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**CLIMBING BACK:
AN ANALYSIS OF THE SUMMARY INSTALMENT
ORDER:
THE NEW ZEALAND CONSUMER-DEBTOR
REPAYMENT PROGRAM**

**A thesis presented in partial
fulfilment of the requirements
for the degree
of Masterate of Applied Economics at
Massey University**

KATHRYN REDHEAD

1997

ABSTRACT

The Summary Instalment Order (SIO) court-administered repayment plan was introduced as an experimental response to the problem of overcommitment. Three decades after its institution, this research forms a profile of its applicants, suggests reasons for their financial difficulty, and conducts the first evaluation of this experimental program.

Comparing the profile of the SIO sample with the general population, SIO applicants are younger, have larger families, are more likely to be separated or divorced, and are more likely to reside in rented accommodation. SIO applicants are also mostly beneficiaries or in unskilled employment. Correspondingly, they have lower income and assets compared to the general population. In addition, they are more committed in terms of indebtedness, though less committed in regard to outgoing.

Overcommitment is the reason for SIO application, and inadequate income, current consumption preference, and the occurrence of an unanticipated event provides explanation for overcommitment. In SIO applications, evidence of inadequate income, current consumption preference, and the occurrence of an unanticipated event suggests these have contributed to the overcommitment of SIO applicants.

The SIO was intended to interrupt an indebted individual's passage to bankruptcy and to provide applicants with rehabilitation and a fresh start. Tracing applicants against the National Insolvency Database, 10.8% of applicants continued to bankruptcy in the 4-6 years following their SIO application. Analysis of the demographic and financial profile of applicants continuing to bankruptcy reveals the SIO may not have failed in any particular way. When analyzing reasons for bankruptcy application, however, SIO failure is more apparent. In addition, the high dropout rate, refile, and evidence of applicants unable to repay their debt within the three year term reinforces SIO failure.

Denial of the SIO, inadequate income, current consumption preference, and the occurrence of an unanticipated event are reasons for SIO failure. Recommendations of: acceptance based upon ability to service debt, improved screening, investigation into

compulsory budgeting assistance, and informing applicants regarding repayment progress and costs associated with bankruptcy application, are among suggestions outlined to combat causes of SIO failure. In addition, increased accessibility to the SIO and continued monitoring of the program's effectiveness is recommended.

ACKNOWLEDGMENTS

Ironically, in a thesis concerning the dangers of credit, much credit is due.

First, I am greatly indebted to staff of the Department for Courts and Commercial Affairs throughout New Zealand. Without the sacrifice and hard work of these forthcoming individuals, the research could not have been conducted. Special mention is due to David Cole who ran the computer search against the National Insolvency Database, Joanne Pickford for acting as an intermediary between myself, the Official Assignee, and various Commercial Affairs Divisions, and Wayne Goodall for his overall support of the research.

For their contribution of anecdotal evidence, credit is due to New Zealand Federation of Family Budgeting Services Chairperson, Raewyn Nielsen, and to SIO supervisor, Lynne Wyman. Thank you for your assistance.

The financial support of the New Zealand Treasury and the Massey University Alumni Association is also greatly appreciated. In addition, thanks is due to the Department of Applied and International Economics for their contribution of resources required for this research.

I would also like to acknowledge those who assisted in the harrowing task of searching for a thesis topic. Of these, special mention is due to Ross Judge from the New Zealand Treasury.

Credit is due to Professor Larry Rose for his support and continued enthusiasm. The discarding of the typical formal supervisor-student relationship and the positive (?) *net* effect on my written vocabulary was also most appreciated.

On a more personal note, thank you to:

- ⇒ Saint Albans Presbyterian Church, for its unique character and its love, acceptance, and community.
- ⇒ Kerry Betteridge and Jeanette Head, for being catalysts to a year of incredible personal growth.
- ⇒ Tina Heaven, Roqiah Akramy and Carolyn Studman, for the consistency of their friendship. (Long may it continue!!)
- ⇒ Rachel (Roomy) Bate, whose spirit of mischief lingered in her absence in 1997.
- ⇒ Sue Cassells, for her friendship, support, and the (all-to-rare) prayer times.
- ⇒ Nic Gidden, for his encouragement and prayer.
- ⇒ flatmates, both past and present, for their tremendous love and support.
- ⇒ my family (including Hamish McWilliam), ... words do not do you justice ... I love you.
- ⇒ my God, Father of Jesus Christ; it wasn't luck that was on my side...

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1. INTRODUCTION

Fare-welling his son to France, Polonious, in Shakespeare's Hamlet, advised that he be neither borrower nor lender.

"For loan oft losses both itself and friend; and borrowing dulls the edge of husbandry".

(Shakespeare, 1600-1, Act 1 Scene 3)

Today's economy is dubbed a 'credit economy'. Lenders entice and borrowers readily accept the use of credit. In the 20th century, the advice of Polonious is mostly unheeded.

Attitudes towards credit are identified by Ford (1988) as an important factor in influencing credit use. Based on biblical passages instructing to lend freely without expectation of repayment (Deutronomy 15:1; Luke 6:35), Cannon Lawyers of the 10-14th centuries traditionally viewed stipulation of reward for loan of money as sin. Indeed, condemnation of usury was supported by civil law (Dugdale, 1981). The institutionalization of credit in England in the 14th century marked the beginning of greater acceptance of credit use. From then, attitudes have changed such that the negative social stigma has today been replaced with a view, "if you are not in debt you don't exist" (Leicester Money Advice Centre, 1986).

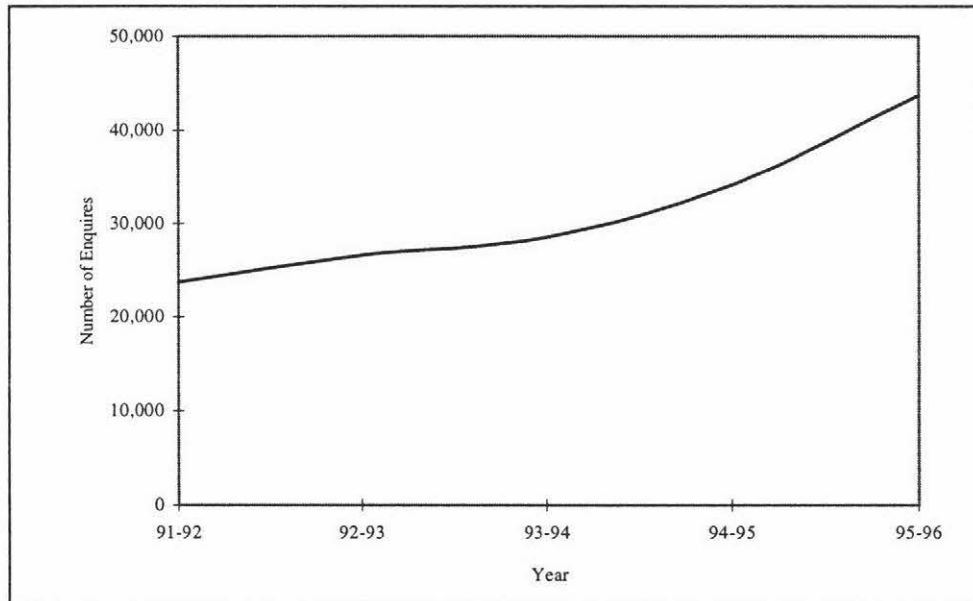
Credit use is rampant. Between 1980-1990 credit cards circulating in Britain tripled to 29.8 million (Rowlingston and Kempson, 1994). In New Zealand, credit card use has also increased. Between 1986-1996, average monthly billings increased by 330% (Statistics New Zealand, Accessed 1997). In 1993, approximately half of the adult population owned at least one plastic card (Cunninghamme, 1993). While to many the credit card is a symbol of the credit economy, other sources of credit have also been increasingly employed. In 1987, New Zealand moneylending companies lent six times as much as they did in 1979, and hire-purchase debt increased by almost 500% between 1977-86 (Special Correspondent, 1987 April 13).

Conventional economics holds that credit is a means by which individuals can escape from poverty. Credit availability enables individuals to invest in a better future. In the absence of credit, then, the poor are destined to remain poor. Only in the presence of unsuccessful risk-taking does conventional economics consider that credit may contribute to, rather than alleviate, poverty.

Coinciding with rapid and widespread growth in credit use, overcommitment has increased. Overcommitment is "the stage that consumers reach when ... unable to repay the debts they have incurred" (Ministry of Consumer Affairs, 1988, p.54). Between 1981-1987 the number of debt collecting agencies in New Zealand increased by 179.3% (Department of Statistics, 1987). In 1997, the New Zealand Federation of Family Budgeting Services (NZFFBS) Chairperson reports that debt in excess of \$40 million has been incurred by people without capacity to repay (Ferguson, 1997). While unsuccessful risk-taking may be a contributing cause to this overcommitment, factors such as inadequate income, a preference for current consumption, and the occurrence of unanticipated events may also play a role. These factors are generally ignored by conventional economics.

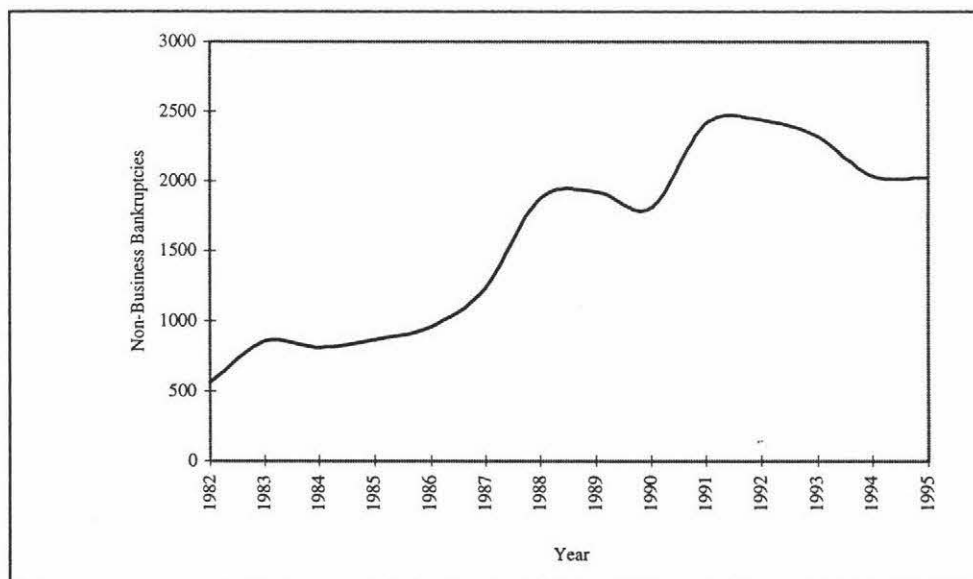
In reaction to overcommitment, debtors have the option of declaring bankruptcy or repaying their debt. Figures 1.1 and 1.2 reveal increased demand for both options. In 1990 there were so many bankruptcy petitions in the high court in Auckland, New Zealand, that the system began to clog (Staff, 1990 March 1, p.1). Indeed, voluntary bankruptcy provisions were being used to such an extent that giving up the fight against debt became considered a '90's phenomena' (Murphy, 1992 October 22, p.1). Simultaneously, demand for budget advice assistance has increased. Between June 1991-96, the NZFFBS recorded an 85% increase in enquires to their service (NZFFBS, 1997). Both bankruptcy and repayment of debt have therefore been employed in reaction to increased overcommitment.

