
</tr>
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<tbody>
<tr>
<td>Type of Bankruptcy</td>
<td>Liquidation</td>
<td>Repayment</td>
</tr>
<tr>
<td>Qualifications</td>
<td>Debtor must pass means-test based on median income.</td>
<td>Debtor must owe less than maximum debt threshold (around $400,000 of unsecured debt and $1 million of secured debt).</td>
</tr>
<tr>
<td>Payment</td>
<td>All non-exempt assets are forfeited and liquidated to pay off creditors.</td>
<td>Repayment plan consisting of paying all dischargeable income to creditors during each payment period.</td>
</tr>
<tr>
<td>Conclusion of Bankruptcy</td>
<td>Court enters discharge order upon surrender of non-exempt assets. At this point dischargeable debt is forgiven.</td>
<td>Debtor finishes repayment plan. At this point dischargeable debt is forgiven.</td>
</tr>
<tr>
<td>Time for Conclusion</td>
<td>3 to 5 months of proceedings to determine exempt assets and non-dischargeable debt.</td>
<td>3 to 5 Years including proceedings and the length of the repayment plan.</td>
</tr>
<tr>
<td>Effect on Credit</td>
<td>Bankruptcy remains on credit report for up to 10 years after the date of filing.</td>
<td>Bankruptcy remains on credit report for up to 10 years after the date of filing.</td>
</tr>
<tr>
<td>Success Rate</td>
<td>Over 90%</td>
<td>Under 50%</td>
</tr>
</tbody>
</table>

As outlined in Table 2.1, the most important difference between chapter 7 and chapter 13 bankruptcy is that chapter 7 is liquidation and chapter 13 is repayment. Thus, it is important to note that the payments that are required of a debtor are very different, chapter 7 being the overturning of assets and chapter 13 being period based payments to creditors. The situation then creates circumstances that affect the creditors and debtors in different ways (American Bar Association).

Due to the differences in the law, chapter 13 allows for credit card companies to diminish losses when compared to chapter 7 bankruptcy. The most substantial of these
differences is that chapter 7 eliminates unsecured debt, which is mainly credit card debt (Scott, 2007). The common outcome of chapter 7 bankruptcy for credit card companies was to incur heavy losses since the debtor’s assets were far less than the outstanding debt. Upon the debtor turning over the assets, all of the credit card companies claims would be completely forgiven. On the other hand, in chapter 13, the repayment plan is much more friendly to creditors. This is because the payment plan goes directly to creditors just as credit card payments are paid every month. In this way, the repayment plan is the court ordering the debtor to pay all disposable income towards credit card payments.\textsuperscript{1} Also, repayment is beneficial to credit card companies over liquidation because it means that the only way for the consumer to get the debt forgiven is through following the entire payment plan that can last up to five years. This benefit for the credit card companies then, in turn, is the greatest cost that chapter 13 bankruptcy has over chapter 7 for debtors. If filing for chapter 7 bankruptcy, the costs are incurred heavily upfront, but only last for a few months, estimated between three and five months (American Bar Association). On the other hand, chapter 13 bankruptcy lasts for years and requires a person to make periodic payments. This leads to a massive disparity in the success rate of bankruptcies, as over 90 percent of chapter 7 bankruptcies are successful while less than half of chapter 13 bankruptcies end successfully (Wenli Li, 2007). For this statistic, a case is successful if the debtor turns over agreed upon assets in chapter 7, or if the debtor follows the chapter 13 repayment plan fully. For bankruptcies that are

\textsuperscript{1} This was also changed as part of the BAPCPA. Previously, debtors would propose the repayment plan if filing under Chapter 13 protection.
unsuccesful, the consumer does not have debts forgiven and ends up in a worse financial situation.

**B. Fees Associated with Bankruptcy**

Other aspects of the law were crucial in increasing the costs associated with filing for bankruptcy. As a part of the law, bankruptcy attorney fees went up as a result of some of the changes. The change from chapter 7 to chapter 13 is partially tied to attorney fees as well. During the three to five years for the repayment plan of chapter 13, a person needs to continue employing a bankruptcy attorney until the proceedings conclude and the debt is expunged. Further, the BAPCPA established greater requirements of bankruptcy attorneys. This was because the law made the attorneys personally liable for any information that was falsified by the filer (Benton, 2005). This provision was required so that attorneys would add further oversight to cases, in addition to the oversight of the Trustee Program. The increased costs have been a reason that some lawyers have stopped offering services for Chapter 7 cases. Attorneys that still represent clients filing Chapter 7 have to spend more time on each case looking over the submitted paperwork and ensuring that their clients are not lying to the bankruptcy court. This entails not only accepting information from the client, but also conducting a further check on the financial situation of clients, or what is known as “reasonable investigation” into a client (Scott, 2007). Also, the law now requires that more submissions need to be made by debtors, such as submitting the previous five years of tax returns (White, 2007).

Overall, as Albanesi and Nosal (2015) present, in chapter 7 cases, attorney fees have increased by 38 percent. The article by Weller, Morzuch, and Logan (2008) further
emphasizes this point, “Several additional changes almost doubled the attorney and staff time needed for a case… costs that are passed on to clients as higher filing fees (p. 2).”

