Explaining Racial Disparities in Personal Bankruptcy Outcomes

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Motivation

- Bankruptcy is a major source of debt relief in the US
  - ► 1 in 10 Americans have filed at some point in their life (Keys, 2018)
  - ► $832 in debt per US adult is discharged each year in bankruptcy (US Courts, 2019)

- There are significant racial disparities in financial outcomes in the US
  - ► Median wealth of white households is 10x Black and Hispanic wealth: ($171k vs. $17k) (2016 SCF)
  - ► Minorities pay higher interest rates than whites with the same credit score (Ghent Hernández-Murillo Owyang, 2014; Bayer Ferreira Ross, 2017, Butler Mayer Weston 2021)
  - ► Black consumption falls 50% more in response to the same income shock (Ganong Jones Noel Farrell Greig Wheat, 2020)

This Paper

- **Question:** what racial disparities exist in personal bankruptcy? And why?

- **Approach:**
  - ▸ What observable filer characteristics explain disparities in bankruptcy outcomes?
  - ▸ Quantify racial homophily between filers and judges/trustees
  - ▸ Random assignment of judges/trustees $\Rightarrow$ detect & partially identify racial bias

- **Main findings:**
  - ▸ Black filers' cases are more likely to be dismissed (without debt discharge) on average
    - Chapter 7: 4 pps more often (118% higher) than non-Black filers
    - Chapter 13: 28 pps more often (55% higher) than non-Black filers
  - ▸ Observable variables reduce disparities to 0.6 and 12.5 pps for Chapters 7 and 13
  - ▸ Random assignment to white trustees $\Rightarrow$ Ch 13 dismissal rate $\uparrow$ 13-20 pps for Black filers

Contributions to Related Literature

- **Racial disparities in household finance:** Munnell, Browne, McEneaney, and Tootel (1996); Braucher, Cohen, and Lawless (2012); Reid Bocian, Li, and Quercia (2017); Bayer, Ferreira, and Ross (2018); Begley and Purnanandam (2020); Barlett, Morse, Wallace, and Stanton (2019); Fuster, Goldsmith-Pinkham, Ramadorai, and Walther (2020); Morse and Pence (2020); Blattner and Nelson (2021)
  - ▸ New focus on racial disparities in bankruptcy and drivers

- **Impact of legal decision-makers:** Anwar, Bayer, and Hjalmarsson (2012, 2019a, 2019b); Arnold, Dobbie, and Yang (2018); Arnold, Dobbie, and Hull (2020); Iverson (2020); Iverson, Madsen, Wang, and Xu (2020)
  - ▸ Highlight role of bias and importance of bankruptcy trustees

- **Methods for detecting and quantifying bias:** Becker (1957, 1993); Knowles, Persico, and Todd (2001); Anwar and Fang (2006); Arnold, Dobbie, and Yang (2018); Arnold, Dobbie, and Hull (2020); Canay, Mogstad, and Mountjoy (2020).
  - ▸ Formalize link between homophily and bias, and partially identify bias

Outline

1. Background and Data

2. Racial Disparities in Bankruptcy Dismissals

3. Detecting and Quantifying Racial Bias

4. Conclusion

Background and Data

What is Personal Bankruptcy?

- Discharge unsec. debt (credit card, medical, etc.); make partial payments to creditors

- Households file under one of two Chapters:
  - **Chapter 7:** discharge received upon initial legal ruling ($\sim$3 month process)
  - **Chapter 13:** discharge received after completing 3-5 year repayment plan

- Three important legal decision makers (**DMs**):
  - **Judge:** ultimately decides case outcomes (e.g., dimissal)
  - **Trustee:** evaluates filer's accuracy and honesty; facilitates payments to creditors
  - **Attorney:** advises filer on Chapter choice and reporting

Data

- **Lexis Nexis** and **Federal Judicial Center** bankruptcy case data
  - ▸ Docket header info: filer name, address, chapter, case outcomes, **DM names**
  - ▸ Detailed schedule data: assets, debts, income, expenses
  - ▸ Today: FL and MN *(full US in progress)*

- Imputing **race** *(today's results)*
  - ▸ Bayesian prediction of race using location and surname (Imai and Khanna, 2015)
  - ▸ Uses Census Surname List (and Spanish Surname List) and 2010 block-level data on race

- Self-reported race from public records *(in progress)*

Bankruptcy Outcomes

- Possible case outcomes: **discharge**, **conversion** of chapter, and **dismissal**

- What are the main reasons for **dismissal**?
  - ► Fraudulent reporting by filer (e.g. concealing property)
  - ► Failure to make promised payments in Chapter 13 over 5-year period

- **Trustees** and **judges** make **subjective** evaluations of filers
  - ► Procedural error vs. intentional fraud?
  - ► Did Ch 13 payments stop due to severe hardship beyond filer's control?

