Bipartisan bankruptcy "reform" punishes US consumers, rewards banks

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On July 25, the same day the US Congress passed its much-touted corporate governance legislation, a House and Senate conference committee composed of members of both parties quietly approved a deal on a bankruptcy bill that will severely limit the ability of individuals to file for protection from creditors.

The agreement casts the official debate over corporate reform in sharp relief. In response to mounting public anger generated by the wave of accounting and business scandals, both the Democrats and the Republicans have sought to present themselves as the defenders of the “little guy” against corporate criminals. Their timid anti-fraud bill was portrayed by the media as a morally-driven measure to protect consumers, workers, small investors, retirees and small businessmen from unethical business sharks. [See “US corporate reform bill: much fanfare for a fig leaf,” http://www.wsws.org/articles/2002/jul2002/refo-j26.shtml]

But only hours after that bill was passed, the conference committee on bankruptcy reform agreed on measures—long lobbied for by giant credit card companies and financial institutions—that will undermine the financial position of hundreds of thousands, if not millions, of “little” people. While providing a windfall to financial institutions at the expense of ordinary debtors, the bipartisan legislation contains nothing to stop the owners and managers of major companies that file for bankruptcy from reneging on benefits to employees or outstanding bills to small suppliers.

Democratic Senator Patrick Leahy presided over the Senate-House conference committee that approved the new legislation. Passage of the bill has been held up in the House of Representatives by Republicans allied to the Christian right, who object to a compromise that was reached on an attached measure dealing with anti-abortion protests. Nevertheless, it is expected that the bill will be passed when Congress reassembles in September.

The very people who have been hardest hit by the bursting of the stock market bubble and the criminal corporate practices that have been exposed in recent months—those who have lost their jobs or seen their retirement savings gutted—will bear new financial burdens under the proposed legislation. As the economic malaise deepens, more and more ordinary Americans will look to bankruptcy as a last resort, which is why the credit card companies and banks are eager to see a bill passed quickly that will end the ability of such people to forego payment of their unsecured debt.

To this end, the financial institutions have paid out generous subsidies to members of both political parties. Measured by employee donations, MBNA Corp., the biggest credit card company and a principal backer of the bill, was the largest corporate contributor to George W. Bush’s 2000 campaign. But the firm did not discriminate when it came to buying political influence. In 1998, MBNA gave a $447,000 debt-consolidation loan to Democratic Representative James Moran. Only days later Moran became a lead sponsor of the bankruptcy “reform” bill. In December of 1999, six weeks before the Senate passed an earlier version of the bill, the company gave the Democratic Senatorial Campaign Committee a $150,000 check, its first-ever soft money contribution to the committee.

Other major backers of the bill, including the financial conglomerate Citigroup, contribute heavily to both parties. Citigroup is itself under investigation for its involvement in the Enron scandal as well as the role of its investment banking arm, Solomon Smith Barney, in the corruption of giant telecom firms such as

WorldCom.

The new legislation will require many individuals to file under Chapter 13 instead of Chapter 7 of the bankruptcy code. Under Chapter 7, individuals are generally relieved of all unsecured debt such as that owed to credit card companies or auto financing firms. In return, they must agree to sell off almost all of their assets, retaining only critical items such as their homes and pensions. A trustee distributes the proceeds from this sale to the individuals' various creditors.

Individuals filing under Chapter 13 are not relieved of all their debt. They must restructure their loans and pay at least part of them off over a certain period of time. Under current legislation, an individual does not have to prove insolvency in order to file for Chapter 7, but can be denied this protection if a judge determines that the law is being abused.

The new legislation, in contrast, would require anyone able to pay back 25 percent of his debt over five years, or earning the median state income, to file under Chapter 13. By one estimate, this will affect 25,000 to 84,000 filings per year.

The legislation would also limit the time available for small businesses to settle their debts under Chapter 11 of the bankruptcy code, which shields businesses from creditors and allows for continued operation. This will force many to shut down as debt obligations mount. Small businesses have been hit particularly hard by the economic downturn, facing shrinking sales and a restricted access to capital. Elizabeth Warren, professor at Harvard Law School and adviser to the National Bankruptcy Commission, said the bill is "deliberately designed to liquidate small businesses."

The legislation comes in the wake of a string of giant corporate bankruptcies such as WorldCom, Enron and Global Crossing. Existing corporate bankruptcy law is designed to shield managers and owners of large corporations from financial liability arising out of the collapse of their firms. When a large corporation goes bankrupt, big lenders get priority on available funds. Employees, retirees, shareholders and small businesses rarely get back the money they have lost.

The past decade has seen a dramatic increase in US bankruptcies. In 1990, the number of personal and business bankruptcies was 700,000. By 2000, it had reached 1.3 million and in 2001 this figure increased by an additional 10 percent, to 1.43 million. Individuals file the overwhelming majority—about 95 percent—of these bankruptcies.

The gutting of social services such as welfare and the rising cost of medicine and health services, particularly for the elderly, have exacerbated the trend. One study estimated that 40 percent of bankruptcy filings come as a result of a sudden explosion of health care costs, such as those associated with an unforeseen medical emergency. A quarter of Americans filing for bankruptcy have medical debts in excess of $1,000.

While credit card companies claim to be unduly affected by personal bankruptcies, profits for many of these companies have steadily risen. MBNA had an after-tax income of $622 million in 1997. In 2001, this figure was nearly three times as much—$1.7 billion. Citigroup has seen its income rise from $7 billion to over $14 billion over the same period.

The very business practices of credit card firms have contributed in a major way to the increase in personal bankruptcies. US credit card companies flood consumers with $5 billion worth of unsolicited credit card offers per year. Certain firms target the poor and those with bad credit histories, offering credit cards at exorbitantly high interest rates. With individuals living from paycheck to paycheck and burdened with enormous debt, a single accident or unfortunate circumstance can lead to a bankruptcy declaration.