The court fees for filing were also increased as a part of the law. The increase for chapter 7 bankruptcy was from $209 to $299 and the increase in filing fee for chapter 13 increased from $194 to $274 (Weller, Et al., 2008). These fees go directly towards the budget of the Trustee Program. Along with this, the law change required that debtors take part in credit counseling classes that the consumer must pay for in order to file for bankruptcy (Benton, 2005). The intention of this provision is to educate debtors and ensure that they are aware of all options for repaying debts, including non-bankruptcy options.

### IV Conclusion

As this chapter sets up, year-over-year increases in bankruptcy filings since the 1980s was an issue that required considerable changes to resolve the problem. In the early 2000s, the government attempted a crackdown on filers attempting to exploit the system, but these actions only made it more evident that sweeping reform was necessary. Out of this came the 2005 BAPCPA, which substantially altered the U.S. bankruptcy code. The revisions had one clear goal in mind, to decrease the number of people filing for bankruptcy protection. The two most significant rule changes were the new means test, which set standards for people to qualify for chapter 7 protection, and the increase in bankruptcy fees, such as filing fees, attorney expenses and fees to get the proper documentation for filing. These two major changes decreased the supply of bankruptcy protection while increasing the costs that would decrease the number of bankruptcy
filings. However, the following chapters will show that the BAPCPA had further consequences than just decreasing the number of people filing for bankruptcy. The next chapter will show that the goal of the BAPCPA should have been to focus on decreasing filings among people exploiting the bankruptcy code instead of discouraging all consumers from filing.
Chapter 3: Theory

The years prior to the law change in 2005 emphasized the need for reform to block those that abused the bankruptcy code. The drastic increase in bankruptcy cases coupled with increasing consumer debt lead to support for the reform. However, upon the publishing of the changes the BAPCPA would bring, some economists theorized that the code change would do more harm than good. My argument is that changes made by the BAPCPA were beneficial to credit card companies but were ineffective in pushing U.S. bankruptcy code closer to optimal bankruptcy law. The focus will be on two problems with the law, the means test that instituted guidelines for filing for chapter 7 bankruptcy and the increase in associated costs, such as higher attorney fees and filing fees. Discussed first will be the need for bankruptcy laws and then how it ties to establishing optimal or the most efficient bankruptcy code. From there, the chapter will go into the effects that the BAPCPA had on the actions of consumers and credit card companies. Specifically, it will present the factors that can lead a person to incur credit card debt, and how the same concepts of behavioral economics, present-bias and bounded rationality, mean that debtors will most likely stay in debt. From the perspective of the credit card companies, we will look at the rationale of why credit card companies give lines of credit to risky borrowers as well as targeting consumers with low credit or previous bankruptcies.

I Importance of Bankruptcy Protection Law

Bankruptcy laws are classified as consumer protection laws, but, as Knot and Vychodil (2005) state, the reason for bankruptcy law is as a correction for when a debtor
is unable to pay-off a debt contract (p. 111). The bankruptcy code attempts to correct the issue of a debtor’s debt being greater than total assets or greater than what could feasibly be repaid. In this instance, debt contracts are insufficient as the debtor does not possess enough in assets to repay all of the contracts. Debt contracts are replaced with the stipulations outlined in the bankruptcy code (Knot and Vychodil, 2005, p. 111). Thus, the bankruptcy code establishes an alternate way in which assets and future income are used to repay debts. The system offers a more feasible repayment plan to lenders.

Specifically for the consumer, the importance of bankruptcy is to improve welfare for people that cannot manage repayment of debts. Albanesi and Nosal (2015) show that a debtor that is insolvent and does not file for bankruptcy is associated with greater financial distress. In this situation, debtors are far less likely to manage to pay off debts. This is then associated with defaults on secured debt and repossession of assets. The unfavorable outcomes of insolvent debtors that do not file for bankruptcy will be especially important in looking at how the BAPCPA affected debtors and the economy.

A. Optimal Bankruptcy Law

To open the conversation on optimal bankruptcy law it is important to note that Knot and Vychodil (2005) do not come to a firm conclusion on what exactly the optimal law is and instead focus on what the goals of bankruptcy code are and how they are achieved. The goal of the bankruptcy code is to create socially optimal outcomes, but this can be achieved by having tough, pro-creditor, or weak, pro-debtor, laws. Further, bankruptcy code should be measured by what the authors call ex-ante and ex-post effects. Ex-post effects are any outcome that is directly a result of bankruptcy proceedings.
These effects are aspects such as the amount of debt paid off and the amount of debt discharged, as well as the distinction between exempt and nonexempt assets. The other side, ex-ante, pertains to outcomes that happen prior to bankruptcy, that is, “how debtors and creditors adjust their behavior in the pre-bankruptcy stage conditional to what happens in bankruptcy” (Knot and Vychodil, 2005, p. 114). The ex-ante effects will be what is observed as the consequence of the BAPCPA, and how aspects of the law worked against creating optimal bankruptcy code. Though optimal bankruptcy law cannot be perfectly determined, the conclusion is that, at the very least, bankruptcy code should work to help debtors that can no longer feasibly repay debts (Knot and Vychodil, 2005, p.111). Thus, the bankruptcy code should incentivize consumers that are insolvent to file for bankruptcy, while then establishing some balance of repayment to creditors and giving financial protections to filers.