Figure 1.1: Enquires at the New Zealand Federation for Family Budgeting Services



Source: NZFFBS. (1997).

Figure 1.2: Non-Business Bankruptcies 1982-1995



Source: Statistics New Zealand. (Various Years).

1.1 Bankruptcy

Harsh penalties have traditionally been associated with failure to honour a credit agreement. In the era of Shakespeare's play, Merchant of Venice, the penalty was death.

*Why, this bond is forfeit;
And lawfully by this the Jew may claim
A pound of flesh to be cut off
Nearest the merchant's heart.*

(Shakespeare, 1596-7, Act 4 Scene 1)

During the 16th century insolvents were imprisoned for non-payment of debt. Unlike other prisoners, however, the state did not provide for them. Without provision by family or friends, debtors were doomed to starvation. Dickens' Pickwick Papers outlining the atrocities in debtor prison were instrumental in the eventual elimination of this punishment in the 18th century.

The practise of apportioning a debtor's flesh has today been replaced by increased debtor orientation in bankruptcy law, yet the quasi-criminal feel surrounding bankruptcy lingers. Even the term reeks of malfeasance as it derives from bankus ruptus, a medieval practise of defaulting the bankrupt through breaking their work bench and hence their livelihood. Today, though creditors do not destroy the workbench themselves, the court assigns responsibility to a third party to take over a bankrupts assets and apportion their estate (Massey University, 1996, p.22).

Sullivan, Westbrook and Warren (1989) describe today's bankruptcy system as a free market solution to borrowing and lending pathologies.

"In the modern setting, bankruptcy is one of the safety valves that sophisticated capitalism keeps in place to release the pressures of fear and greed that accompany free market incentives. Every machine must have

give in the joints or it will destroy itself, and bankruptcy is part of the give in a free market society.

(Sullivan et al., 1989, p.334)

The give generally enables debtors to be discharged from obligations unmet by the apportioning of their estate. As such, the bankrupt is not treated as a debtor for the rest of their life. This practise of modern bankruptcy whereby debts are discharged, actually dates back to Biblical times.

At the end of every seven years you must cancel debts. This is how it should be done: Every creditor should cancel the loan to his fellow Israelite. He shall not require payment from his fellow Israelite or brother, because the Lord's time for canceling debt has been proclaimed".

(Holy Bible, Deutronomy 15:1-2)

Howard Pugh, the Official Assignee for New Zealand in 1992, stated that "it is not useful for society to have people that are totally hamstrung with debts for the rest of their lives" (Portanger, 1992 August 28, p.42). In addition to releasing bankrupts from their obligations, Burton (1959) identifies a secondary result of bankruptcy legislation, the provision of an opportunity for rehabilitation in the financial community. The extent to which debtors receive release and rehabilitation, however, varies between countries.

United States

United States bankruptcy laws were mostly unsuccessful and hence short-lived prior to 1898. Even then the system was widely criticized. In response to the criticism, the Bankruptcy Reform Act 1978 was introduced, effecting increased uniformity to bankruptcy law throughout the United States.

The United States' consumer-debtor liquidation bankruptcy is termed Chapter 7 (Ch7) bankruptcy. Bankrupts forego non-exempt assets in exchange for the opportunity to start again. Creditors receive payment from the sale of these non-exempt assets, and debtors receive discharge and a fresh start within approximately four months. Wages received post-bankruptcy are not included in the estate so the bankrupt is able to retain all future income. Where an application for bankruptcy suggests 'substantial abuse' of

this provision, however, the Judge or United States Trustee may dismiss the application.

While Ch7 bankruptcy is intended to provide the bankrupt with a fresh start, this is not always the case. Firstly, the bankrupt may elect to reaffirm secured debts. In doing so, the bankrupt continues to be responsible for the reaffirmed debt until repaid. Secondly, creditors or the United States trustee may object to the discharge. Finally, because filing for bankruptcy may remain on a bankrupts credit record for up to 10 years and since the bankrupt is restricted from filing for bankruptcy again within 6 years, then the bankrupt is not granted a fresh start in the sense that restrictions are imposed upon them.

Canada

The governing legislation for Canadian insolvency is the Bankruptcy Act 1970. Instituted just over a century after Canada's first insolvency statute, the Bankruptcy Act 1970 aims: to prevent an insolvent individual from incurring more debt, to equitably treat creditors, and to provide an insolvent with a fresh start. (Leonard, 1988)

The principal condition in application for bankruptcy is that the debtor is insolvent. The trustee, the most important player in the administration of the bankruptcy, acts as a private sector representative in bankruptcy administration. Aside from the right to file proof of claim with the trustee and the right to receive a proportionate share of the bankrupts estate, unsecured creditors have no rights in regard to the bankrupt. After bankruptcy, however, unsecured creditors can pursue what is due to them with permission of the court. (Leonard, 1988)

While bankruptcy affords protection to its applicants, it also has associated costs. In addition to foregoing non-exempt assets, bankrupts are restricted from being a director, and holding an elected office. Further, bankrupts are unable to attain more than C\$500 in credit without disclosing they are an undischarged bankrupt. (Leonard, 1988)

Australia

The Bankruptcy Act 1966 is the principal legislation for Australian insolvency. Under the Act a debtor may be bankrupt by either a debtor or creditor petition. In terms of the latter, the process is preceded by service of a "bankruptcy notice". (Hattaway, 1997)

When declared bankrupt, the debtor foregoes most of their property. Personal effects, household furniture, and a vehicle valued less than \$5000 are the exceptions. In addition to foregoing assets, where the bankrupt is deemed to have sufficient earnings, payments to the estate are required. Further, should the debtor inherit or win any money, this becomes the property of the estate. (Hattaway, 1997)

While bankrupt, restrictions regarding leaving the country, incurring debt, and managing a company limit the bankrupts actions. After 3 years, however, the bankrupt is automatically discharged and the slate is wiped clean, given the bankrupt trustee does not object,. (Hattaway, 1997)

New Zealand

Prior to revisions made to the Insolvency Act in 1967, New Zealand bankruptcy law in essence had remained relatively unchanged since 1893. Since the 1893 bill was criticized for being "negative and incapable of penetrating the heart of the matter" (New Zealand Parliament, 1967, p.2190), it was hoped that the 1967 replacement would bring "order, coherence and a larger measure of justice to the statute" (ibid., p.2070). Mr. Faulkner, MP for Roskill at the time, identified the 1967 bill as having a "warmth for debtors". (ibid., p.740)

A person adjudicated bankrupt in New Zealand is disqualified from being a citizen in many ways: bankrupts are not allowed to manage a business, leave the country, open a bank account, raise over \$100 in credit without admitting their bankrupt status, or hold certain offices of appointment. Aside from up to \$2000 of personal effects, \$400 of cash, and \$500 of trade equipment, the bankrupt forfeits their belongings to the Official Assignee. In addition, where a debtor receives income which is not solely derived from a Government-issued benefit, Clause 45 of the Insolvency Act empowers the Court to require contribution of income exceeding that deemed necessary for survival (New

Zealand, 1968). In essence, the Official Assignee becomes the bankrupt; possessing this excess income and their assets and distributing these among creditors. (Massey University, 1996)

The bankrupt remains responsible for court fines, maintenance commitments, court orders for reparation, and debts procured after being declared bankrupt. On expiry of the bankruptcy after three years, however, the bankrupt is discharged from all other debts if no objection is made by the Official Assignee or creditors.

1.2 Repayment plans

The previous section detailed the use of bankruptcy in response to overcommitment. The alternative to bankruptcy is repayment of debt. Overcommitted individuals have the option of a budget advice or a court-administered repayment plan where repayment requires the apportioning of debt over time.

1.2.1 Budget Advice Repayment Plans

Budget advisory services are increasingly being employed to provide assistance to overcommitted debtors. Aimed at assisting families to develop money management skills and to handle their own financial affairs, the Ministry of Consumer Affairs (1988) states that “budget advisory services and similar organisations provide vital support for debtors who are in financial difficulty” (p.57).

Since 1971 when initial budget advice services were established in England, budget advice services have grown in number and range of organisation. In 1995, England boasted at least 500 services in operation (Kempson, 1995). These services employ a number of approaches in the provision of budget advice. In addition to traditional one-on-one counseling, budget advice services in England provide telephone helplines, self-help packs, preventative education, services based in courts aimed at assisting debtors involved in court hearings, and business debt-lines.

New Zealand budget advice services have also experienced incredible growth. From modest beginnings in Kaikohe in the early 1960's, these services have spread throughout New Zealand. Today in excess of 153 budget advisory services are in existence (Raewyn Nielsen, 1997). The establishment of these budget advisory facilities has arisen from phenomenal growth in demand. This increased growth is illustrated in Figure 1.1 on Page 7.

While New Zealand budget advisory services generally provide rescue/crisis, umbrella, custodial/management, or educational assistance, the NZFFBS Chairperson, Raewyn Nielsen (1997), identifies that approximately 90% of clients approach the Porirua Budgeting service for rescue/crisis advice. In recognising the need for clients to receive in-depth on-going support, the service encourages clients to continue onto umbrella assistance. Umbrella assistance involves forming a budget, advising creditors of the budget advisors involvement, and formalising the client's commitment to a repayment scheme by requiring them to sign a budgeting agreement. The agreement states that the client will refrain from incurring further debt and making purchases disallowed by the repayment plan, however, since the client may withdraw from the services at any time, the agreement is only enforced to the extent that the client will lose any benefits the service obtains from their creditors, if they do not comply. (Raewyn Nielsen, 1997)

Though the success of budget advice services in achieving the above objective is undetermined, snap-shot studies identify that the service is effective in increasing income, reducing expenditure, and encouraging greater commitment than in the absence of budget advice support.¹

1.2.2 Court-Administered Repayment Plans

Court-administered repayment plans are required where debtors need protection from creditor action while repaying their debt. Like budget advice services, growth in the use of these plans coincides with increased credit use and overcommitment among consumers.

¹ See: Wilson et al. (1995); Kempson (1995)

United States

An application for a Ch13 repayment plan effects an automatic stay on creditor collection activities while restructuring debt to be repaid through an approved schedule of payments. The program enables debtors to retain their assets while repaying their debts over a 3-5 year period. Any debt remaining at the conclusion is discharged.

