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Emulation and state-by-state variations in bankruptcy rates

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ABSTRACT

This paper explores differences in personal bankruptcy rates across the American states. Particular emphasis is given to the Veblenian idea of emulative consumption where a desire to "keep up with the Jones"' results in over-borrowing leading eventually to bankruptcy. The paper posits an empirical model that incorporates a set of standard variables mentioned in the literature and variables specifically related to emulation, income level, income distribution and urbanization. Using state level pooled data for the period 2000–2009 the paper finds that the more unequal the distribution of income in a state and the more urban the state, the greater the bankruptcy rate in the state. These basic findings point to emulative consumption behavior as an important factor in explaining differences in personal bankruptcies across the states.

1. Introduction

1.1. Background

Bankruptcy has received a substantial amount of academic and policy attention over the years. Recently papers have focused on explaining the dramatic upward trend in the number of bankruptcies since the mid-1980s, analyzing the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), and exploring the impacts of various social and economic variables on bankruptcy rates. Bankruptcy filings have increased substantially. In the early 1980s there were about 400,000 bankruptcies per year. By the early 1990s there were approximately 1,000,000 bankruptcies per year. By the mid-2000s bankruptcies reached a peak of about 1,600,000 per year. After a drop to about 700,000 in the immediate aftermath of the 2005 reform, bankruptcies began to increase again.

Much of the increase in bankruptcies came from an increase in non-business bankruptcies. In the early 1980s the non-business percentage share of bankruptcies was in the low 80s. This share grew steadily and in recent years the non-business percentage has been in the high 90s peaking in 2005 at over 98%. The national trend discussed above masks the fact of substantial variation in state-to-state bankruptcy rates, the focus of this paper. Figs. 1 and 2 provide a visual representation of the variation in bankruptcies across states and across years within states.

Fig. 1 shows average bankruptcy rates, state-by-state, since the early 1980s. Obviously there is substantial variation in cross-state rates. Alabama, Georgia, Nevada, and Tennessee have the highest average rates while Alaska, Hawaii, and Vermont have the lowest and there is substantial variation in between.

Around the averages shown in Fig. 1 are substantial degrees of annual variation in bankruptcy rates within states. Fig. 2 shows the coefficient of variation (standard deviation/mean) in within-state bankruptcy rates over the 1981–2009 period.

The information above sets the stage for the present study. To summarize, since the 1980s, there has been a substantial upward trend in bankruptcy rates. The upward trend was temporarily disrupted by policy change in the mid-2000s. More importantly for this work is that bankruptcy rates vary substantially across states.

1.2. Purpose

As will be seen in the literature review, few researchers have tried to explain the variation in state bankruptcy rates using primarily socioeconomic data. The interest is more often on policy cross-state policy differences. The purpose of this paper is to develop an empirical model that accounts for the substantial state-by-state variations in non-business bankruptcy rates with a particular emphasis on exploring the potential role of emulative consumption in bankruptcy. This task will be accomplished in a series of steps. The next section will briefly explain emulative consumption and posit a set of related hypotheses. Rather than being deduced from standard models the hypotheses are taken from Veblen's statements regarding emulative behavior. Given this it may be more proper to refer to the hypotheses as propositions but for simplicity the standard term will be used. Second, a literature review will reveal and discuss similar work as well as provide

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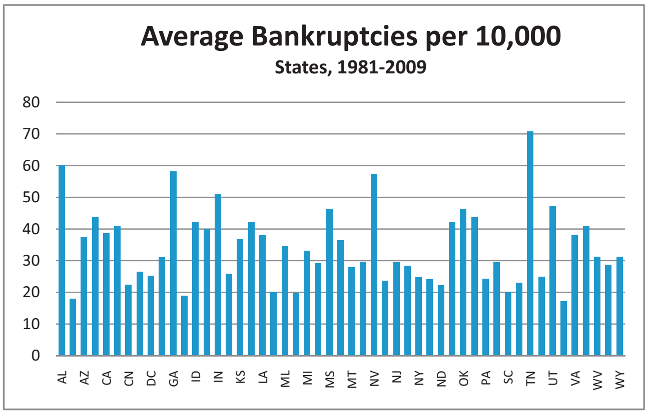
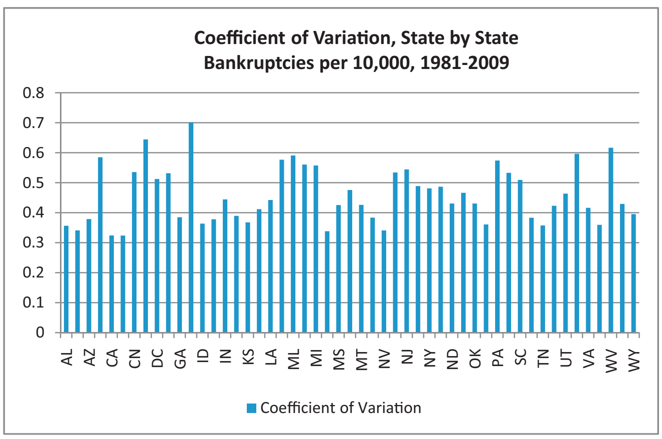


Source: Author's estimations with data from the American Bankruptcy Institute

Fig. 1. Average bankruptcies per 10,000 (states, 1981–2009).
Source: Author's estimations with data from the American Bankruptcy Institute.



