

SAVING UP FOR BANKRUPTCY

Ronald Mann

ABSTRACT

This paper probes the puzzle of why only a few of those for whom bankruptcy would be economically valuable ever choose to file. We use empirical evidence about the patterns of bankruptcy filings to understand what drives the point in time at which the filings occur, and to generate policy recommendations about how the bankruptcy and debt-collection system sorts those that need relief from those that do not.

The paper combines three kinds of data. First, quantitative data collected from judicial filing records that show the weekly, monthly, and annual patterns of bankruptcy filings. Second, 40 interviews with industry professionals (consumer and creditor attorneys, trustees, and judges) from five states (Georgia, Iowa, Massachusetts, Nevada, and Texas). The interviews probe why people file when they do and what distinguishes those that choose to file from those that hold off. Third, survey data from the 2007 Consumer Bankruptcy Project, the first nationally representative sample of bankrupt households. The survey data explores the struggles families endure before they choose to file.

The data support two empirical findings. The first is about the role of aggressive collection in motivating bankruptcy filings. Generally, apart from foreclosure-related filings, the emergency bankruptcy filing is largely a myth. Creditor collection activity does not force people into an immediate bankruptcy. On the contrary, it wears them down slowly but ineluctably, like water dripping on a stone. Second, the primary factor that affects the date on which people actually file is their ability to save up the money to pay their attorneys and filing fees. Thus, among other things, we see an annual peak shortly after families receive their tax refunds, and a semi-monthly peak related to the receipt of paychecks.

Finally, we build two important policy recommendations on those findings. First, we argue that the existing collection process is flawed by a prisoner's dilemma that leads to excessive and wasteful "dunning" by creditors. Because each creditor has an incentive to be first in line to collect, and because the creditors can dun their debtors at little or no cost to themselves, creditors as a group naturally engage in dunning activities that debtors find intolerable – a level of activities from which a rational single creditor would refrain. We recommend a variety of solutions to strengthen the FDCPA. Some are at the level of detail (extending it to in-house collection, increasing the statutory damages, and the like). But the most important is a "do-not-call" rule modeled on the do-not-call list for telemarketers. Specifically, we recommend a low-transaction-cost mechanism (activated by telephone call or Internet site) that would automatically and immediately stop all creditor collection activity.

Second, corollary to our argument that excessive collection causes inappropriate filings, we also believe that the excessive filing costs deter socially valuable filings. To respond to that problem, building on earlier work, we argue that low-income low-asset filers should have access to a simplified administrative process that provides prompt relief without the costs and delay of judicial process.