The use of Ch13 is restricted to consumer debtors with secured debt less than \$US350,000, and unsecured debt less than \$US100,000. Applicants are required to pay at least the amount repaid under a liquidation bankruptcy. A "good faith" test is undertaken to ensure that applicants do not have income exceeding that required for necessary living expenses after repayment is made. (Sullivan et al., 1989)

Filing statistics indicate that Ch13 remains a minor facet of American bankruptcy choice (Richard Aaron, 1997). In addition, two-thirds of filers fail to complete their repayment plan (Ian Domowitz, 1997). As debt is discharged at the completion of the 3-5 year period, debtors failing to complete the program are liable for the full extent of their debts and creditors may resume action.

Canada

Canada's court-administered repayment plans include the Consumer Proposal and the Orderly Payment of Debts. The latter is limited to overcommitted individuals whose unsecured non-business debts are less than C\$1,000, and requires debts to be repaid in full. The former, however, is less restrictive. Individuals with non-mortgage debts of less than C\$75,000 may be granted a Consumer Proposal. For both plans, an immediate stay of proceedings applies to unsecured creditors on application. Protection from creditor collection activities remains until the plan has been defeated, annulled or completed. (Klotz, 1995)

Because the conditions of application for an Orderly Payment of Debts is restrictive, Klotz (1995) states that its usefulness is extremely limited. In 1993 and 1994, however, the number of consumers opting for the Orderly Payment of Debts far exceeded those choosing the Consumer Proposal. Prior to 1992, Consumer Proposals were predicted to account for 20-40% of total consumer filings. In 1993 and 1994 they accounted for

only 3% (Klotz, 1995). Where adopted, however, Klotz (1995) identifies the success rate of these proposals are between 70-75%. The definition of success upon which this statistic is based was not made clear.

Australia

Under the Bankruptcy Amendment Act 1996 (Cth) a new form of insolvency legislation was introduced, providing an alternative to filing for bankruptcy. The debt agreement enables individuals with debts under \$52,000, non-exempt assets less than \$52,000, and annual income in excess of \$26,000, to avoid bankruptcy filing. The debtor formulates a proposal opting to repay at less than 100%, suspend payments, or repay debts over time. Acceptance of the proposal is contingent upon approval by a majority of creditors, accounting for over 75% of the value of debt.

New Zealand

The New Zealand Insolvency Act (1967) provides for two forms of pre-adjudication court-administered repayment programs, Statutory Proposals and the Summary Instalment Order.

Statutory Proposals

The statutory proposal, like its name suggests, is an offer extended for the satisfaction of debts in exchange for the cessation of creditor actions. The Insolvency Act (1967) allows for some or all of the following propositions to be made:

- (a) an offer to assign property to a trustee for distribution among creditors
- (b) an offer to repay debts via installments
- (c) an offer to compromise debts, paying less than 100 cents in a dollar
- (d) an offer to repay debts in the future
- (e) any other offer for an arrangement which satisfies debts. (Section 140 (2))

Because the proposal is composed by the debtor, each proposal is unique in its approach to satisfying outstanding debts. Nonetheless, all proposals are administered by a trustee and must go through the High Court. In addition, all must be accepted by a majority vote of creditors, and those accepting the proposal must account for at least 75% of the debt owing.

Summary Instalment Order

Introduced in 1967 as a “completely new approach” to the problem of defaulting debtors (New Zealand Parliament, 1967, p.738), the SIO scheme was “designed to give practical assistance and guidance to people who [found] themselves in financial difficulties, unable to meet their debts when...due” (Spratt and McKenzie, 1972, p.437) Prior to its introduction, New Zealand insolvency legislation was described by the Minister of Justice, Honorable J.R. Hanan (New Zealand Parliament, 1967, p.2190) as piecemeal, concerned with what was often merely symptoms. The SIO was a response to recognition that rehabilitation of debtors was essential.

“The scandals and agonies of the debtor’s prisons which were so graphically described by Dickens and others are, fortunately, well in the past and it is an accepted principle and is recognised as being in the interests of the community that a person who, whether by folly or even knavery, has allowed himself to get into a position where he is unable to meet his debts, should be rehabilitated and put back into circulation...”

(ibid., p.2191)

The SIO was designed to provide small non-business insolvents with incentive to repay their debts. Though under the original act filers with unsecured debts exceeding \$1,000 can not apply, amendments to the act enable debts up to \$12,000 to be included in an order. In making an order, a schedule of debts and intended payments to satisfy these within 3 years must be produced. Filers have the option of repaying a percentage of their debts or repaying their debts in full. However, the SIO is not be granted where the proposed repayment of debts would not be satisfied within three years. (Leys and Northey, 1982). Also, in the absence of Court approval, a SIO is not be granted if the debtor reapplied within six months of an initial order being refused, set aside, rescinded, or discharged.

The purpose of the SIO is to facilitate repayment out of income rather than sale of possessions. Section 146 of the Insolvency Act, however, enables the court to make an order providing for the disposal of goods owned or possessed by the debtor. The Act

also includes a rule requiring that debtors advise potential creditors of involvement in a SIO repayment plan when incurring debt in excess of \$100.

Though a creditor is able to initiate their debtor's SIO through an 'Application for an Order by a Creditor', when the SIO is in force the debtor is protected from all creditor action. Failure to make required repayments, however, may result in termination of the order, and hence the protection from creditor action. If the applicant's supervisor is not contacted with explanation for non-payment, the applicant is considered to have had sufficient means but to have refused or neglected to pay and the application is terminated. In response, an attachment order may be administered to ensure the plan is adhered to. The attachment order involves the employer deducting required repayments directly from the debtor's wages.

On successful completion of the plan the applicant is discharged. For initial policy makers, discharge represented not only release from debt and restoration to a sound financial basis, but also experience in family budgeting (Spratt and McKenzie, 1972). Through requiring the debtor to survive on reduced income and through provision of training in budgeting and money matters by their supervisor, policy makers were optimistic that the SIO would rehabilitate its applicants. Indeed, at the time of its institution, the Minister of Justice stated that the SIO represented for New Zealand a bold and fresh approach to a very real problem.

"we have here a procedure whereby the court, having regard to the debtor's circumstances - his family considerations, his earning capacity and all the rest of it - can short circuit the bankruptcy proceedings, so that step, with all its consequences, need not necessarily be taken.

(New Zealand Parliament, 1967, p.739)

1.3 Proposed Research

Though the Minister of Justice identified that the SIO was promising, he emphasized, "only experience will determine how useful it will be" (ibid., p.2190). The SIO was

experimental, yet to date no analysis has been conducted to determine whether this program has achieved its objectives: to short circuit bankruptcy proceedings, and to provide applicants with a fresh start. This research seeks to fill this void by establishing a profile of SIO applicants, the reason for their financial difficulty, and a measure of the effectiveness of the SIO in deterring bankruptcy and providing a fresh start.

2. LITERATURE REVIEW

The consumer revolution, characterised by conspicuous consumption and impulse shopping, has corresponded with widespread credit availability and use. Though traditionally associated with shame and disgrace, acceptance of credit has increased such that today consumers experience pressure to finance their needs by borrowing money. Indeed, the prevalence of the phrase “How would you like to pay” is evidence of this; it reflects freedom regarding means of payment and acceptance of these means. Clearly proverbs, “he that borrows must pay again with shame and loss” and “better to go to bed supper-less than to rise in debt” have been discarded along with society’s reservations towards credit as people embrace the use of credit to finance a better lifestyle.

Cote (1992) maintains that credit enables a superior standard of living through allowing assets to be purchased while individuals are young. The availability of credit is also found to provide both convenience and peace of mind for potential users in Rowlingston and Kempson’s (1994) nationwide interview study. In addition to the individual gains associated with credit use, efficiency benefits arising from transferring household resources to the most productive user are identified by Neufeld (1966). Cote (1992) states that macroeconomic benefits arise because credit availability allows for a more productive mix of personal savings and borrowings. Kubinski (1974) shows that these macroeconomic and individual benefits associated with credit are enhanced where consumer credit is harnessed for investment which increases earning capacity.

Household and macroeconomic benefits accrue where credit is employed for income enhancing investment. Where credit is used for postponable consumption at the expense of this investment, however, the benefits associated with credit use are foregone. For low-wage households using credit to balance inadequate budgets, credit use may jeopardize future earning capacity and consumption through its adverse effect on the investment of the household. This adverse effect is not peculiar to low-wage households, however. Glassman (1996) identifies that credit fosters a “buy now, pay later” mentality (p.53). Given this, all households are vulnerable to purchase of

consumption-postponables in preference to making income-enhancing investments. Where this substitution takes place, efficiency benefits cited by Neufeld (1966) are diminished as credit is reallocated from productive investment to less productive consumption-postponable uses.

By fostering a 'buy now, pay later' mentality, Glassman (1996) also argues that credit availability reduces the need to 'save for a rainy day'. Contrasting to Cote's (1992) view that credit availability allows for a more productive use of personal savings and borrowings, Glassman suggests that credit availability serves as a crutch in reducing the necessity of saving. This suggestion is supported by Rowlingston and Kempson's (1994) finding that the availability of credit contributes to consumer peace of mind. Summarised by the Ministry of Consumer Affairs in New Zealand (1988), "the use and availability of credit can lull people into a false sense of security" (p.54).

The false sense of security encouraging credit usage, combined with widespread and increasing credit availability, has contributed to the overcommitment of many credit users. Overcommitment is defined by the Ministry of Consumer Affairs (1988) as the stage at which "consumers are unable to repay the debts that they owe" (p.54). While an all-encompassing and accurate measure of overcommitment is unavailable, statistics on the use of budget advice and the level of outstanding credit card debt give some indication regarding the extent of the overcommitment problem. In New Zealand, like overseas, these figures reflect a dramatic increase in recent years. In addition, bankruptcy statistics, providing insight into the frequency of severely overcommitted debtors, reflect similar growth.

2.1 Profile of Debtors

Household Age

The lifecycle model of saving and consumption holds that credit use is essentially negative savings in response to an optimal lifecycle plan (Modigliani and Brumberg, 1954). Individuals incur credit to fund family formation and asset purchases, repaying later in the lifecycle. As a result, younger households with dependent children are

expected to have higher credit commitments and therefore face a greater risk of overcommitment.

Various studies support the prediction that younger households have higher debt levels. Livingstone and Lunt (1992) and Kubinski (1974) state that people in debt are younger, and Sullivan (1982) and Kempson (1995) identify that problematic debt is featured most often among 25-34 year olds. Indeed, Kempson (1995) found 39% of their budget advice client sample fell within this range. Although Canner and Lockett (1991) found no statistically significant relationship between payment problems and household age when simultaneously considering factors which contribute to debt problems, they identify that under 35's were four times as likely to report payment problems than over 55's.

Younger households are associated with higher debt levels, however the very young have few debts. Cameron and Golby (1991a) found that those under 25 had half the debt levels of the rest of the sample and Kempson (1995) notes less representation of people under 25 or over 55 in her budget advice survey. The absence of the latter is further supported by Canner and Lockett (1991) who found that debt levels began to decline at 54 years.

