Utah FOUNDATION

Executive Summary

Report Number 670, December 2004

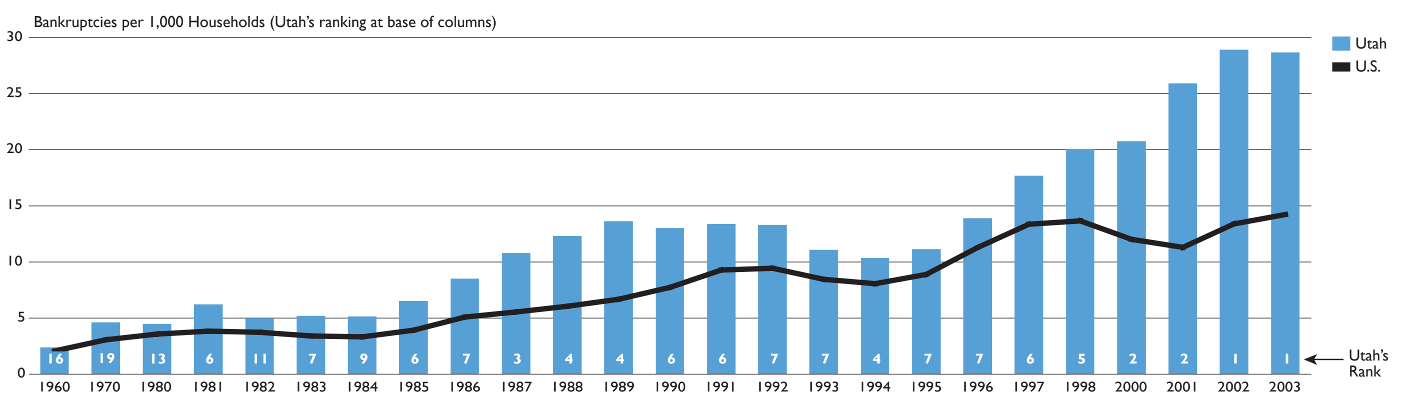
GOING FOR BROKE:
UTAH'S ALARMING BANKRUPTCY PROBLEM

A wave of increasing bankruptcy rates has swept across the nation, causing economic, political, and social hardships. Utah has emerged in recent years as the number one state in terms of the number of bankruptcies compared to the number of households. Why would Utah fare worse in this national trend than other states, and how is this possible in a state that prides itself on responsible social behavior and self-reliance? What is unique about Utah's economy, culture, demographics, or legal climate that would put Utah atop this national trend?

Ideally, the purpose of bankruptcy is to give an individual who has fallen on hard times an opportunity to obtain a fresh start—free of existing debt. In order for this to occur, debtors are granted a discharge or release from specific debts outright, or are required to follow a repayment plan that grants protection from creditors. While a discharge absolves an individual from repaying certain types of debts, valid liens against property from a secured creditor are not discharged. Also, individuals are not generally able to discharge debts incurred based on dishonest or improper behavior, tax claims, debts owed for spousal and child support, or debts owed for government funded or guaranteed student loans.

Bankruptcy is divided up into several different chapters, the most prominent being Chapter 7 and Chapter 13. About 70% of all debtors file a Chapter 7 bankruptcy, which allows for the complete discharge of all debts except those exempted from bankruptcy. Of all Chapter 7 debtors, 99% are granted a discharge of debts. Individuals cannot file for another Chapter 7 bankruptcy within six years of a previous discharge of debts, unless they are filing for a Chapter 13 repayment plan.

Figure 3: Bankruptcy Filings in Utah and U.S.



*1999 data was not produced by the U.S. Census Bureau
Source: Household Data derived from American Community Survey (ACS), 2003, U.S. Census, Bankruptcies total from American Bankruptcy Institute (ABI)

Chapter 13 bankruptcies are used primarily by individuals to reorganize their finances by utilizing a partial debt repayment plan supervised by a trustee. These repayment plans may last three to five years, and at the end of the plan, remaining unsecured debts are discharged. Individuals with mortgages often choose Chapter 13, because they are able to keep their home through this type of bankruptcy.

