Economic Decisions of Financially Constrained Households

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What causes households to choose bankruptcy?

- The ideal dataset is not feasible.
- What do we have to work with?
  - Sample of households with certain financial characteristics that are a function of past circumstances and past choices.
  - During the period of study, some households receive a negative consumption, income or asset price shock.
  - During the period of study, some households will declare bankruptcy.

The interesting questions

- Are the households who received these shocks more likely to choose bankruptcy?
- How random are these shocks? Who is more likely to receive them?
- Does the household's initial financial condition magnify the effect of these shocks? What is the relevant definition of "financially constrained?"
- Are financially constrained households more likely to receive a shock than other households?
- Why did some households for which we did not observe a shock declare bankruptcy during the study period? And vice versa?

Deeper questions

- How did some households become financially constrained? How much is due to circumstances, how much to choices?
- Do households make these choices because they are uninformed, or because they cannot commit to following through?
- What can reduce the likelihood of shocks, improve choices, and households' ability to follow through?

Coping with Adversity

- Data Source: Community Advantage Program.
- Population: LMI mortgagors.
- Sample: Community Advantage Panel Survey (CAPS)
  - Annual longitudinal survey of 3,743 CAP participants, data from 2003-2009.
  - Have you declared bankruptcy in past year?
  - Demographics, financial information (yearly), borrower and loan-level data at time of mortgage origination (between 1999 and 2003).
  - Some item nonresponse.

Where does this fit?

- Identifying relevant shocks, defining financially constrained.
- Overall, the paper would benefit from a more focused discussion of the main hypothesis and the household choice being modeled. What are you controlling for and why?
- Shocks (?): unemployment, unexpected expense and reported difficulty paying medical expenses.
- Initial financial conditions: Mortgage LTV at origination, DTI ratio, No health insurance, Emergency savings, Emergency loan unavailable, Financial benefit of bankruptcy.
- No interaction terms – missed opportunity.
- Demographics?

Pushing harder on the data to get at the deeper questions.

- In some sense, the entire sample is financially constrained, but…
- …can you use the data to define financially constrained?
- …these are panel data so can you tell us something about the path to bankruptcy? Prior shocks? Time to bankruptcy? Hazard model.
- …later responses give reasons for filing. Does the path to bankruptcy differ by the reason given?
- …questions on homeownership counseling. Does this have any effect on relevant initial financial conditions?

Financially Fragile Households: Evidence and Implications

- Data source: TNS Global Economic Crisis Survey.
- Population: U.S. population aged 18 to 65.
- Sample: snapshot in 2009. Designed to be nationally representative, but collected via internet.
  - How confident are you that you could come up with $2,000…? If confident, how would you?
  - Demographics, financial condition and literacy.

Where does this fit?

- Doesn't focus on shocks or outcomes, but on the relevant initial financial conditions broadly defined.
- Claim: This measure is relevant to the definition of "financially fragile."
  - Intuitively appealing.
  - Empirical work still developing.
- Claim: By this measure, lots of people are financially fragile.
  - Who are the 19% of households with wealth > $250 K who can't come up with $2 K? Weighting?
  - SCF doesn't show the same level of financial fragility.

Getting at the deeper questions: Who can put together $2,000?

- Probit model
  - There is a level of income above which households believe they can put together $2,000.
  - More education, financial literacy and life experience helps this belief.
  - Wealth feels somewhat tautological.
  - No leverage measure.
  - Number of coping mechanisms doesn’t seem to help.

How do they cope?

- Claim: There is a “pecking order” of coping mechanisms; can a more precise statement be made?
- Good news: The most important are the most often measured (savings, borrowing from family and friends and mainstream credit).
- Puzzle: Income does not affect which one is used. “Current income” is not an option.
- Unemployed and less educated turn to less traditional methods - Suggests a need to measure different initial financial conditions, such as access to these methods.

Household Debt and Saving during the 2007 Recession

- Credit records – 5% random sample of US individuals with credit files, plus their household members.
- Two surveys from RAND American Life Panel (ALP)
  - Population: U.S. population aged>18.
  - Sample: Randomly selected Reuters/U.Mich Survey participants. Internet survey.
    - NYFed Survey 900 participants
    - RAND Survey 2,057 participants

Where does this fit?

- Some measures of shocks, financial conditions and outcomes.
- Shocks: house price changes, stock value changes, unemployment, hypothetical income change.
- Initial financial conditions: Income, mortgage debt, non-mortgage debt.
- Outcome: Real and hypothetical spending changes.

Broad Comments

- A lot of data presented!
- Overall, this paper would benefit from a sharper hypothesis; without one my comments will necessarily be less focused.
- For example, do shocks to employment, house prices or asset prices affect spending (expand on Table 9)? Does this vary by initial financial conditions?
- You split statistics by “bubble” states and by homeownership, but not by homeowners in “bubble” states.

More comments

- It would also benefit from some acknowledgement of the shortcomings of the sampling technique and how these were addressed with the weights.

- How representative do the weighted statistics look? Homeownership rate still seems high.

- “Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009,” Bricker et.al. 2011.

Spending and saving results

- What conclusions can you draw from the variation in spending declines across households? Can you define "financially constrained" or "credit constrained" in terms of the effect of shocks on spending?
- Hypothetical income changes
  - For income declines, similar in spirit to the "how would you cope?" question.
  - Fifty-three percent cut spending by the whole amount? Did you frame it as a temporary cut or a permanent cut? Argues for adding "current income" as a coping method to the previous study discussed.
- With respect to aggregate saving. Use caution about assuming that an empirical regularity in aggregate data holds for all households.