Marital Status

Dessart and Kuylen (1986), Sullivan (1982), and Canner and Lockett (1991) found that the separated, divorced or widowed featured disproportionately in experiencing problematic debt situations. Tokunaga's (1993) analysis of credit card debt found the divorced marital status was 11.2% more common among the problem debt group compared to the control group. Further, over 46% of households with payment difficulties in Canner and Lockett's (1991) survey were headed by people who were separated or divorced. Indication as to how this proportion compared with the general population, however, was not provided.

Education

Coinciding with the low-skilled and semi-skilled nature of employment characteristic of debtors, Kubinski (1974) identifies a low stock of human capital and minimal education

among heavily indebted households. Indeed, Kubinski (1974) acknowledges the importance of the level of education in distinguishing heavily indebted households. Dessart and Kuylen (1986), though recognising the importance of knowledge, argue that higher level education in itself will not always lead to adequate financial management. They identify a non-linear relationship between the probability of problematic debt and the level of knowledge whereby those with very low and very high levels of knowledge experience low probabilities of debt problems. Those with moderate knowledge and confidence in their understanding are identified as having a greater risk of problematic debt as they are less willing to seek assistance. As such, the latter group is vulnerable to financial problems.

The level of education held by individuals experiencing problematic debt is determined by Sullivan (1982), Canner and Lockett (1991), and Tokunaga (1993). Sullivan's (1982) sample consists mainly of debtors with high school education, and in Canner and Lockett's (1991) study the largest group of debtors were those who had completed high school or had some college education. Tokunaga's (1993) research into the educational profile of credit card users found that most users had attended or completed college.

Gender

Shuchman (1983) identifies a "substantial, perhaps even dramatic, increase in the number of separate female bankrupts within the past decade" (p.289). Female filers account for 40% of the 645 single filers in the Consumer Bankruptcy Project (Sullivan et al., 1989); this is equivalent to 17% of the overall sample. Tokunaga's (1993) sample was 67% female and Lea, Webley, and Walker (1995) indicate that debtors were more likely to be women.

Psychological Profile

Dessart and Kuylen (1986) state that the most discriminating personality factor in identifying problematic debtors is an external locus of control. Though the locus of control was not significantly different between the 'no debt', 'mild debt', and 'serious debt' categories in Lea et al.'s (1995) study, Tokunaga (1993) found that people experiencing credit card problems were more likely to have a lower internal locus of

control. Low levels of self efficacy, the view of money as a source of power and prestige, less concern for the retention of money, and less awareness of financial matters are other psychological factors corresponding to credit card debtors identified in Tokunaga's (1993) research. Contrary to earlier research², Tokunaga (1993) also found the problem-credit group to be more risk averse compared to the control group.

Dessart and Kuylen's (1986) research supports Tokunaga's (1993) finding that debtors are characterised by less awareness of financial matters. When identifying discriminating factors of those in problematic debt situations, Dessart and Kuylen (1986) found that details regarding terms of credit, reliability of financial institution, and the interest rate were considered unimportant by problem debtors. In addition, Dessart and Kuylen (1986) identify a past or future, rather than a present, orientation and an unwillingness to defer satisfaction among problem debtors.

Lea et al. (1995) found debtors are characterised by short time horizons. Debtors are found to be more likely to miss appointments, to rate themselves as poor money managers, to describe their parents financial situation as positive, and to expect understanding from both friends and family for their financial predicament. Further, Lea et al. (1995) state that debtors are more likely to own less than their reference group of friends and family, and are generally discontented by this. This latter finding underlies Fortin's (1966) assertion that consumer credit enables the individual to temporarily emulate the living standards of rich households. Where individuals are dissatisfied compared to a reference group of wealthier households, consumer credit may bridge the gap. Restricting credit therefore forces the poor to remain poor.

Number of Dependents

The lifecycle hypothesis holds that individuals incur debts earlier in life to fund family formation. Berthoud and Kempson (1992) and Tokunaga (1993) found that families with children are more likely to be indebted and Kubinski (1974) identifies the importance of dependents in distinguishing heavily indebted households. Forty-four percent of clients were couples with children and 14% lone-parents in a survey of

² See: Adcock et al. (1977); Canner, G.B., & Cynrak, A.W. (1986); Hirschman, E.C., & Goldstucker, J.L. (1978).

budget advice clients in England. By comparison, 41% of the survey had no dependents (Ford, 1992). In New Zealand, Wilson, Houghton, and Piper's (1995) research into budget advice clients found 56% of wage earners seeking assistance were two-parent families and 49.2% of beneficiaries were lone-parent families.

Income

Various research supports a negative relationship between income and debt levels³. The lowest two income groups were twice as likely to have been late or missed a scheduled payment compared to the highest income group in Canner and Luckett's (1991) study. Further, Sullivan et al. (1989) found incomes of bankrupts were one third lower than the average American. The Ministry of Consumer Affairs in New Zealand (1988) identifies people in problematic debt situations as low-income employees or beneficiaries. Wilson et al.'s (1995) finding that 74% of budget advice clients are beneficiaries, and Sullivan's (1982) and Kubinski's (1974) finding that problematic debt occurs among semi-skilled and unskilled workers also supports the Ministry of Consumer Affairs (1988) assertion.

Most literature supports a negative relationship between debt and income levels, however Canner, Kennickell, and Luckett (1995) suggest that low-income households are less likely to have debt of any type. In addition, Cameron and Golby (1990, 1991b) found that when low income was given as a reason for the existence of a debt crisis, lower overall indebtedness was statistically significant. Cameron and Golby (1991a) also found overcommitment increased with income. Since Cameron and Golby (1990) defined overcommitment as "excessive borrowing at the vector of interest rates, earnings growth etc." (p.244), the vagueness of 'excessive' brings this finding into question.

Debt-Income Ratio

Income or debt in isolation do not provide indication of debtor's ability to service a loan. A debtor with a \$5,000 debt may easily repay on an income of \$2000 per month. By contrast, an \$800 debt may be crippling for the \$200 per week beneficiary. The

³ See: Lea et al. (1995); Canadian Welfare Council. (1970); Dessart, W.C., & Kuylen, A.A.A. (1986); Fortin, G., & Tremblay, M. (1964); Berthoud, R., & Kempson, E. (1992).

debt-income ratio, though a deficient measure of debt burden⁴, provides indication of the proportion of income committed to debt repayment. The consumer installment debt-income ratio for all households in the United States averaged 20% in 1983; just over 2 months of each American's annual income was committed to debt repayment (Sullivan et al., 1989).

To determine the debt-income ratio of Consumer Bankruptcy Survey debtors, Sullivan et al. (1989) divided each debtor's reported debt by their reported annual income. For all debts, an average ratio of 3.2 was achieved. For consumer debt only, an average of just under 2 years income was owing in debt repayment.

Types of Debt

Berthoud and Kempson (1992) identify debts on household bills as being more significant than consumer credit arrears. By contrast, Kempson (1995) found a disproportionate number of budget advice clients had difficulty in repaying consumer credit arrears. The Canadian Welfare Council (1970) report repayment of bills as the third most common reason for borrowing, however over 25% of monthly disposable income was also devoted to debt repayment (pp.94, 98, 99-104). It appears, therefore, that household bills and consumer credit arrears are both significant in causing problematic debt situations.

Dessart and Kuylen (1986), Berthoud and Kempson (1992) and Kempson (1995) identify the number of commitments is positively correlated with the level of debt. In Ford's (1992) study, the number of budget advice clients with one creditor is greatly underrepresented while those with over four commitments are over-represented. Berthoud and Kempson (1992) state, however, that the risk of an additional debt is reduced at higher levels of commitment, and in their credit card survey, Tokunaga (1993) surprisingly found that those with problematic debt used fewer sources of credit compared to the control group.

⁴ Refer to Canner, G., & Lockett, C. (1991) for caveats in the use of the debt-income ratio.

Fortin and Tremblay (1964) identify that the bulk of consumer goods purchased on credit are consumption postponables. Furniture and cars are the first and second reasons for borrowing in the Canadian Welfare Council's (1970) survey. Car or motorcycle, household appliances, and electrical leisure goods account for 66% of one-off advances in the Policy Studies Institute (PSI) survey⁵ (Berthoud and Kempson, 1992). Canner and Luckett's (1991) survey of consumers found that 3% of households had mortgage debt exclusively, 45% had consumer credit only, and 38% had both.

Wealth

Canner et al. (1995) argue that when households acquire debts while accumulating assets the ability to liquidate the assets mitigates the burden of debt. While many studies focus on the flow rather than the stock of financial resources, Sullivan et al. (1989) attempt to attain a measure of the net worth of their sample of bankrupts. Defining net worth as homes, cash, savings, stocks, investments, and similar assets, less liabilities, Sullivan et al. (1989) found three-quarters of bankrupt debtors had a net worth of less than zero while only one-third of the general population in the United States had a net worth less than \$5,000.

2.2 Reasons for Problematic Debt

The Ministry of Consumer Affairs (1988) identifies two explanations for overcommitment. First, individuals accept credit they could never hope to repay, and second, unanticipated changes influence the individual's ability to repay.

2.2.1 Accepting Credit without Capacity to Repay

Current Consumption Preference

The historical criminal flavour of bankruptcy legislation reflects the traditional view that debtors willingly and intentionally accept credit with no means to repay. Indeed, the opening sentences of England's earliest bankruptcy legislation makes reference to persons 'craftily' obtaining other men's goods and fleeing with no intention of repaying

⁵ Eight percent of one-off advances were to make ends meet.

their creditors (Burton, 1959). Though bankruptcy legislation has altered worldwide such that bankrupts are no longer viewed and punished as quasi-criminals, Burton (1959) states that New Zealand bankruptcy statutes have “always retained the criminal idea” (p.2). Belief that individuals are willingly and intentionally receiving credit they are unable to repay is further evident in bankruptcy debate throughout America. Sullivan et al. (1989) identify that a “deep-seated suspicion that bankruptcy petitioners are not the needy of America, but instead are clever manipulators...” permeates bankruptcy discussions (p.191).

The view that debtors are willingly and intentionally overcommitting themselves is widespread, yet bankruptcy abuse research undertaken by Sullivan et al. (1989) suggests that minimal debtors may fall in this category. Since bankruptcy is the only option for debtors which provides discharge and therefore the incentive to accumulate debt without means of repayment, Sullivan et al.'s (1989) findings suggest debtors in general do not willingly and intentionally accumulate debts.

Rather than willing and intentional accumulation in response to economic stimuli, various authors suggest overcommitment resulting from acceptance of credit without means of repayment is involuntary or unintentional. In identifying relationships between credit card possession and spending patterns, Hirschman (1979), Deshpande and Krishnan (1980) and Feinberg (1986) illustrate unintended accumulation of debt: Hirschman (1979) found a positive relation between the number of credit cards owned and the frequency and value of purchases, Deshpande and Krishnan (1980) found that card possession was associated with the purchase of higher priced items, and Feinberg (1986) found that exposure to a credit card sign when making spending decisions encouraged greater willingness to spend, with less deliberation over price. These studies suggest debt accumulation may be an unconscious reaction, rather than an intentional action.