UTAH'S RISE IN BANKRUPTCIES

As shown in Figure 1, Utah has consistently ranked in the top quarter of states for bankruptcies since 1960. In the 1980s, Utah broke into the top ten among states, and then bankruptcies soared in Utah during the late 1980s. After falling in the early 1990s, Utah's bankruptcy rate once again accelerated in the late 1990s, at which time, Utah achieved the highest bankruptcy rate in the nation in 2002 and 2003.

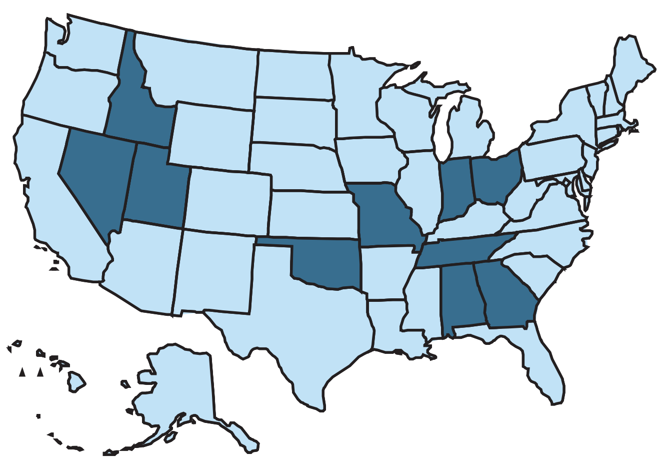
Over time, there is little variation from year to year in regards to which states round out the top positions in term of high bankruptcy filing rates. A handful of states consistently report high household filing rates, as show in Figure 2. Alabama, Georgia, Idaho, Indiana, Nevada, Missouri, Oklahoma, Ohio, Tennessee, and Utah not only post high filing rates today, but have appeared in the top quarter of states since 1960. In other words, it appears that a state struggles with high filing rates over a long period rather than suddenly developing a "problem" with bankruptcy.

WHY IS BANKRUPTCY ON THE INCREASE?

Many theories exist to explain the rise in bankruptcies nationally. The most popular response seems to be to blame irresponsible consumers who spend too much on luxuries and do not save money for emergencies. Affluenza, a PBS documentary and book by John De Graaf, David Wann, and Thomas H. Naylor argues that Americans are caught up in a "painful, contagious, socially transmitted condition of overload, debt, anxiety, and waste resulting from the dogged pursuit of more."

Americans do have greater debt than in past years, and many blame this on credit cards. Credit card use is widespread throughout all