Leading up to the BAPCPA, it was filers exploiting the bankruptcy code that worried legislators, creditors, and consumers. The problem with having bankruptcy protection for debtors is that it creates a moral hazard. A moral hazard is a situation in which a person can take a risk without having to bear the full cost associated with the risk (McEachern, 2006). Therefore, the moral hazard of having bankruptcy protection is that consumers incurring debt can file for bankruptcy and will then not have to pay all the debts back. The credit card companies have already given out the money to the debtors and have to incur the costs of what the consumer purchased. Since credit card companies lose money due to bankruptcy filings, some of the cost is then passed on to other consumers with credit cards. This is especially problematic if it is beneficial for
individual consumers to acquire large amounts of debt and then have it wiped away by filing for bankruptcy. Bankruptcy protection has to be a balance between allowing insolvent debtors to file while keeping people from abusing the system and passing the costs of debt onto others and creating a moral hazard.

II What Effect did Changes Have on Consumers?

From the literature on the subject, such as Albanesi and Nosal (2015), and White (2007), the 2005 BAPCPA was successful in causing a nearly 75 percent cut in filings from 2005 to 2006. However, the important question is did the change to bankruptcy code move it closer to optimal law, or did it simply increase the cost to debtors and thus decrease the possible losses for creditors? The following chapters will show statistical models that show that the law decreased bankruptcy filing among people that were not exploiting the law and were instead insolvent and should have been incentivized to file. Instead, the law has incentivized some people to not file, though they would be better off according to Albanesi and Nosal (2015). Specifically, two concepts lead consumers to choose not to file for bankruptcy, even if it would be beneficial in the long run: present-bias and bounded rationality.

A. Present-bias

People go into credit card debt because they are biased towards spending money now and paying it off or saving later (Benhabib, Bisin, and Schotter, 2007). This is the mindset of a hyperbolic discounter. White (2007) expands upon this idea using the contrast of the rational consumer and the hyperbolic discounter. In this case, the rational consumer can weigh different options at different times in a way that makes sense for
him to maximize utility. If a consumer has to choose between $10 one month and $15
the next month, they would use a discount rate to find the value of the $15 one month
erlier. The hyperbolic discounter has a different approach to value the two options. For
this case, assume that the consumer will accept $10 today over $15 in a month, but the
same investor would value $15 in a year and a month greater than $10 in a year. This
concept can be applied to a consumer's choice to save or spend money. When a
hyperbolic discounter decides between saving or going into debt they will always have
the assumption that consuming now will yield greater utility. The hyperbolic discounter
is always in the negative for saving such that he can consume more in the present
(Laibson, 1997). Figure 3.1 shows a consumer's choice to either borrow money, save
money, or spend all disposable income. The 45° line represents consuming all disposable
income, thus any consumption level that lies above that line would require borrowing and
the consumption curve being below that line would represent the consumer saving. This
figure represents both rational consumers and the hyperbolic discounters. The difference
is that a rational investor would have negative saving only during times of low income or
high consumption, such as if the person lost a job or had an unforeseen expense. Then
the consumer will save money when disposable income increases. The hyperbolic
discounters will always be toward the left of the graph, incurring debt to increase
consumption today. Instead of deciding on consuming or saving their disposable income,
they decide to consume or borrow money today and will then have the disposable income
in the future to save or pay off debt. This is not to say that the hyperbolic discounter is
purposefully going in debt to the point that they cannot pay it off, instead, the hyperbolic discounter perpetually has the mindset that he will start saving tomorrow.
The same principle that gets people into credit card debt can lead them to become insolvent and not file for bankruptcy. In the same way that hyperbolic discounters would rather spend today and save tomorrow, they are biased against spending money now to save money later. In the short run, both chapter 7 and chapter 13 bankruptcy have high upfront costs, but even greater saving for the future. Thus, some people, especially those that find themselves in credit card debt, either do not want to file for bankruptcy or will continuously put it off till later.

**B. Bounded Rationality**

Even consumers that do not have present-bias and weigh future benefits against upfront costs can decide to not file for bankruptcy due to bounded rationality. Herbert Simon was the first to theorize about bounded rationality, and it is explained by The Economist (2009) in the following statement:

Contrary to the tenets of classical economics, Simon maintained that individuals do not seek to maximize their benefit from a particular course of action (since they cannot assimilate and digest all the information that would be needed to do such a thing). Not only can they not get access to all the information required, but even if they could, their minds would be unable to process it properly. The human mind necessarily restricts itself. It is, as Simon put it, bounded by “cognitive limits” (p. 1).

For this example, the focus is on two of Simon’s main points, that people have limited or incorrect information and that people only have limited capacity to make decisions. To analyze this, it is important to note that the outcomes of declaring bankruptcy and being
insolvent are impossible to know upfront. The only factors that are known at the
beginning of proceedings are the upfront costs. After paying the bankruptcy and attorney
fees and agreeing to terms on either the asset forfeiture in chapter 7 or the payment plan
in chapter 13, consumers have no guarantee that they will recoup the costs in the future.
Even Albanesi and Nosal (2015) come to the conclusion that the majority of people are
better off filing for bankruptcy if insolvent, but that is on average and based on
nationwide data and analysis.