Source: Author's estimations with data from the American Bankruptcy Institute

Fig. 2. Coefficient of variation, state-by-state (bankruptcies per 10,000, 1981–2009).
Source: Author's estimations with data from the American Bankruptcy Institute.

guidance in model specification. Third will be a section describing the data and model to be estimated using a pooled data set including 46 American states over a 10-year, 2000–2009.[2] This will be followed by a presentation and discussion of the results. Finally, conclusions will be drawn.

2. Emulative consumption and bankruptcy

The concepts of emulative consumption and conspicuous consumption are typically associated with the work of Thorstein Veblen, especially his book, The Theory of the Leisure Class (1899 [1979]). The two concepts, emulation and conspicuous consumption are closely related. Emulation suggests that "members of each [socioeconomic] stratum accept as their ideal of [consumptive] decency the scheme of life in vogue in the next higher [socioeconomic] stratum" Conspicuous consumption, alternatively, is a means to show that one has achieved a level of consumption worthy of emulation. The consumption of certain goods "is an evidence of wealth, it becomes honorific; and conversely, the failure to consume in due quantity and quality becomes a mark of inferiority and demerit" (Veblen, 1899 [1979], p. 74). Veblen sees these behaviors as universal. "No class of society, not even the most abjectly poor, foregoes all customary conspicuous consumption" (Veblen, 1899 [1979], p. 85). Yet, while all classes are given to conspicuous consumption, Veblen sees urban dwellers as being particularly affected. "The result [of conspicuous consumption] is that, in order to keep up a decent appearance, the former [urban dwellers] habitually live hand-to-mouth to a greater extent than the latter [rural dwellers]" (Veblen, 1899 [1979], p. 87).

Current student of urban society, Glaeser (2011), reports behavior similar to that suggested by Veblen. In describing the modern city as a consumption center he writes, "cities pull people out of private space into public areas, which helps make them [cities] centers for socialization and conspicuous consumption" (p. 124). Similarly he observes that "[i]n a diverse, complicated city, clothes indicate the interests and income of their wearer. Since cities have more social heterogeneity and more social interactions, clothing plays a somewhat more important role there than it does elsewhere" (pp. 126–127).

Simply put, someone who is bankrupt has more debt than he/she can service. The reasons for the mismatch between debt and ability to repay are many and multidimensional. For example, personal tragedies such as divorce, unemployment, and excessive medical expenses are often precursors to personal bankruptcy (Ramsay, 1997; Sullivan et al., 1997; Jacoby et al., 2001; Johnson, 2005; Gross and Notowidigdo, 2011). Similarly, exogenous events such as housing or stock market bubbles/crises or broad economic downturns can quickly convert otherwise well-laid plans into recipes for financial disaster.

With or without an attending tragedy, unsustainable consumption choices, living beyond one's means, seems a likely catalyst to bankruptcy. If Veblen is correct, many, perhaps all, consumers will have a tendency to live beyond their means as they model their consumption after the consumption patterns of their economic superiors. This may be especially true given that bankruptcy provides a type of consumption insurance (Lehnert and Maki, 2002). To the extent it this leads to over borrowing, emulative consumption should be positively related to bankruptcy. Even if the consumption itself is not enough to cause bankruptcy it may still keep consumers close enough to the edge of financial security that a slight nudge can make them "victims to even slight adverse events" (Zhu, 2011, p. 2). The empirical work below tests Veblen's propositions, at least indirectly. Technically the paper asks whether the socioeconomic conditions that Veblen relates to conspicuous consumption also relate to bankruptcy. It is not clear that these propositions have ever been specifically subjected to formal statistical analysis. The emulative consumption – bankruptcy proposition is formally expressed below as two hypotheses and one research question.[3]

H1. The more unequal the distribution of income in a state, the greater the bankruptcy rate in the state.

Rationale: Veblen proposes that consumers set their standard of decency in consumption by the consumption level of the next higher socioeconomic stratum in society. Where income is more unequally distributed, it seems that there would be greater distance between socioeconomic strata as compared to a society in which incomes and wealth are more equally distributed. The further the distance to the next stratum, the further a consumer must stretch his/her budget to emulate the stratum above them. The greater

[2] Four states are excluded, California, Colorado, Indiana, and Louisiana, because they do not report divorce rates. Other data limitations constrained the time period covered. The 10 year period was selected to cover the period of substantial growth in non-business bankruptcy and to include the mid-decade reform, and have reason to include data that is available for the decennial census but not for every year.

[3] Obviously it is difficult or impossible to clearly identify a consumer's motives in his or her consumption. For this reason failure to reject either of the two hypotheses not directly validate the emulation hypotheses.