Racial Disparities in Bankruptcy Dismissals

Disparities and Decisions Makers (Outcome = 1[Dismissal])

	(1)	(2)	(3)	(4)	(5)	(6)
	Panel A: Chapter 7					
Black Filer	0.04***	0.04***	0.03***	0.03***	0.03***	0.03***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
N	988,463	988,463	988,463	988,463	988,463	988,463
R2	0.02	0.03	0.04	0.04	0.05	0.06
	Panel B: Chapter 13					
Black Filer	0.28***	0.23***	0.19***	0.18***	0.17***	0.17***
	(0.003)	(0.004)	(0.005)	(0.005)	(0.005)	(0.005)
N	319,691	319,691	319,691	319,691	319,691	319,691
R2	0.06	0.10	0.11	0.16	0.20	0.21
Year FE	✓	✓	✓	✓	✓	✓
County FE		✓	✓	✓	✓	✓
ZIP FE			✓	✓	✓	✓
Judge FE				✓	✓	✓
Trustee FE					✓	✓
Attorney FE						✓

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Judge FE				✓	✓	✓
Trustee FE					✓	✓
Attorney FE						✓

Racial Disparities in Dismissal Rates

Sample	(1) FJC	(2) FJC	(3) FJC	(4) FJC (Ch 7)	(5) FJC (Ch 13)
Black Filer	0.092*** (0.004)	0.057*** (0.003)	0.056*** (0.003)	0.006*** (0.002)	0.125*** (0.008)
Chapter 7		-0.427*** (0.009)	-0.386*** (0.009)		
Pro Se		0.342*** (0.007)	0.191*** (0.004)	0.048*** (0.002)	0.533*** (0.008)
N	624,879	624,879	575,853	443,970	131,709
R2	0.613	0.649	0.626	0.510	0.606
Case Controls			✓	✓	✓

Case controls: 1[filing fee paid in full], 1[repeat filer], debt/assets, % secured debt, 1[joint filing], 1[nonexempt assets], 1[homeowner], ln(monthly income), ln(assets), income - expense gap

Fixed Effects: Year, ZIP, Judge, Trustee   **Clustering:** ZIP and Trustee (two-way)

Ch. 13 Dismissal Hazard Rate (cumulative)
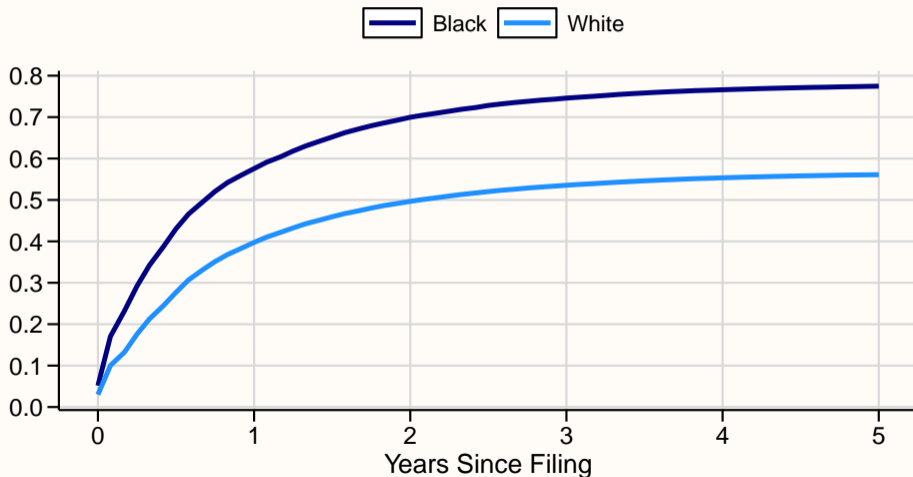
Detecting and Quantifying Racial Bias

Partially Identifying Bias from Homophily

- Random assignment of **DMs** $\Rightarrow$ identify difference in bias between **DMs**

- Difference in Black/non-Black bias is a lower bound for average bias
  - Requires assumption that Black **DMs** are weakly negative biased against Black filers
  - Psychology research documents pro-white implicit bias among US minorities
    Nosek, Banaji, and Greenwald (2002); Livingston (2002); Ashburn-Nardo, Knowles, and Monteith (2005)

- Econometric specification:

  $$Dismissed_i = \beta_0 BlackFiler_i + \Delta\beta BlackFiler_i \times WhiteTrustee_i + \alpha_t + \gamma_z + \delta_j + \mu_k + \varepsilon_i$$

Homophily Results

Sample	(1) FJC	(2) FJC Ch 7	(3) FJC Ch 13	(4) Full	(5) Full	(6) Full
Black Filer	-0.029	0.015**	0.018	-0.027	-0.017	-0.022
	(0.025)	(0.007)	(0.095)	(0.027)	(0.084)	(0.081)
Black Filer x White Trustee	0.084**	-0.012	0.134	0.091**	0.190**	0.201**
	(0.038)	(0.009)	(0.100)	(0.037)	(0.098)	(0.091)
Black Filer x White Trustee x Ch 7					-0.195*	-0.216**
					(0.100)	(0.097)
N	511,306	431,170	79,867	1,185,851	1,185,851	1,185,851
R2	0.613	0.510	0.609	0.650	0.650	0.650
Case Controls	✓	✓	✓			
Interact Pro Se & Ch w/ Race						✓

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Conclusion

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- Black filers' experience higher bankruptcy dismissal rates

- Observables explain most Ch 7 disparities, but only $\sim$50% for Ch 13

- Black filers assigned to white trustees see higher dismissal rates

- Bias among bankruptcy DMs can limit Black households' access to debt relief

- Future work: expanding data and examining events surrounding Ch 13 dismissal

Thanks!