Even if a consumer attempts to act completely rationally in deciding whether to
file for bankruptcy, they still will not have all of the information. If a person with
$50,000 of credit card debt is contemplating bankruptcy, the first step is to hire an
attorney, that now costs twice as much and could require constant payments for the next
few years. If the consumer decides to go through with filing, the upfront charge is in the
range of hundreds of dollars. This is, on average, over $1,000 in expenses on top of the
$50,000 already owed. Then the means test is the most consequential decision that the
judge will make during the bankruptcy proceedings, and for a filer that does not qualify
for Chapter 7, filing for Chapter 13 means even greater short-run and long-run costs as
well as a far greater chance of failure to get the debt expunged. Even in a Chapter 7 case,
delays may arise and postpone the discharge of debts. Overall, the consumer is unable to
fully know what the costs of filing for bankruptcy will be and has no guarantee of any
benefit until the conclusion of the proceedings.

With both of these concepts in mind, it is evident that even before the law change
that some people would prefer not to file for bankruptcy, and that the new provisions
would only increase this problem. Both of these cases show how increasing the upfront costs of bankruptcy, such as what was enacted as part of the BAPCPA, drive bankruptcies down even among insolvent debtors that would be better off filing. The broader picture is that these factors have resulted due to changes made in 2005 to the bankruptcy code, and have increased prices for all consumers instead of cracking down on filers that were exploiting the old bankruptcy code. The job of the government should be to drive the bankruptcy code towards the most optimal law, but some aspects of the BAPCPA have driven people that should optimally file for bankruptcy away from doing so. Scott (2007) summarizes the motivation for filing bankruptcy: “consumers do not file bankruptcy by rationally calculating anticipated gains/losses due to filing. Instead, they found that a majority of consumers file for bankruptcy only when they became overwhelmed by debt.”

### What Effect did Changes Have on Credit Card Companies?

Credit card companies offer one of the best examples of the trade-off between risk and return of investments. Many people own credit cards solely to make purchases and repay the full balance on time. For these cardholders that do this every period, the credit companies incur no risk, but also have very limited ability to make money from those customers. These people use credit cards for transactions and are only subject to transactions costs (White, 2007). Credit card companies make money on accounts in which the holder leaves a balance on the card from month to month, allowing for the collection of interest on the outstanding balance. These customers are also more frequently subject to fees and charges on the credit card. They not only use credit cards
for transactions, but also for borrowing money and can be charged transaction costs and interest (White, 2007). It is, however, the risk of these customers that is a burden for credit card companies. The unsecured credit card debt is one of the few debts that can be discharged under Chapter 7 protection with no guarantee of repayment.

Even prior to the BAPCPA, Scott (2007) saw that people that have already filed for bankruptcy are the best customers for credit card companies. The previous bad credit history allows for credit card companies to charge high interest rates and fees, and these people are much more likely than people with no bankruptcy history to be carrying credit card debt (52 percent to 36 percent) (Scott, 2007). Most importantly, though, credit card companies target people who have filed for bankruptcy before and will only be more aggressive in this practice because of the BAPCPA. For many, completing bankruptcy does not get a person out of a bad financial situation, and these people can be easy for credit card companies to get them signed up for a card. The fact that a bankruptcy stays on a person’s credit score for 10 years tells companies that a person could become a repeat customer.

With the intention to decrease the number of consumers filing for bankruptcy protection, the BAPCPA introduced changes that would make debtors less likely to file for bankruptcy. However, the two main provisions of the law did not help to solve the problems of the U.S. bankruptcy code. Optimal bankruptcy law is not dependent on how many people file, it is about who is filing. Therefore, the law is closest to optimal if it can effectively incentivize insolvent people who require bankruptcy protection to get out of debt to file while keeping other people from being able to exploit the system. Prior to
the BAPCPA, bankruptcy was available to debtors that needed it. It was also easily exploitable which meant that changes to the law should have made it more difficult for exploitation to happen. The means test and increasing fees were not aimed at solving the problem of exploitation and were, instead, directed at helping credit card companies make money. These features were more likely to have an effect on filers that were not exploiting the system, as these filers would be less able to pay higher upfront costs. They would also deter hyperbolic discounters from filing because of their aversion to upfront costs. Deter hyperbolic discounters is ineffective because they are the consumers most likely to incur large amounts of credit card debt. Now, with 10 years of data since the BAPCPA and the financial crisis over, bankruptcy data can be used to represent the effects of the change in the law. The next chapter will provide information that supports that filing rates decreased along with displaying the ineffective policies of the law.
Chapter 4: Empirical Evidence

In order to observe the shortcomings of the BAPCPA, this chapter will take a look at data that will indicate what effect the change in bankruptcy law had over the past decade. Overall, this chapter will look at six distinct variables that will successfully portray the current landscape of credit card debt and bankruptcies. First will be the two most important stats to look at, the number of filings with the bankruptcy courts by year and revolving debt per household. These statistics will offer the best marker for the effect of the BAPCPA. Also described in greater detail in this section will be the link between credit card debt and bankruptcy. The next section will focus on the means test condition of the BAPCPA, specifically looking at Chapter 7 filing rates. Also being explained will be the annual assessed interest on credit cards to explain how credit card companies have reacted to the BAPCPA. The final section of the chapter will be more in-depth data on filed bankruptcies and how the outcomes in court have partially shifted after 2005.