Another factor supporting this hypothesis is identified by Cameron and Golby (1990, 1991a, 1991b). Cameron and Golby (1990, 1991a, 1991b) suggest that a process of filtering, whereby individual's screen unwanted information, influences the individual's volume of debt. Cognitive dissonance is defined as the cost in terms of reconciliation

when individual's hold beliefs conflicting with their environment (Cameron and Golby, 1991b). As acknowledgment that the environment is contrary to beliefs is considered unpleasant, individuals may seek to avoid this reconciliation. Where this is the case, information that confirms the wished-for belief is favoured regardless of whether it is contradicted by reality. In the case of debt, this may involve screening the risk associated with the individual's earning stream or screening projected upswings in the interest rate such that the individual could continue to feel at ease with their high spending levels (Cameron and Golby, 1990). While the extent of this selective exposure is difficult to quantify, qualitative evidence supports its existence. Citizens Advice Bureau (CAB) counselors report incidences whereby "individuals shut their eyes to their predicament to the extent of not opening bills which arrive" (Cameron and Golby, 1991b, p.312). They state that "these are frequently hidden away in a drawer until the debtor finally admits that a problem exists" (ibid., p.312). Rather than intentional, the accumulation of debt where individuals can not repay may be unintentional, resulting from unconscious screening of unwanted information.

Tokunaga's (1993) research into the psychological theory of addiction suggests a further way in which individual's unintentionally accumulate debt. Tokunaga (1993) found resemblance between his survey subjects and addicts when using variables identified in literature as distinguishing between addicts and non-addicts. Uncertainty as to whether these factors of low self-esteem, self efficacy and the external locus of control were a cause or effect of the debt problem limits these findings, however Tokunaga's (1993) research identifies the possibility that people with credit-related problems may be addicted and therefore involuntarily accumulating debt they can not repay.

A further factor in explaining the unintentional accumulation of debt where repayment can not be achieved is identified by Dessart and Kuylen (1986) and Tokunaga (1993). The economic model assumes perfect information and perfect knowledge. These studies, however, suggest lack of understanding regarding credit terms and interest rates contribute to debt problems. Dessart and Kuylen (1986) identify problems mostly occur among borrowers with moderate knowledge who overestimate their understanding and hence do not seek further information and advice. Tokunaga's

(1993) findings indicate that those experiencing problems with credit may fail to understand the mathematics behind interest. As the Ministry of Consumer Affairs (1988) states that “the issues surrounding credit are complex and not always well understood by consumers”. (p.1), the accumulation of debt where repayment can not be made may be unintentional, arising from lack of information or understanding.

Inadequate Income

A final cause of involuntary debt accumulation is identified by Fortin and Tremblay (1964) and the Canadian Welfare Council (1970). Both studies suggest that involuntary accumulation of credit arises as a result of income insufficiency.

“A part of future income is used to satisfy immediate needs. But since future income is already too low to satisfy future needs the gap will increase - and therefore also the need for increased amounts of credit. It is a kind of vicious circle”.

(Fortin, 1966, p.32)

This vicious circle is further illustrated in the Canadian Welfare Council’s (1970) finding that payment of accumulated bills is the third most common reason for borrowing in their sample of 235 low-income families. Among the heavily indebted households, fifty percent borrowed to repay accumulated bills (pp.94, 98, 99-104). The Canadian Welfare Council (1970) states that “with such limited income it becomes virtually impossible for a family to avoid falling into a state of chronic indebtedness” (p.87). In identifying this, the accumulation of debt without means of repayment may be involuntary.

2.2.2 Unexpected Change in Circumstances

The first explanation provided by the Ministry of Consumer Affairs (1988) in explaining overcommitment involved individuals accepting credit they could never hope to repay. By contrast, in the second case the individual is able to meet repayments at the time of taking on the debt. The experience of an unanticipated change in circumstances is the cause of overcommitment, affecting the individual’s ability to meet formerly manageable

repayments. Much literature has sought to determine the reasons for the existence of problematic debts, and the importance of unanticipated events has been identified. Cameron and Golby (1991b) conclude that exogenous shocks have significant affects on the level of debt in their CAB survey, and Tokunaga (1993) notes that the presence of adverse life events is significant in differentiating between his problem-debt and control group of credit card users.

The significance of a particular unanticipated event varies between studies, yet health and employment related changes consistently feature in explanation of problematic debt. In the Consumer Bankruptcy Survey, 1502 debtors accounted for \$US1.4 million in medical debts. Among the 778 reporting a medical debt, the ratio of medical debt to income was 0.2, in excess of two months income was committed to medical debt repayment. (Sullivan et al., 1989, p.170-169). Stanley and Girth (1971) identify health problems as the second most important underlying cause of debt, and 6% of participants in Canner and Luckett's (1991) survey experience medical related problems. Shuchman (1983), Sullivan (1982), Brimmer (1981), and Cameron and Golby (1991a, 1991b) also identify the importance of medical expenses in contributing to debt-problems, while Cameron and Golby (1990) differentiate between individuals identifying medical-related problems as the direct cause of their debt problems, and those who experienced unemployment as a result of their health problems⁶.

Various authors identify employment related shocks as a cause of debt-problems⁷. Indeed, strikes, layoffs and loss of overtime combine to be the third most important reason in causing bankruptcy among the 400 interviewees in Stanley and Girth's (1971) study. Loss of jobs, unemployment or loss of hours account for 24% of explanations for debt in Canner and Luckett's (1991) study, and Ford (1988) identifies, "at least 40% of defaulters at the judicial stage could not pay because they had lost income from labour-market-related changes" (p.60).

⁶ Those in the latter group had substantially less debt than the former group. This is explained by the fact that the latter group are less likely to be extended credit in the first instance.

⁷ See: Stanley, D.T., & Girth, M. (1971); Canner, G., & Luckett, C. (1991); Cameron, G., & Golby, D. (1990, 1991a, 1991b); Brimmer, A.F. (1981); Sullivan, A.C (1982); Ford, J. (1988).

Though Ford (1988) did not differentiate between employment and loss of income in explaining the overcommitment of individuals, a number of studies have singled out loss of income as a separate variable in explaining problematic debt. In 13% of cases studies by Mathews (1969) and 26% in the Policy Studies Institute Report, loss of income featured as explanation for current debt problems (Berthoud and Kempson, 1992). Further, Cameron and Golby (1991b) found a significant positive correlation between loss of income and debt arrears in 1988. Though not statistically significant in 1989, their previous studies support a positive relationship⁸.

Only two variables feature a significant positive relationship with debt arrears in both 1988 and 1989 in Cameron and Golby's (1991b) study. Business failure was one of these variables. This finding corresponds to Cameron and Golby's (1990, 1991a) earlier studies which support a positive relationship between business failure and debt levels.

In addition to examining the relationship between business failure and the level of debt, research has sought to identify the relationship between marital failure and debt levels. While Cameron and Golby (1990, 1991a, 1991b) fail to find a statistically significant relation between relationship breakdown, marital status and the extent of debt problems, marital difficulties were among the most frequently mentioned reasons for bankruptcy in both Sullivan's (1982) study and the Brimmer (1981) study. Further, in Canner and Lockett's (1991) survey of debtors with payment difficulties, 31 of the 58 debtors listing difficulties with either mortgage or consumer debt were divorced, separated or widowed (p.225). Finally, Lockett (1988) found the rise in consumer bankruptcy has coincided with an increased divorce rate.

A final demographic factor associated with problematic debt is the number and age of dependents. As previously identified, families with children are more likely to be indebted. Stanley and Girth (1971) found, however, that babies were considered an important factor underlying the bankruptcy decision of 400 former bankrupts.

⁸ Cameron, G., & Golby, D. (1990, 1991a)

The Ministry of Consumer Affairs (1988) cites unexpected change in circumstances as a reason for individual's becoming overcommitted. Shocks to health, employment, income, business, or family life may create a situation whereby the individual is unable to meet their debts as they fall due. Since these unanticipated events may cause overcommitment in isolation, in combination overcommitment may be intensified. The importance of considering unanticipated events in combination is supported by Doling, Ford, and Stafford (1988). In addition, Ford (1988) states, "empirical accounts of defaulting and defaulters clearly now need to focus on interactions" (p.60). In doing this, Tokunaga (1993) found a significant difference between the problematic-debt and control groups in terms of the number of events in the last 12 months⁹.

The Ministry of Consumer Affairs (1988) holds that overcommitment results from individuals accepting credit they could never hope to repay or experiencing a change in circumstances that jeopardizes ability to repay. Instead of mutually exclusive, however, Tokunaga (1993) and Sullivan et al. (1989) state both explanations combine to cause overcommitment. Literature on credit use and policy making debates tend to portray people with credit problems as either unfortunate recipients of an adverse life event, poverty stricken and chronically unemployed, or a willing and intentional abuser of financial obligations. Tokunaga (1993) and Sullivan et al. (1989) found neither of these stereotypes describe the 1980's debtor. According to Tokunaga (1993), "The truth....appears to lie somewhere in the middle" (p.310)

2.3 Alternatives for Problem Debtors

Overcommitment arises when individuals accept credit they could never hope to repay or experience an unanticipated event jeopardising their ability to meet formerly manageable payments. In reaction to overcommitment, debtors have the option of going bankrupt or repaying their debt.

⁹ This difference was significant at the 95% level.

2.3.1 Bankruptcy

Recent decades have witnessed phenomenal growth in bankruptcy as a response to overcommitment. This growth in bankruptcy filing has coincided with increased debtor orientation in bankruptcy law. It appears that individuals have responded to economic incentives, yet Canner and Lockett (1991) identify that two factors impact bankruptcy filing. An increase in bankruptcy filing may be due to increased willingness to respond to overcommitment using bankruptcy or to an increase in the number of overcommitted individuals per se. Since evidence of the latter has also been observed over past decades, the increase in filing does not necessarily support the economic model which holds that people react to incentives in choosing between alternatives.

Whether the increase in bankruptcy filing results from greater willingness to respond with bankruptcy or an increasingly indebted population, high costs associated with bankruptcy cause bankruptcy growth to be a concern. Canner and Lockett (1991) and Lockett (1988) identify costs to the macroeconomy through constraining consumption and provoking a reduction in credit supply, and Weston (1977) refers to social costs as resources are devoted to conduct credit checks, monitor loans, and provide services required by the bankruptcy system. Lockett (1988) identifies distributional costs through transferring resources from borrowers to bankrupts, and Canner and Lockett (1991) state that “debt repayment problems can impair the profitability of lending institutions by generating higher loan-loss provisions and collection costs” (p.218). Finally, Lockett (1988) and Stokes (1995) highlight the significant personal and social ramifications with a bankruptcy declaration.

“The emotional effects of filing bankruptcy have been equated to losing a loved one. The moral obligation to pay one’s debts is a strong one, and the shame of being unable to do so exacts a high personal toll. Individuals report losing friends and business associates as a result of filing bankruptcy. Others try to keep it a secret, even from family members, thus creating the additional stress of deception”.