Figure 2: States with Historically High Bankruptcy Rates

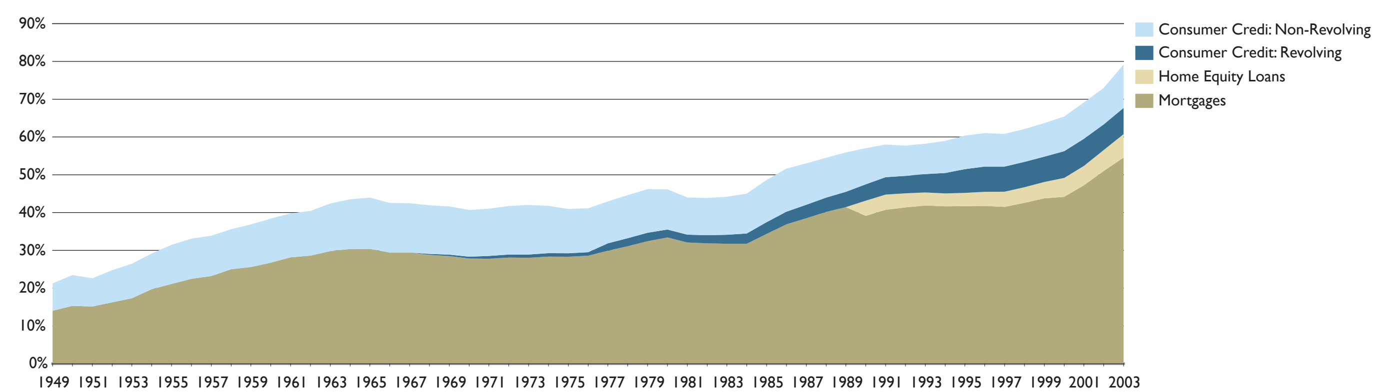


demographic categories, though it is considerably higher among low-income households and younger households. The Federal Reserve estimates that 76.2% of all American families have some form of credit card. However, according to figures obtained from the Federal Reserve, over the long term, credit card debt seems to have merely replaced other kinds of debt, such as installment loans. Figure 3 shows U.S. household debt as a percent of Gross Domestic Product (GDP). American debt levels, in proportion to the economy, are larger than ever, but the increase is caused by increased mortgages and home equity loans. Mortgage debt has been steadily rising since the mid 1980s, and has accelerated in recent years as interest rates hit historic lows. By the end of the second quarter 2004, mortgage debt was over $7 trillion, representing a 33% increase since 2001.

Coupled with increased debt, the U.S. savings rate has fallen dramatically in the past 30 years and accelerated in the past ten years (see Figure 4). In 1990, the personal savings rate (as a percentage of disposable personal income) was 7%. By 2003, the personal savings rate had fallen to 1.4%.

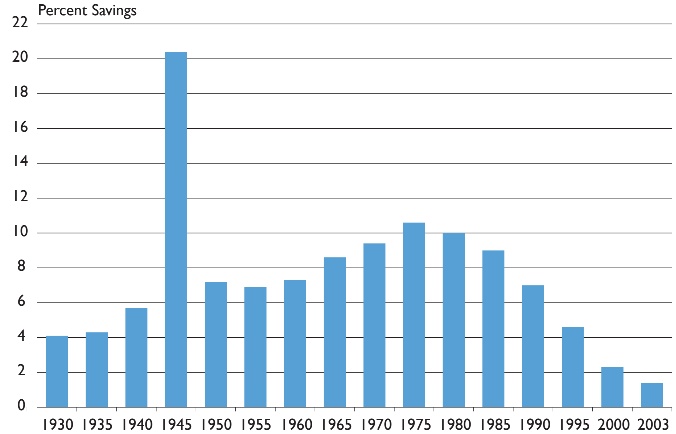
While the authors of Affluenza paint the picture that Americans are

Figure 3: U.S. Household Debt as Percent of GDP



Source: Federal Reserve Bank; U.S. Bureau of Economic Analysis (BEA)

Figure 4: U.S. Personal Savings as a Percent of Disposable Personal Income



Source: BEA

spending more and more money in vain attempts to buy happiness, Elizabeth Warren and Amelia Warren Tyagi in The Two-Income Trap paint a decidedly different picture. Warren and Tyagi instead argue that while Americans are spending a fair portion of their money on dining out, new clothes, and appliances, the percentage of income spent on those items is actually considerably less than American families spent fifty years ago.

American families—especially middle class families—are in financial trouble and the single biggest factor according to Warren and Tyagi is the cost of housing. More specifically, rising home prices are a problem for families much more than for childless individuals. Warren and Tyagi's research demonstrates that, between 1983 and 1998, home prices for families with children increased three times faster than for families without children.

Other factors that seem correlated with rising bankruptcies are increasing divorce rates and the number of single mothers raising children. In addition, Medical emergencies create large debt loads for some families, and a report by Teresa Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook reported that more than one in five debtors listed medical problems as their primary reason to file bankruptcy.

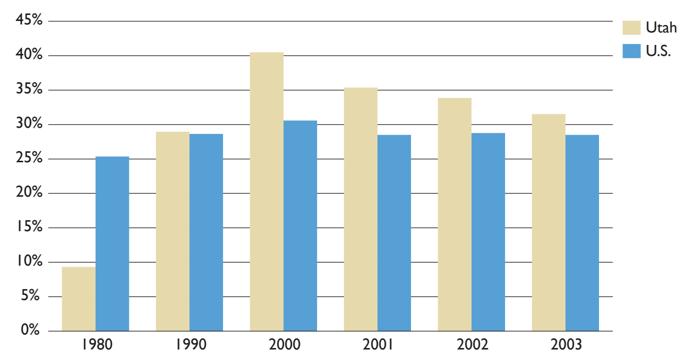
WHY IS UTAH LEADING THE U.S. IN BANKRUPTCY FILINGS?