The most important factor to remember for each of these data sets is the effect of the 2008 financial crisis. This is also the most unfortunate condition about the data sets as it renders the years directly following the BAPCPA as less reliable observations.
I  Changes in Filing Rates and Household Debt

Table 4.1. 1993 to Present: Filing Rates and Debt per Household
(Data from the U.S. Department of Justice, the Board of Governors of the Federal Reserve System, and the U.S. Census Bureau)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total # of Filings</th>
<th>%Δ in Filings</th>
<th>Revolving Debt per Household</th>
<th>%Δ in Revolving Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>812898</td>
<td></td>
<td>$5,572</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>780455</td>
<td>-3.99%</td>
<td>$6,358</td>
<td>14.11%</td>
</tr>
<tr>
<td>1995</td>
<td>874642</td>
<td>12.07%</td>
<td>$7,359</td>
<td>15.74%</td>
</tr>
<tr>
<td>1996</td>
<td>1125006</td>
<td>28.62%</td>
<td>$8,032</td>
<td>9.15%</td>
</tr>
<tr>
<td>1997</td>
<td>1350118</td>
<td>20.01%</td>
<td>$8,181</td>
<td>1.86%</td>
</tr>
<tr>
<td>1998</td>
<td>1396182</td>
<td>3.56%</td>
<td>$6,539</td>
<td>4.38%</td>
</tr>
<tr>
<td>1999</td>
<td>1281581</td>
<td>-8.34%</td>
<td>$8,658</td>
<td>1.39%</td>
</tr>
<tr>
<td>2000</td>
<td>1217972</td>
<td>-4.96%</td>
<td>$9,299</td>
<td>7.40%</td>
</tr>
<tr>
<td>2001</td>
<td>1452030</td>
<td>19.22%</td>
<td>$9,159</td>
<td>-1.51%</td>
</tr>
<tr>
<td>2002</td>
<td>1539111</td>
<td>6.00%</td>
<td>$9,376</td>
<td>2.37%</td>
</tr>
<tr>
<td>2003</td>
<td>1625208</td>
<td>5.59%</td>
<td>$9,217</td>
<td>-1.70%</td>
</tr>
<tr>
<td>2004</td>
<td>1563145</td>
<td>-3.82%</td>
<td>$9,304</td>
<td>0.94%</td>
</tr>
<tr>
<td>2005</td>
<td>2039214</td>
<td>30.46%</td>
<td>$8,241</td>
<td>-0.66%</td>
</tr>
<tr>
<td>2006</td>
<td>597965</td>
<td>-70.68%</td>
<td>$9,567</td>
<td>3.53%</td>
</tr>
<tr>
<td>2007</td>
<td>822590</td>
<td>37.56%</td>
<td>$9,945</td>
<td>3.95%</td>
</tr>
<tr>
<td>2008</td>
<td>1074225</td>
<td>30.59%</td>
<td>$9,637</td>
<td>-4.10%</td>
</tr>
<tr>
<td>2009</td>
<td>1412838</td>
<td>31.52%</td>
<td>$8,703</td>
<td>-8.74%</td>
</tr>
<tr>
<td>2010</td>
<td>1536799</td>
<td>8.77%</td>
<td>$7,820</td>
<td>-10.15%</td>
</tr>
<tr>
<td>2011</td>
<td>1362847</td>
<td>-11.32%</td>
<td>$7,527</td>
<td>-3.75%</td>
</tr>
<tr>
<td>2012</td>
<td>1181010</td>
<td>-13.34%</td>
<td>$7,264</td>
<td>-3.49%</td>
</tr>
<tr>
<td>2013</td>
<td>1038720</td>
<td>-12.05%</td>
<td>$7,179</td>
<td>-1.17%</td>
</tr>
<tr>
<td>2014</td>
<td>908912</td>
<td>-12.41%</td>
<td>$7,297</td>
<td>1.64%</td>
</tr>
<tr>
<td>2015</td>
<td>819760</td>
<td>-9.90%</td>
<td>$7,583</td>
<td>3.92%</td>
</tr>
<tr>
<td>2016</td>
<td>770846</td>
<td>-5.97%</td>
<td>$7,939</td>
<td>4.69%</td>
</tr>
</tbody>
</table>

This table is the two most important statistics for tying together bankruptcy and credit card debt. Overall, the data’s range of years shows what lead up to the law change, the years directly around it as well as more recent years in which the BAPCPA has been in effect without a recession. In all of these cases, the bankruptcy measured is all nonbusiness cases in the U.S. Further, it is important to understand why revolving debt
per household is the best way to measure consumer credit card debt. Revolving debt is synonymous with credit card debt because it is debt that can be used at the consumer's discretion and is uncollateralized. The distinction for revolving debt is that the loan starts off at zero and can only increase as it can be used repeatedly, while non-revolving debt begins at the maximum value and is paid down from that point. Mortgages, car loans, student loans and most other debt are examples of non-revolving because payments are made to pay down the premium, while credit card debt, as an example of revolving debt, increases as a consumer makes purchases, and grows if not fully paid off. The values for revolving debt are real values represented in 2016 dollars.