(Stokes, 1995, p. 4)

High costs associated with bankruptcy in themselves are a deterrent to bankruptcy use. Combined with evidence of refile implying bankrupts are not rehabilitated, the appropriateness of bankruptcy may be further questioned¹⁰. Staten (1991) identifies that 16.2% of his sample of filers had received a new line of credit within a year of filing, and within 5 years of filing for bankruptcy 53.5% had received new credit¹¹. Of those credit lines granted within a year of filing, Staten (1991) establishes that 40.7% may be termed 'bad' files. The evidence that bankruptcy fails to rehabilitate debtors, combined with high costs associated with bankruptcy, has encouraged legislators, creditors, and debtors alike to seek an alternative means to deal with problematic debt situations. A movement towards repayment plans as an alternative to bankruptcy has resulted.

2.3.2 Repayment of Debt

Budget Advice¹²

Budget advisory services aim to assist families in the development of money management skills to equip them to handle their own finances. Based on the premise that consumers will be better off avoiding bankruptcy (Wallace, 1990), these services establish plans by which debtors are able to repay their debts over time. Legally they have no authority to restrict creditor action, yet these services are often effective in negotiating with creditors on the client's behalf: freezing interest, reducing debt, or extending the duration over which the debt is to be repaid.

While creditors are not required by law to adhere to the requests of budget advice services, Daly (1993) identifies that it is generally in an unsecured creditor's interests to do so. According to Daly (1993), self interest rather than altruism drives the counseling boom. In 95% of liquidation bankruptcies unsecured creditors receive nothing. This compares to Consumer Credit Counseling Service (CCCS) repayment plans where 60% of debts are eventually repaid. As well as securing higher repayment than available

¹⁰ See: Donovan, J.T. (1995); Sullivan et al. (1989); and Stanley, D.T., & Girth, M. (1971) for information regarding refile.

¹¹ Evidence that filers receive credit soon after their bankruptcy is not surprising. Since the bankrupt is prohibited by law to reapply for bankruptcy within 6 years, Sullivan, A.C., & Worden, D.D. (1991/2) state that "giving recently bankrupt cardholders new credit lines may not be a bad strategy" (p.33).

¹² For this research, the term budget advice is considered synonymous with money advice and credit counseling services.

under bankruptcy, budget advice services are also found to achieve higher repayment than in the absence of budget advisor intervention (Hinton and Berthoud, 1988; Mannion 1992).

Though adherence to the plan is purely voluntary, continued assistance generally requires a client's dedication to their debt repayment program. In the absence of this dedication, budget advice services and the associated creditor benefits, may be withdrawn and the client forced to fend for themselves.

Budget Advice Repayment Plan: Success

Berthoud and Kempson (1992) found that while 60% of people with debt problems sought no advice at all, only one in twenty managed to sort things out with their creditors (p.175). Research undertaken by Hinton and Berthoud (1987) suggests debtors fail to recognize they are in the process of negotiation. For debtors making use of budget advice services, 50% received assistance in creditor negotiation (Berthoud and Kempson, 1992). Indeed, creditor negotiation resulted in debt repayment being the greatest cause of expenditure reduction in Wilson et al.'s (1995) analysis of New Zealand budget advice clients. Budget advice services are therefore successful in securing increased creditor responsiveness in negotiation relative to results achieved independent of the services.

In addition to negotiation and reduction of debts owed by clients, budget advice services attempt to improve a client's financial situation through ensuring that benefit entitlements are being received, encouraging additional employment to be sought, or suggesting a boarder be taken in. Wilson et al. (1995) identifies that a substantial proportion of change in weekly surplus resulting from budget advice service assistance derives from increased income. Indeed, after 3 months average weekly income had increased for all clients, ranging from an average increase of \$44 for a two adult family with dependents, to an average increase of \$14 for a one adult household with dependents.

Combined with expenditure reduction, increased income assisted in establishing a break-even situation or enabling larger debt repayment for the majority of Wilson et

al.'s (1995) sample. Wilson et al. (1995) also identified of those who completed an initial budget worksheet, two-third's had developed a workable budget within 3 months. Finally, Wilson et al.'s (1995) analysis reveal reduced indebtedness as a result of budget advice assistance.

Wilson et al.'s (1995) findings paint a positive picture of budget advice services. The value of this snapshot analysis is limited, however. Hinton and Berthoud (1988), Mannion (1992), and Jones, Wainwright, and Doling (1993) reveal that the client's initial enthusiasm in budget advice assistance begins to wane after 6-9 months. Also, while workable budgets may be achieved by budget advice services, Jones et al. (1993) found some of their sample's schedules stretched beyond the client's lifetime. Nonetheless, Kempson (1995) identified that budget advice clients kept up their payments more frequently than those who had not sought advice.

Like Wilson et al.'s (1995) study, most studies focus on clients at the outset of their budget advice process. The aim of budget advice, however, is to "help families find security in handling their own financial affairs through the development of good money management skills" (NZFFBS, 1997a). The effectiveness of budget advice should therefore be measured by reduction in probability of future problems.

CCCS branch in Great Denver reports that less than one percent of clients return to their service for additional counseling (Anonymous, 1988). The extent to which clients seek alternative assistance, struggle alone, or go directly to bankruptcy, however, is undetermined. Since problematic debtors change accommodation frequently, clients may employ the services of CCCS in other regions. Finally, by excluding clients categorised as unable to be assisted, this is an inadequate measure of rehabilitative effectiveness of budget advice.

Wilson et al.'s (1995) sample of budget advice clients identifies that 25% of beneficiaries and 20% of wage earners had previously used budget advice services. These services, however, may have been employed for immediate intervention rescue/crisis assistance rather than umbrella support. Since the former entails little

education and follow up, a measure of budget advice repayment plan rehabilitation is not attained.

Anecdotal evidence of debtor rehabilitation is varied. Some clients feel budget advice was successful in providing them with the ability to deal with future financial problems. Others, however, form dependency on the service as a result of the intensive intervention approach (Jones et al., 1993). Anecdotal evidence, like minimal quantitative analysis, clearly fails to provide a picture of the long-term effectiveness of this voluntary repayment program.

Court-Administered Repayment Program

In determining predictive characteristics in selection between a Chapter 13 (Ch13) repayment plan and a Chapter 7 (Ch7) liquidation bankruptcy, Sullivan and Worden (1990) identify credit counseling as a substitute for Ch13 for debtors with disposable income, but unable to meet existing contracts. This substitution, however, is dependent on both the availability of these services and the cessation of creditor activities. In the absence of these, a court-administered repayment program may be undertaken to avoid the filing of a liquidation bankruptcy.

Common to United States' Ch13, Canada's proposals, Australia's debt agreement, and New Zealand's Summary Instalment Order is protection from creditor action while outstanding debts are repaid. Given Sullivan and Worden's (1990) findings, where budget advice is available, filing for a court-administered repayment plan in these countries indicates creditor collection activities have not ceased. Logic implies, then, that loss of protection from creditor collection activities would act as a sanction and serve to encourage increased adherence to the plan. The court-administered repayment plan would therefore be expected to receive a higher level of commitment than the budget advice repayment plan.

Court-Administered Repayment Program: Success

The Administration Office of the United States Courts states that approximately 65% of Ch13 applicants fail to complete payments called for under the plan (Donovan, 1995). Though Ch13 petitioners propose to repay only a small percentage of their debts,

Sullivan et al. (1989) found that a substantial number failed in paying the percentage proposed (p.213). Indeed, only 34% of Sullivan's et al.'s (1989) sample of Ch13 cases were categorised in a "still paying" category. Troubled cases accounted for 31% and failures for 32% of their sample. Of those classed as failures, 69% were dismissed and 31% filed for liquidation bankruptcy. Since Sullivan et al.'s (1989) statistics were derived from a snapshot inspection of files prior to the plan's completion, files were categorised according to subjective 'possible' results rather than their actual outcome. These findings are therefore deficient in providing an accurate measure of the rehabilitative effectiveness of the court-administered repayment plan.

The Debtor Rehabilitation and Credit Re-establishment program provides credit management and budgeting skills to Ch13 debtors. In recognising that successful completion of a Ch13 plan requires perseverance and financial control, the program also assists Ch13 filers to re-enter the credit world. Over three years, the program assisted 500 debtors to receive credit. Olson (1993) found less than a 1% default rate was experienced on the 500 loans extended to this group. The extent to which the success of this program can be attributed to successful completion of the Ch13 bankruptcy rather than the provision of credit management and budgeting skills is unknown.

The rehabilitation of debtors is a requisite to long-term avoidance of bankruptcy. Indeed, Tokunaga's (1993) finding that money is viewed as outside the control of people illustrates that anything short of rehabilitation will be ineffective. Measures of the extent to which the court-administered repayment program provides this rehabilitation is undetermined. Instead, measures of the effectiveness of court-administered repayment programs are limited to: an approximation of Ch13 failure lacking both definition or explanation, subjective 'possible' outcomes of Ch13 applications, and a measure of the success of a post-bankruptcy rehabilitation plan. As rehabilitation is fundamental to avoiding future debt problems, a measure of the extent to which the court-administered repayment plan rehabilitates debtors is essential. Through determining the extent to which SIO applicants continue into bankruptcy, this research seeks to gain a measure of the extent to which a court-administered repayment plan rehabilitates debtors.

3. DATA AND METHODS

3.1 Period of Analysis

The New Zealand economy experienced extensive change in the 1980's and early 1990's. The wage-price freeze (1982), the floating of the New Zealand dollar (1985), tax cuts (1988), the Reserve Bank Act 1989 concentration on price stability, benefit cuts (1991), and the Employment Contracts Act 1991 removal or reduction of penal rates, all equate to considerable turbulence in the economy over this period.

Sullivan et al. (1989) indicate that statutory, business cycle, and general changes in the economy influence United States bankruptcy. The period for analysis of the SIO enables the changes in the New Zealand economy to influence the indebtedness of New Zealand consumers. At the same time, the 1991-93 period for analysis enables research to be recent, while allowing an average of five years for an applicant to file for bankruptcy.

3.2 Sampling procedure

A two-stage sampling process was employed to select the SIO files required for the research. A process of random number generation was used to obtain a sample of 30 courts from the population of 67. A letter outlining proposed research and requesting a copy of the 1991-93 register of SIO applicants was sent to each selected court. A letter expressing the support of the Department for Courts Head Office was included to encourage participation, and a closing date was specified to elicit a timely response.

Courts opting not to participate in the research, or courts which had no applicants for the 1991-93 period, were asked to communicate promptly so a replacement court could be contacted. Following the closing date, courts that had not responded were approached and asked whether they were intending to participate. In total, 39 courts

were approached, 23 of which had applicants for the period specified and were willing to participate in the research¹³.