Utah's high bankruptcy rate is troubling, especially if it signals weakness in Utah's economy that could hamper the growth of the economy or the well being of Utah residents. Some economic weaknesses are apparent, but an interesting legal phenomenon may be equally responsible for Utah's high bankruptcy rate.

Today in Utah, approximately 32% of all consumer cases filed are in Chapter 13 repayment plans, but a few years ago the number was 40%. Nationwide approximately 29% of all consumer bankruptcy cases are filed in Chapter 13. Chapter 13 bankruptcies both locally and nationally have been on the rise since the 1970s, when only 16% of filings were Chapter 13. As can be seen in Figure 5, the percentage of Chapter 13 cases in Utah escalated through 2000 before falling to 32% in 2003.

One theory to explain Utah's high bankruptcy rate is that many Chapter 13 filings fail to result in a discharge of debts. Failed bankruptcy cases have the potential to drive up the filing rates in Utah. Even though a bankruptcy case fails, a family or individual may still be in financial distress, and the only viable option is to re-file. Of the total Chapter 13 filings in Utah in 1997, only 23.8% of those were completed and resulted in a discharge of remaining unsecured debt. The remaining cases were either dismissed or converted to a Chapter 7 bankruptcy. Nationally, one third of Chapter 13 filings reach a successful discharge.

Figure 5: Chapter 13 Filings as a Percentage of Total Filings



Source: ABI

More research is needed to establish how many families or individuals are filing for bankruptcy as opposed to how many bankruptcy case numbers are filed each year. It is possible that the number of refilings due to failed Chapter 13 cases is inflating Utah's bankruptcy rate. Looking at other states, those with historically high bankruptcy filings rates are over-represented in the top tier of states with high Chapter 13 filings. It may be that the combination of a high rate of Chapter 13 filings plus a low rate of Chapter 13 success leads to high bankruptcy filing rates.

Of course, economic factors also have an influence on Utah's high bankruptcy rate. Utah has the largest family size in the nation (3.57 persons per family as compared to 3.14 nationally). About 46% of all Utah households have a child under the age of 18 living at home compared to 36% nationally. Larger families frequently have higher debt levels due to increased need for larger homes, bigger cars to accommodate all family members, and additional expenses for clothes, food, medical expenses, and other items. Utah has larger than average home sizes, and Utahns also have a higher than average number of vehicles per household. In addition, the average cost of raising a child to age 18 can cost a middle class family as much as $165,630 according to the USDA.

Utahns also struggle with low rates of pay. The Bureau of Labor Statistics reports that average annual pay in Utah sits at 82% of the national average, and it has been declining relative to the nation for

20 years. Furthermore, Utah has one of the largest gender wage gaps in the nation with women earning 70.3% of male wages as opposed to 76.2% nationally. To illustrate this, in 2000, median female earnings in Utah were $24,872 as compared to $36,935 for men for full-time, year-round workers.

In addition to legal and economic factors, some social phenomena may influence bankruptcies. The Catalogue for Philanthropy ranks Utah 8th in the nation in charitable generosity. It is interesting to note that seven of the top 10 most generous states are also states that have historically high bankruptcy rates. More research is needed to ascertain what role this plays in a state's bankruptcy filing rates.

RESEARCH ON UTAH BANKRUPTCIES WILL CONTINUE

As can be seen from this report, there are no easy answers to the bankruptcy question in Utah. Several different possible explanations loom large in discussions—are large family sizes to blame? Are low wages and high home prices the reasons why Utah ranks high in bankruptcy filings? Or is it simply that the local legal culture pushes more debtors into a Chapter 13 solution that is not working, creating an inflated rate because of multiple filings? The answer to these questions is not readily apparent and until additional research is conducted, they simply remain hypotheses. Utah Foundation, Utah State University, The Salt Lake Tribune, and other organizations plan to continue exploring Utah's bankruptcy phenomenon to provide needed data and analysis in the coming year. Hopefully, this will help to not only understand why Utahns file bankruptcy at high rates but also have the potential to offer insights on policies that may curb future high filing rates.

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