**A. Did the BAPCPA decrease the number of bankruptcy cases?**

In the couple of years after the BAPCPA, the decrease in bankruptcy cases was considerable. However, due to the recession, the levels crept back up to the levels seen before the BAPCPA. The important thing to know about this is that even during a terrible financial crisis, the number of bankruptcies only returned to the 2001-2004 level. After the recovery from the recession, the rate of bankruptcy filing noticeably decreased. The decrease in bankruptcy filings is almost certainly due to the increase in upfront costs associated with bankruptcy.

**B. Have consumers changed habits since the BAPCPA?**

Possibly due to the financial crisis, consumer credit card habits have changed over the last five years. In many ways, it is unprecedented credit card debt has constantly increased since the start of the revolving debt boom in 1978. This decreased debt burden is due to a change in consumer preference as the BAPCPA did nothing to curb consumer
borrowing of revolving debt.

II Chapter 7 Filers and Credit Card Interest

Table 4.2. 1994 to Present: Share of Chapter 7 and Credit Card Collected Interest
(Data from the U.S. Department of Justice and the Board of Governors of the Federal Reserve System)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total # of Filings</th>
<th>%Δ in Filings</th>
<th>% of Chapter 7 Filings</th>
<th>Credit Card Average Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>780455</td>
<td>-3.99%</td>
<td>68.88%</td>
<td>15.77%</td>
</tr>
<tr>
<td>1995</td>
<td>874642</td>
<td>12.07%</td>
<td>68.26%</td>
<td>15.74%</td>
</tr>
<tr>
<td>1996</td>
<td>1125006</td>
<td>28.62%</td>
<td>69.30%</td>
<td>15.52%</td>
</tr>
<tr>
<td>1997</td>
<td>1350118</td>
<td>20.01%</td>
<td>70.85%</td>
<td>15.74%</td>
</tr>
<tr>
<td>1998</td>
<td>1398182</td>
<td>3.56%</td>
<td>72.06%</td>
<td>15.73%</td>
</tr>
<tr>
<td>1999</td>
<td>1281581</td>
<td>-8.34%</td>
<td>70.98%</td>
<td>14.78%</td>
</tr>
<tr>
<td>2000</td>
<td>1217972</td>
<td>-4.96%</td>
<td>68.85%</td>
<td>15.26%</td>
</tr>
<tr>
<td>2001</td>
<td>1452030</td>
<td>19.22%</td>
<td>71.02%</td>
<td>13.90%</td>
</tr>
<tr>
<td>2002</td>
<td>1539111</td>
<td>6.00%</td>
<td>70.59%</td>
<td>12.78%</td>
</tr>
<tr>
<td>2003</td>
<td>1625208</td>
<td>5.59%</td>
<td>71.07%</td>
<td>12.93%</td>
</tr>
<tr>
<td>2004</td>
<td>1563145</td>
<td>-3.82%</td>
<td>71.48%</td>
<td>13.92%</td>
</tr>
<tr>
<td>2005</td>
<td>2039214</td>
<td>30.46%</td>
<td>79.98%</td>
<td>14.49%</td>
</tr>
<tr>
<td>2006</td>
<td>597965</td>
<td>-70.58%</td>
<td>58.37%</td>
<td>15.09%</td>
</tr>
<tr>
<td>2007</td>
<td>822590</td>
<td>37.56%</td>
<td>60.86%</td>
<td>14.38%</td>
</tr>
<tr>
<td>2008</td>
<td>1074225</td>
<td>30.59%</td>
<td>66.50%</td>
<td>13.36%</td>
</tr>
<tr>
<td>2009</td>
<td>1412838</td>
<td>31.52%</td>
<td>71.41%</td>
<td>14.37%</td>
</tr>
<tr>
<td>2010</td>
<td>1536799</td>
<td>8.77%</td>
<td>71.58%</td>
<td>13.67%</td>
</tr>
<tr>
<td>2011</td>
<td>1362847</td>
<td>-11.32%</td>
<td>70.34%</td>
<td>12.78%</td>
</tr>
<tr>
<td>2012</td>
<td>1181016</td>
<td>-13.34%</td>
<td>69.12%</td>
<td>12.81%</td>
</tr>
<tr>
<td>2013</td>
<td>1038720</td>
<td>-12.05%</td>
<td>68.02%</td>
<td>12.89%</td>
</tr>
<tr>
<td>2014</td>
<td>909812</td>
<td>-12.41%</td>
<td>66.04%</td>
<td>13.68%</td>
</tr>
<tr>
<td>2015</td>
<td>819760</td>
<td>-9.90%</td>
<td>63.33%</td>
<td>13.70%</td>
</tr>
<tr>
<td>2016</td>
<td>770846</td>
<td>-5.97%</td>
<td>61.66%</td>
<td>13.61%</td>
</tr>
</tbody>
</table>