After obtaining the SIO register from each participating court, each applicant on the register was numbered. In total, there were 1184 applicants in the 23 courts for the 1991-93 period¹⁴. A process of random number generation was then employed when selecting 175 files from each year. In total, 525 files were selected¹⁵. Courts were then approached with a list of files for which the 'Application by Debtor for a Summary Instalment Order' (Form 3) and the 'Statement of Debtor's Affairs' (Form 4) were required. For three courts, random number generation failed to select any of their SIO applicants and therefore no files were requested.

Courts that had not responded by the closing date were contacted and encouraged to participate. Owing to misplaced files, 462 of the 525 SIO Form 3 and 4 files requested were received. For 40 of the files which could not be located, courts were able to provide the full name of the applicant so a total of 502 applicant names could be matched against the bankruptcy database.

Upon receiving SIO files, applicant names were entered into a spreadsheet in Microsoft Excel (Version 7). Where the name was unclear or an alias was given, variants were also included. In addition, joint applicants for the SIO were entered individually. In total, 642 names were entered into the spreadsheet.

A computer check against the National Bankruptcy Database from 1991 to the present was then conducted by David Cole, Commercial Affairs. The full 'Statement of Affairs for Non-Business Bankrupts' was requested from various branches of Commercial Affairs for SIO applicants that had filed for bankruptcy. Of the 65 files requested, 59 files were provided.

¹³ Four courts opted not to participate in the research due to lack of resources, 11 courts had no applicants for the 1991-93 period, and 1 court had misplaced their register in a recent relocation.

¹⁴ This corresponds to 332 applicants in 1991; 451 in 1992; and 401 in 1993.

¹⁵ The SIO sample size was based upon the sample size employed in other consumer-debtor studies.

3.3 Data and Analysis

Information contained in both SIO and bankruptcy applications were entered into Microsoft Excel (Version 7) spreadsheets. To ensure accuracy in the spreadsheets, the 35,000 data were double-checked against SIO and bankruptcy applications. Monetary figures were adjusted for inflation using Consumer Price Index quarterly data (Statistics New Zealand, 1997). The December 1993 quarter was used as the base quarter.

Conventions were employed to minimise inconsistency in data handling. Details regarding conventions relating to each variable are included in Appendix A. For the spreadsheets as a whole, conventions included using the average where a range of figures were provided and using figures calculated by applicants. Also, where considerable uncertainty in regard to the accuracy of a figure existed or where the figure was illegible, a missing value was entered.

In determining the profile of both SIO and bankruptcy filers, Microsoft Excel worksheet functions and pivot tables were employed. In reporting findings, bracketed N values refer to the number of applicants for which the analysis is conducted and all significance tests for the difference of means are two-tailed.

3.4 Limitations of the data

As with all panel data, SIO and bankruptcy applications are subject to error. Some applications listed creditors with no corresponding level of debt, some had question marks in place of asset, income, or debt values, and some had listed secured debts as unsecured or vice versa. Where possible, conventions were employed to minimise inaccuracy in the files. In terms of the latter, for example, files were altered such that debts were categorised correctly. Details of the conventions are included in Appendix A.

A further limitation of the data is divergence in the level of detail in regard to assets and outgoing. Some applicants were detailed in specifying outgoing, including items such as the weekly contribution to the half-yearly WOF testing (\$15), while others defined

outgoing in terms accommodation, power, phone, and food only. In some cases, even these essentials were excluded, and outgoing was defined as debt repayment commitments. In reaction to the extremes in identifying outgoing, a bundle of essentials, defined as accommodation, food, gas and power costs, was established to enable comparisons among applicants. Unfortunately, no appropriate measure could be compiled to contend with the divergence in detail when specifying assets.

Disparity among debt figures in SIO Form's 3 and 4 reinforce that conclusions must be carefully interpreted. Though conventions are employed to minimise the extent of inaccuracy in the files, inaccuracy still remains. But while the SIO and bankruptcy files are imperfect, they are the sole, and hence best, sources of information for the analysis undertaken in this study.

4. WHO ARE THE APPLICANTS?

Sullivan et al. (1989) identify that bankrupt debtors are a cross-section of Americans rather than an identifiable class. This chapter examines the demographic and financial profile of SIO applicants to determine whether SIO applicants are an identifiable class of New Zealanders.

4.1 Demographic Profile

Gender

The even mix of male and female applications for the SIO differs from Lea et al.'s (1995), Tokunaga's (1993), and Wilson et al.'s (1995) samples where debtors were more likely to be women. Also contrasting with previous literature, joint applications for the SIO constitute a relatively small proportion of total applications. This compares to Wilson et al.'s (1995) finding where 35% of budget advice clients were couples, and Sullivan et al.'s (1989) Consumer Bankruptcy Project in which 57% of filings were joint applications.

Table 4.1: Gender of SIO Applicants

Gender	Male	Female	Couple		N
Percentage	42.1%	45.2%	12.8%		454

Applicant Age

Livingstone and Lunt (1992) and Kubinski (1974) state that people in debt are younger. This assertion corresponds with budget advice and SIO findings, summarised in Table 4.2. Compared to the general population, the 20-39 age bracket are over-represented in terms of budget advice and SIO use.

Sullivan (1982) and Kempson (1995) identify problematic debt is featured most often among 25-34 year olds. Indeed, Kempson found 39% of budget advice clients fell

within this range. In SIO applications, 46% are aged between 25-34 years. While Canner and Luckett (1991) identified under 35 year olds were four times as likely to report payment problems than over 55's, in SIO applications this difference is more substantial¹⁶. The number of applicants under 35 is 19 times greater than the number over 55. One explanation for this considerable difference is the high representation of the very young in SIO applications. While Kempson (1995) identified less representation of under 25's in her budget advice study¹⁷, 17% of SIO applicants were aged in this range.

Table 4.2: Age Distribution

Age Range	SIO Applications (N = 450) (%)	Budget advice ^a (%)	New Zealand Population ^b (%)
15-20	1.1	1.7	11.0
20-29	39.1	32.7	21.0
30-39	36.9	43.6	20.0
40-49	16.0	15.2	16.4
50-59	4.9	4.2	11.5
60+	2.0	2.6	20.1

Source: ^aWilson et al. (1995); ^bDepartment of Statistics (1992).

Marital Status

Single applicants consist of those reporting a single, separated, divorced, widowed, or never-married marital status. Single applicants constitute 60% (N=377) of SIO applicants. The remaining 40% of SIO applicants are either married or in defacto relationship. This same result is reported in Wilson et al.'s (1995) analysis when two-adult households are considered as one couple.

¹⁶ Differences in the age structure of United States, England and New Zealand populations may account for some variance in the proportion of problematic debtors in each age range.

¹⁷ Less than 10% of Kempson's (1995) sample of budget advice clients are under 25.

Dessart and Kuylen (1986), Sullivan (1982) and Canner and Luckett (1991) found the separated, divorced, or widowed featured disproportionately in experiencing problematic debt situations. While the widowed are not over-represented in SIO applications, the divorced and separated do feature disproportionately compared to the general population. Indeed, the proportion that are separated or divorced, at 23% (N=377), is 2.5 times higher in SIO applications than in the general population (Department of Statistics, 1992). This figure is also likely to be understated since later SIO application forms provide applicants with the option of categorising their marital status as single.

Employment Status

The Ministry of Consumer Affairs (1988) in New Zealand identify people in problematic debt situations as beneficiaries or those in low income employment. This assertion corresponds with the information contained in Table 4.3. Approximately half of Kempson's (1995) sample and a quarter of SIO applicants are employed. This finding coincides with Wilson et al.'s (1995) finding that 74% of budget advice clients are beneficiaries, but contrasts with Sullivan et al.'s (1989) Consumer Bankruptcy Project where 83 - 93% of bankrupts were employed at the time of filing.

Table 4.3: Employment Status

Employment Status	SIO Applications (N=427) (%)	Budget Advice ^a (%)
Employee	26.7	49
Beneficiary/Homemaker	72.1	49
Student	1.1	2

Source: ^a Kempson (1995).

Unemployed applicants constitute approximately one-third of the SIO sample and 47% of those not in active employment or education. Domestic Purposes Benefit (DPB) beneficiaries and home-makers combine to account for a further 24% of the sample's employment status. This contrasts with Wilson et al.'s (1995) study in which 36%

reported DPB as the main income source, while 19.3% reported the unemployment benefit. In both studies, however, these two combine to account for over half of the sample's employment status.

Sullivan (1982) and Kubinski (1974) found problematic debt occurred most frequently among semi-skilled and unskilled workers. While occupations in SIO applications range from store-man to manageress¹⁸, one factor the majority of these occupations have in common is they are predominantly unskilled or semi-skilled, and hence have a low wage associated with them. Plant and machinery operators, service and sales employment, and applicants employed in elementary occupations account for 53% of SIO occupations¹⁹. In the 1991 New Zealand Census, only 29% were employed in these occupations (Department of Statistics, 1992).

Number of Dependents

Table 4.4: Number of Dependents

Dependents	SIO Applicants (N=455) (%)	New Zealand Population ^a (%)
0	36.9	49.0
1	21.8	19.6
2	20	19.1
3 ⁺	21.3	12.3

Source: ^a Department of Statistics. (1992)

Various authors have identified that families with children are more likely to be indebted²⁰. In SIO files, families with children are over-represented compared to the

¹⁸ Ironically, a SIO application was made by a debt collector.

¹⁹ Elementary occupations include: building caretakers and cleaners, messengers and door keepers, refuse collectors, packers, freight handlers, labourers, and those employed in occupations unable to be identified. Statistics New Zealand also includes those not reporting any occupation among those in elementary occupations.

²⁰ See: Cameron, G., & Golby, D. (1991); Berthoud, R., & Kempson, E. (1992); and Tokunaga, H. (1993).

general population (Department of Statistics, 1992). In addition, SIO applicants have larger families. The proportion of SIO applicants reporting three or more children in Table 4.4 is 1.7 times higher than the general population.

Accommodation Type

SIO applicants renting their place of accommodation constitute 65% (N=409) of the SIO sample. For the general population, a similar proportion owned their own home in 1991 (Department of Statistics, 1992). Wilson et al. (1995) found 71% of their sample rented, 20% were home owners, and 5% boarded. This is broadly consistent with SIO applications, though a slightly smaller proportion of SIO applicants rent and own their own homes, while a slightly larger proportion board.

4.2 Financial Profile

Indebtedness

Mean total indebtedness of SIO applicants is \$10,600. This value is approximately double the average indebtedness of Wilson et al.'s (1995) money advice clients. Wilson et al. (1995) identified average indebtedness of wage earners as 1.7 times that of beneficiaries. In SIO applications, this difference is more pronounced. Wage-earner applicants have an average total debt which is double that of beneficiary applicants.

While 43% of SIO applicants report a non-zero value for secured debt, 52% of the average total debt listed in the SIO sample is secured. This figure is comparable to Sullivan et al.'s (1989) Consumer Bankruptcy Project findings where mean secured debt accounts for 60% of average total debt for repayment and liquidation bankrupts combined. For those SIO applicants reporting secured debts, the average secured debt is \$12,660; mortgage debt accounting for approximately three-quarters of this value. In the absence of mortgage debt, average secured debt is \$1,400; \$3,300 for those reporting a positive value for secured debt less mortgage debt.

