BANKRUPTCY BY THE NUMBERS

Income Trajectories, Debts, and Expenses of Some Chapter 7 Debtors, 1996-1998[1]

Contributing Editors:
Gordon Bermant, Burke, Virginia
& Ed Flynn, Executive Office for United States Trustees

Here we take another step in our effort to characterize the circumstances of recent chapter 7 no-asset debtors, based on information taken from a systematic sampling of case files across the country. The database from which we draw in this article contains 1,452 cases filed for the most part in late 1998 or early 1999. We focus on income trends and the relationships between them and the debtors' levels of unsecured debt and claimed expenses.

The decision to file bankruptcy may be influenced by a debtor's financial *trajectory* as well as his or her immediate financial condition. A debtor's response to his or her immediate circumstances may be importantly affected by the path by which the debtor arrived there. A debtor "on the way down" may react differently to one in objectively identical circumstances who is nevertheless "on the way up." The subjective burden felt by the first debtor may well be greater than the burden felt by the second. Everything else being equal, the first debtor might be more inclined to seek the relief, with attendant stigma and other disadvantages, provided by bankruptcy.

Income trajectories can have objective as well as subjective consequences for debtors. Debtors with declining incomes may carry debt and expense levels based on their previous, higher incomes. The debt-to-income ratios of debtors with identical incomes may be different depending on their income trajectories.

Studies based on petitions and schedules give no insight into the subjective side of the debtors' worlds and decision schemes. But we can gain some understanding of the objective factors.

Data Analysis: From the data base of 1,452 cases we used all that met the following conditions: consumer cases filed 1998 in which the debtor had reported annual income for 1997 and 1996 on the Statement of Financial Affairs. This resulted in a sample of 845 cases.[2] We estimated 1998

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[1] We thank Joe Guzinski for his support. All opinions expressed in this article are those of the authors, and do not necessarily represent the views of the Executive Office for United States Trustees.

[2] We used only those files where the debtor affirmatively entered a value, including $0, for past years' income. We did not assume that the absence of an entry was equivalent to a report of zero income.

incomes by annualizing the monthly income figures, from all sources, provided on Schedule I.

The next step identified two sub-groups of cases that showed either strictly decreasing or strictly increasing income trajectories from 1996 to 1998. In other words, to be a member of the decreasing group, a debtor's 1998 income had to be less than the 1997 income, which in turn had to be less than the 1996 income. There were 97 such "on the way down"cases (11.5% of the total). Going in the other direction, there were 235 "on the way up" cases (28% of the total). More generally, 353 of the 845 cases reported 1998 incomes less than the average of their 1996 and 1997 incomes, while 492 cases reported 1998 incomes equal to or greater than the earlier years' average. Table 1 and Figure 1 display median incomes over three years for the entire group of 845 cases and the two sub-groups.

Debtors were more likely to be on the way up than on the way down at the time of filing, but many of those who were on the way down had fallen hard. The median 1996 income for debtors going down was more than double the median 1996 income of debtors coming up, but their 1998 income was 21% less.

The incomes should be viewed relative to their position in the general population. For example, the highest income on the chart, $38,000, is less than the median income of a family of 4 in over 75% of the counties in which the debtors live. It is also less than the national median incomes of families with 3 or more members.[3] In other words, very few debtors going down were "affluent" in 1996. There were five, however, who reported 1996 incomes greater than $90,000.

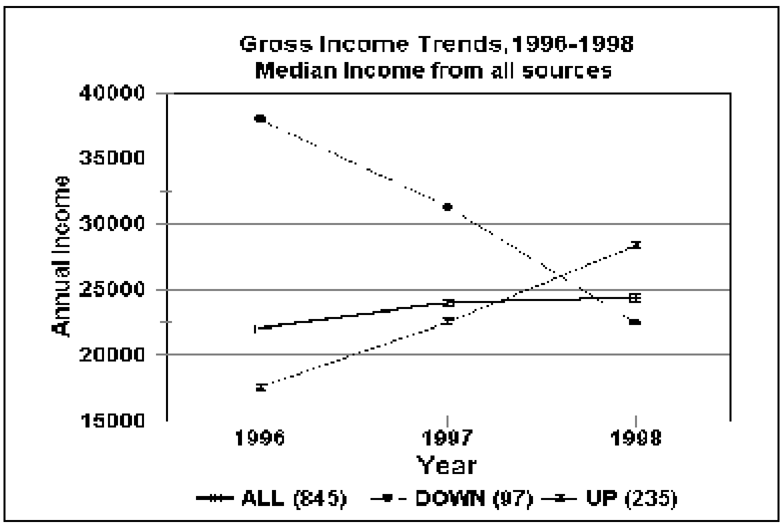
TABLE 1

MEDIAN GROSS INCOMES[4]