A. Was the means test effective in decreasing abuse among Chapter 7 filers?

In the year preceding the law change and the first year it was in effect, Chapter 7 bankruptcies use went from nearly 80 percent of cases to under 60 percent. Overall, though, the ratio of Chapter 7 cases increased in the next years to be on par with levels
observed before the BAPCPA. The main reason for this was that the means test was in some cases easy for wealthier people. The means test set a bar at median income, where anyone higher would not qualify for Chapter 7 protection. The exemptions that exist under the BAPCPA mean that even people with incomes and assets far above average can still file for Chapter 7. Thus it would seem as though the people that were abusing the system before are still able to file for Chapter 7. However, lower income people are the most affected by the law, specifically the increased court and attorney fees. Also, the ratio between chapter 7 and chapter 13 filers saw an increase during the financial crisis because of the number of people filing due to job loss. If a person has to file for bankruptcy because of job loss, they are almost guaranteed to file chapter 7 because they don’t have the disposable income available to work out a chapter 13 repayment plan. So, looking at the data

B. Is credit now cheaper for consumers because of the BAPCPA?

In works on the topic of consumer debt, Posner (1995), Rougeau (1996), Bar-Gill (2004), Peterson (2004), and Mann (2006) have all discussed the possibility of re-implementing usury laws to limit the interest rates that credit cards can charge. Though these articles are not endorsements of a change in the law, it does represent the feeling of many that credit card companies hold too much power over the interest rate charged on debt. For this reason, credit card companies affirmed that the passing of the BAPCPA would decrease interest rates for consumers. The greater protection afforded by the law would make the credit card companies more willing to offer lower, more competitive interest rates on cards.
However, the data shows that interest rates were lowest just before 2005, and went up after the law change. This is because credit card companies use low introductory rates, promotions and rewards getting people to apply for cards. Consumers that use credit cards are drawn to low rates but tend to continue to spend even when the rates go up.

### III

**Table 4.3. 2000 to Present: Outcomes of Bankruptcy Enquiries**

(Information from the United States Courts System)

<table>
<thead>
<tr>
<th>Year</th>
<th>Filed</th>
<th>%Δ Filed</th>
<th>Terminated</th>
<th>%Δ Terminated</th>
<th>Pending</th>
<th>%Δ Pending</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1,253,444</td>
<td>19.04%</td>
<td>1,238,805</td>
<td>9.56%</td>
<td>1,401,552</td>
<td>9.62%</td>
</tr>
<tr>
<td>2001</td>
<td>1,492,129</td>
<td>5.73%</td>
<td>1,475,810</td>
<td>8.74%</td>
<td>1,536,429</td>
<td>6.75%</td>
</tr>
<tr>
<td>2002</td>
<td>1,660,245</td>
<td>5.24%</td>
<td>1,589,383</td>
<td>7.70%</td>
<td>1,711,054</td>
<td>4.32%</td>
</tr>
<tr>
<td>2003</td>
<td>1,597,462</td>
<td>-3.78%</td>
<td>1,661,919</td>
<td>4.56%</td>
<td>1,643,880</td>
<td>-3.93%</td>
</tr>
<tr>
<td>2004</td>
<td>2,078,415</td>
<td>30.11%</td>
<td>1,576,555</td>
<td>-5.14%</td>
<td>2,145,740</td>
<td>30.53%</td>
</tr>
<tr>
<td>2005</td>
<td>617,660</td>
<td>-70.28%</td>
<td>1,435,482</td>
<td>-8.95%</td>
<td>1,361,598</td>
<td>-36.54%</td>
</tr>
<tr>
<td>2006</td>
<td>850,912</td>
<td>37.76%</td>
<td>891,783</td>
<td>-37.88%</td>
<td>1,320,726</td>
<td>-3.00%</td>
</tr>
<tr>
<td>2007</td>
<td>1,117,641</td>
<td>31.35%</td>
<td>1,019,426</td>
<td>14.31%</td>
<td>1,384,363</td>
<td>4.82%</td>
</tr>
<tr>
<td>2008</td>
<td>1,473,675</td>
<td>31.86%</td>
<td>1,284,714</td>
<td>26.02%</td>
<td>1,573,402</td>
<td>13.66%</td>
</tr>
<tr>
<td>2009</td>
<td>1,593,097</td>
<td>8.10%</td>
<td>1,512,402</td>
<td>17.72%</td>
<td>1,657,684</td>
<td>5.36%</td>
</tr>
<tr>
<td>2010</td>
<td>1,410,653</td>
<td>-11.45%</td>
<td>1,422,843</td>
<td>-5.92%</td>
<td>1,645,463</td>
<td>-0.74%</td>
</tr>
<tr>
<td>2011</td>
<td>1,221,091</td>
<td>-13.44%</td>
<td>1,273,813</td>
<td>-10.47%</td>
<td>1,596,313</td>
<td>-2.99%</td>
</tr>
<tr>
<td>2012</td>
<td>1,071,932</td>
<td>-12.22%</td>
<td>1,178,167</td>
<td>-7.51%</td>
<td>1,490,366</td>
<td>-6.64%</td>
</tr>
<tr>
<td>2013</td>
<td>936,795</td>
<td>-12.61%</td>
<td>1,074,261</td>
<td>-8.82%</td>
<td>1,354,757</td>
<td>-9.10%</td>
</tr>
<tr>
<td>2014</td>
<td>844,495</td>
<td>-9.85%</td>
<td>963,820</td>
<td>-10.28%</td>
<td>1,231,690</td>
<td>-9.08%</td>
</tr>
<tr>
<td>2015</td>
<td>794,960</td>
<td>-5.87%</td>
<td>895,280</td>
<td>-7.11%</td>
<td>1,131,341</td>
<td>-8.15%</td>
</tr>
</tbody>
</table>

---

2 The number of filed bankruptcy cases differed slightly in the data from the United States Courts System.
The data collected shows that the BAPCPA has had a significant impact on consumers tendency since 2005. It also affirms that looking at the years following 2005 can offer misleading data because of the 2008 financial crisis. If looking at data from 2005-2010, bankruptcy filing rates had a modest drop but looked on pace to eclipse the number of filings prior to 2005. In that same time period, the data shows no change in chapter 7 filing rate, giving an indication that the means test was inconsequential in people choosing between chapter 7 and chapter 13. However, expanding the presented data to 10 years after the BAPCPA, the data is more telling as to the effects of the law change. After a peak in 2010, the number of bankruptcy filings has dropped off, falling by nearly 50 percent. Without the BAPCPA, the number of bankruptcy filings was on pace to be almost 3 million. It has instead decreased to similar levels with the early 1990s. It also has shown that the years after the financial crisis saw fewer people filing chapter 7 and more chapter 13 cases, directly pointing to the effectiveness of the means test.

This shows the importance of re-evaluating the BAPCPA to account for the way in which the 2008 financial crisis altered the data present following 2005. While scholarly work on the subject theorized that the BAPCPA would change consumers tendencies when it came to bankruptcy, new data from 2010 to 2016 clearly provides evidence in support of these theories. It also further emphasizes that the BAPCPA made bankruptcy more expensive and less available for everyone and did not target exploitation of the system. The BAPCPA achieved the goal of decreasing the number of bankruptcy cases while being ineffective at pushing towards a closer to ideal bankruptcy law in the
U.S. With this information, the next step should be to further change the bankruptcy code, this time shifting towards greater consumer protection while also ensuring that exploitation of the system will continue to decrease.
Chapter 5: Conclusion

In the aftermath of the BAPCPA becoming law, many articles were written outlining the law changes, theorizing how it would alter consumer and debtor actions, and observing how statistics such as bankruptcy filings and consumer debt. Most of the articles were written within a few years of the law change, which is especially problematic due to the change in economic circumstances in those following years. As a result of the 2008 financial crisis, more substantive empirical data has to be used than looking at the immediate years following the BAPCPA. These articles offered a basis for the outcomes of the BAPCPA from a theoretical standpoint, while this research adds to that by looking back at the past decade. Through observing this new data, the initial theories on the effects of the BAPCPA have held true. It shows that bankruptcies have decreased overall, but that the law in no way targeted filers that were abusing the system.

This information does not all point to the BAPCPA as being a harmful change to the U.S. bankruptcy code. As the second chapter outlines, the increase in the number of filings outpaced what was expected and signaled that the system could be easily abused. This then builds off of the model for ideal bankruptcy law, as prior to 2005, the law made it possible for insolvent debtors to file for bankruptcy. However, the bankruptcy code was also exploitable, and more people filing meant a greater moral hazard that credit card companies and other consumers had to pay for the costs.

Instead, the BAPCPA flipped the previous scenario, such that the bankruptcy code is less exploitable, but it has also made insolvent debtors less likely to file. For this reason, the law should be further corrected to achieve a balance between incentivizing
insolvent debtors to file and keeping debtors from exploiting the system. Specifically, the means test and increased associated costs have done more harm than good. These two changes were incredibly effective in decreasing the number of filings but did not target filers that were exploiting the law. In fact, insolvent debtors were the most affected by these laws because they are more likely to be hyperbolic discounters. These debtors are highly susceptible to changes in upfront cost as they would rather not give up money now for future benefits, even though the benefits of filing for bankruptcy outweigh the costs. Further, it is impossible for bankruptcy filers to know the possible benefits upfront because of the consumer’s bounded rationality.

Repealing part of these provisions in the BAPCPA would likely then lead to bankruptcy filings increasing again. To combat this, the target of a new law should be to discourage the root of bankruptcy filings, credit card debt. At the moment, the U.S. has little regulation on credit cards compared to other countries. A reason for the growth in consumer debt is the low minimum monthly payment on credit cards, which sits at 1 percent (White, 2007). At this level, debtors that only pay the minimum payment have no way out of debt. Increasing this threshold would work to decrease the amount of debt that consumers incur while also making it less likely that their credit card debt builds up.

The most effective policy change would be to present more information to debtors on credit card debt. A way that this has been done is adding more information to credit card statements as was done in 2009 with the credit CARD act. A part of this act that was immediately noticeable to consumers and creditors was the requirement that credit card statements offer information on the length of repayment plans, including how long it
would take to repay a debt if only paying the minimum required payment. The number of credit card payments made online has constantly increased which has made this change less noticeable for debtors that do not look at printed statements. Thus, it would be helpful to require credit card companies to be more transparent upfront.

Bankruptcy code is driven by either protecting debtors struggling to keep up on payments or decreasing the moral hazard of bankruptcy and protecting credit card companies and other consumers. The 2005 BAPCPA granted more protection to creditors while severely hurting the protections for debtors. By changing the bankruptcy code, fewer people are able to exploit the system, but fewer insolvent people are able to file. From this point, new changes to the bankruptcy code should be aimed at achieving both the goal of allowing insolvent debtors to file for bankruptcy while also decreasing the number of unnecessary filings.
References