[3]Here we will not consider the important questions of family size and differences between national and county-wide income standards. See Flynn, Ed, and Bermant, Gordon, Measuring Means-testing: It's all in the words. *17 American Bankruptcy Institute Journal* 1 (September, 1998), and Bermant, Gordon, Bankruptcy Reform: Finding the best gross income test. 18 *American Bankruptcy Institute Journal* 18 (July-August, 1999).

[4] Income distributions in this research are highly skewed. We used the Mann-Whitney test to estimate the statistical significance of the difference between the medians of the two sub-groups. For

GROUP / YEAR	1996	1997	1998
ALL CASES (845)	$22,000	$23,968	$24,372
ON THE WAY DOWN (97)	$38,000	$31,320	$22,416
ON THE WAY UP (235)	$17,578	$22,544	$28,404



Income trajectory, unsecured debt, and expenses

Table 2 shows the median levels of unsecured debt and expenses (annualized) reported on Schedules F and J, respectively. Although the debtors on the way down report a higher median unsecured debt than those on the way up ($24,540 vs. $22,088), the difference is not statistically significant. A more informative way to look at this information is presented in the next section. The difference between Schedule J expenses for the two groups (going down=$22,260/yr.; coming up=$23,040/yr.) is statistically significant. We return to this difference in the conclusion of the article.

TABLE 2
MEDIAN VALUES OF UNSECURED DEBT AND EXPENSES

each year, these differences are significantly different with a probability of less than .001.

GROUP/VARIABLE	UNSECURED DEBT	ANNUAL EXPENSES
ALL CASES (845)	$23,707	$21,732
ON THE WAY DOWN (97)	$24,540	$22,260
ON THE WAY UP (235)	$22,088	$23,040

Debt to income ratio

The ratio of debt to income provides a useful window into the debtor's financial world.[5] We used the ratio of unsecured debt to 1998 income to test the conjecture that debtors on the way down bring more debt into bankruptcy than do debtors on the way up. In the last section we noted that the difference between the unsecured debt medians of the two groups, while in the direction supporting the conjecture, was not statistically significant. Tables 3 and 4 clarify the relationship by using unsecured debt to income ratios.

TABLE 3
UNSECURED DEBT TO 1998 GROSS INCOME (MEDIAN RATIOS)

GROUP	RATIO
ALL CASES (845)	0.89
ON THE WAY DOWN (97)	1.08
ON THE WAY UP (235)	0.81

The group of 97 debtors on the way down had a significantly higher median debt-to-income ratio than the 235 debtors on the way up. This relationship is shown even more clearly in table 4, where debtors from the two groups are matched in terms of 1998 income.

[5] For example, Sullivan, Warren, and Westbrook used various forms of debt to income ratio as a fundamental measure of consumers' financial conditions in their treatise *As We Forgive Our Debtors* (1989).

TABLE 4
DEBT-INCOME RATIOS FOR MATCHED INCOMES IN TWO GROUPS

	INCOME LEVEL				
GROUP	<$10,000	$10,000-19,999	$20,000-29,999	$30,000-49,999	>$50,000
ON THE WAY DOWN (97)	110.4(24)	0.92 (19)	1.05 (21)	0.82 (21)	1.05 (12)
ON THE WAY UP (235)	2.75 (7)	1.01 (52)	0.91 (67)	0.59 (73)	0.52 (36)

The debtors on the way down had higher debt-to-income ratios in every matched group except the one between $10,000 and $19,999. Note also that the aberrant median ratio in the less than $10,000 group going down arose from the 12 debtors (half of the group) who reported incomes of zero or close to zero.

Conclusion

The income trajectory of a consumer debtor is a meaningful measure of the debtor's financial world. Whether on the way down or on the way up, consumer debtors in 1998 are overwhelmingly on the lower rungs of the nation's income ladder. More than half of the debtors reported current income greater than their average income over the past two years. This finding does not support the conjecture that most debtors are on a downward income slide at the time of filing. A debtor on the way down is likely to be carrying more unsecured debt relative to income than another debtor, with the same income, who is on the way up. But the same is not true of the expenses claimed by debtors on the way down. As we saw in table 1 and 2, the debtors going down, with less income than the debtors coming up, also claim fewer expenses.