At \$5,100, average unsecured debt accounts for 48% of average total debt listed for the SIO sample. Since two applicants list solely secured debts, average unsecured debt of those reporting unsecured debt is slightly higher than for the overall sample.

Table 4.5: Distribution of Debts.

Distribution	Total Debt	Secured Debt	Unsecured Debt	Credit Card & Charge Card Debt
Mean (All)	\$10,568	\$5,457	\$5,101	\$1,046
Mean (>0)	10,56	12,658	5,124	2,417
Standard Deviation	16,658	15,644	3,651	2,034
Minimum	659	0	0	0
25 th Percentile	3,056	0	2,359	0
Median	5,187	0	4,061	0
75 th Percentile	9,736	1,896	7,259	1,282
Maximum	116,438	109,631	23,840	12,225
N	399	399	456	453

- Mean (All) refers to the mean value for the SIO sample for whom a value could be identified whereas mean (>0) gives a mean value solely for applicants reporting a non-zero value.
- The indebtedness of SIO applicants may be understated as \$82,000 disputed debts pertaining to 36 applicants is excluded.
- Conventions employed in determining the indebtedness of SIO applicants are included in Appendix A.

One of the components of unsecured debt is credit card debt. While the term 'credit card' is often used as a generic term to describe credit cards, charge cards, and store cards, in New Zealand these are distinctly different²¹. The SIO analysis includes both credit and charge cards. Combined, these account for 7% of the total number of debts listed in applications. Charge cards constitute 3.9% of the total number of debts listed in

²¹ A store card extends credit for the purchase of goods and services provided by the store which granted it. A charge card enables an individual to purchase on credit from a collection of participating businesses. Finally, a credit card is an all-purpose card which is not specific to any conglomerate.

applications, and are owned by three-quarters of cardholders. Approximately half of cardholders own solely a charge card (54%).

Ford (1988) found that 17% of total consumer debt outstanding in 1986 was credit card debt. Berthoud and Kempson (1992) found credit card debt constituted 6% of outstanding consumer debt. For SIO applicants, credit card and charge card debt on average account for 14% (N=395) of an applicant's total debt and 20% (N=449) of an applicant's unsecured debt.

As 57% of SIO applicants do not have any outstanding credit card or charge card debt, it follows that credit card and charge card debt constitutes a higher proportion of total and unsecured debts for those reporting this debt. Indeed, for those reporting credit card and charge card debt, these constitute 34% (N=169) and 45% (N=196) of the average debtor's total and unsecured debts respectively. In 15 cases, unsecured debt consists entirely of credit card and charge card debt and in 7 applications total debt is purely credit card and charge card debt.

The total number of debts listed on SIO applications differ from Berthoud and Kempson's (1992) research, but coincide with Ford's (1992) findings. Ford (1992) found that budget advice clients with one creditor were under-represented whereas those with over four debts were over-represented. By contrast, 55% of PSI debtors had one debt and only 12% had four or more (Berthoud and Kempson, 1992). The SIO analysis support Ford's (1992) findings. Only 2.4% (N=453) of debtors have one debt while 86% (N=453) have four or more. Indeed, the total number of debts in SIO applications range from 1-22, with an average of 8.43 debts and a median of 7.

Assets²²

The average value of assets reported by SIO applicants is \$15,700. Over two-thirds of this value may be attributed to investment in housing. The average value of assets less investment in housing is \$4,800; \$5,830 for those reporting assets. Fifteen percent of SIO applicants report zero assets. However, since the value of assets are subjective and

²² Readers are referred to the 'Data and Methods' section for limitations regarding assets reported in SIO applications.

because incentive to under-report these arises from the court's authority to sell assets, applications may understate assets.

Table 4.6: Distribution of Assets for the SIO Sample

Distribution	Assets	Assets-less-House	Debt-Asset Ratio
Mean (All)	\$15,723	\$4,800	5.5
Mean (>0)	18,671	5,827	5.5
Standard Deviation	30,331	8,356	9.9
Minimum	0	0	0.04
25 th Percentile	487	400	0.8
Median	1,948	1,497	2.0
75 th Percentile	10,013	5,166	5.4
Maximum	192,948	51,907	83.2
N	399	397	296

- Mean (All) refers to the mean value for the SIO sample for whom a value could be identified whereas mean (>0) gives a mean value solely for applicants reporting a non zero value.
- Conventions employed in determining the assets of SIO applicants are included in Appendix A.
- For the purpose of analysis, a zero value was entered for a couple reporting no assets aside from two children valued as priceless.

Sullivan et al. (1989) argue that assets and debt must be properly linked to determine the true extent of a debtor's financial situation. Highly indebted individuals may have assets to hedge against financial problems and " 'wealthier' debtors may be those at the bottom, rather than the top of the asset range" (Sullivan et al., 1989, p.67). The debt-asset ratio is calculated to determine the link between assets and debts. Each applicant's debts are divided by total assets, and for the 296 applicants for whom a debt-asset ratio can be determined an average of 5.5 is calculated. That is, reported debts exceed assets by 550%.

A debt-asset ratio of less than one reveals that in terms of their stock of resources, the net worth of the individual is non-negative. In the SIO sample, only 32% of the 296 applicants have a debt-asset ratio less than or equal to one.

Income²³

Just as a measure of net worth is needed for a more balanced view of the burden of debt, a measure of the ability to service the debt is also required. Similar to Wilson et al.’s (1995) analysis, the greatest source of income among SIO applicants is a government-issued benefit. While 70% (N=441) of SIO applicants report benefit income, benefit income only makes a 53% contribution to the sample’s average income. These figures imply that beneficiaries receive lower income.

Table 4.7: Sources of Income for SIO Households

Source of Income	Percentage Reporting (%)	Contribution to sample average income (%)		N
Wage	27.9	32.5		447
Part-time Employment	4.4	1.0		455
Other Income	9.5	3.7		452
Family Benefit	3.9	1.0		456
Other Government Transfer	69.6	53.4		439
Partner Contribution	10.4	8.3		413

- a) Conventions employed in determining the income of SIO applicants are included in Appendix A.
- b) The contribution of each income source to the sample’s average income is determined by summing average SIO income from each income source and determining the proportion attributable to each income source.

In Sullivan et al.’s (1989) analysis, mean income of Ch13 and Ch7 bankrupts was two-thirds the national figure. For SIO filers, however, the difference is more pronounced. The average household income of the SIO sample is less than half the average New Zealand household income received in the year ending March 1992 (Statistics New

²³ Incomes pertaining to two SIO applicants were excluded from the analysis as the applicants reported business, rather than personal, income.

Zealand, 1993). Further, on average SIO applicants receive \$38 less in net-weekly income compared to Wilson et al.'s (1995) budget advice clients²⁴.

In addition to receiving less income, the indebtedness of SIO applicants requires commitment of income to debt repayment. This reduces disposable income even more. After budget advice assistance, average client income less debt repayment was \$289 in Wilson et al.'s (1995) study. For SIO repayment plans, an average of \$241 per week remains after the required repayment is made.

Table 4.8: Average Income of SIO Households

Distribution	Average Income	Average Income less SIO Repayment
Mean (All)	\$272	\$242
Standard Deviation	119	112
Minimum	41	4.9
25 th Percentile	188	161
Median	258	231
75 th Percentile	329	299
Maximum	807	727
N	435	406

- a) Mean (All) refers to the mean value for the SIO sample for whom a value could be identified whereas mean (>0) gives a mean value solely for applicants reporting a non zero value.
- b) Conventions employed in determining the income of SIO applicants are included in Appendix A.
- c) As 15 applicants reported partners but did not respond regarding partner income, average household income may be understated.

As stated, the absolute value of debt in itself does not indicate the financial situation of an individual or household. Through matching debt with the ability to service the debt, the debt-income ratio provides a clearer picture. Table 4.9 reveals the debt-income ratio

²⁴ Wilson et al's (1995) results were converted to December 1993 prices using the Consumer Price Index (Statistics New Zealand, Accessed 1997)

for SIO applicants is substantially lower than bankrupts in Sullivan et al.'s (1989) sample²⁵. On average, just over 9 months of each SIO applicant's income is committed to debt repayment. For 15% (N=377) of the sample, over a year's income is committed to debt repayment.

Because an adequate measure of average indebtedness in New Zealand is not available, comparison of the debt-income ratio to the New Zealand population is not possible. In terms of financial institution debt, the debt-income ratio for the average New Zealand household was 1.03 in 1994²⁶. Approximately 85% of this, however, is attributable to mortgage debt. A better comparison of the debt-income ratio can be calculated from Wilson et al.'s (1995) analysis. As current debt and arrears create an average total indebtedness of \$5200, and as average annual income is \$16,300, then the total debt-income ratio is 0.38. While the average SIO applicant has 9 months of income committed to debt repayment, Wilson's (1995) budget advice clients have on average 4 months of income committed to debt repayment.

Interpretation of the debt-income ratio requires consideration of the caveats to its use²⁷. While one applicant may have 9 months income committed to debt repayment, if this debt is apportioned over time, as is mortgage or some hire purchase debts, then this individual may not be struggling to the extent of an applicant who has 4 months income devoted to debts that need to be paid immediately. Recognising this, Sullivan et al. (1989) eliminated mortgage debts from the analysis and found that short-term debts accounted for approximately 2 years income. Sullivan et al. (1989) also found that unsecured debt alone accounted for one year of the average debtor's annual income. In the SIO analysis, the average debt-income ratio is 0.5 in the absence of housing costs. When considering unsecured debts alone, an average of nearly 5 months income is devoted to debt repayment.

²⁵ Sullivan et al.'s (1989) analysis includes both liquidation and repayment plan bankrupts.

²⁶ The household debt-income ratio was determined by dividing total household debt by total household income. Total household income was calculated by deducting tax from average household weekly income and multiplying by the number of weeks in a year, and the number of households in New Zealand. To calculate income, Statistics New Zealand (1995), Department of Statistics (Accessed 1997), and Statistics New Zealand (Accessed 1997) sources were employed for income, number of households, and tax figures respectively. For total household debt, Monthly Monetary and Credit Aggregates were used (Reserve Bank New Zealand, 1997).

²⁷ See Canner, G., & Lockett, C. (1991) for caveats to debt-income ratio use.

Table 4.9: Debt-Income Ratio

Distribution	Debt-Income Ratio: SIO Applicants.	Unsecured Debt- Income Ratio: SIO Applicants.	Debt-Income Ratio: United States Bankrupts ^a .
Mean (all)	0.8	0.4	3.2
SD	1.1	0.4	10.5
Minimum	0.05	0	-
25 th Percentile	0.2	0.2	0.7
Medium	0.4	0.3	1.4
75 th Percentile	0.7	0.5	2.6
Maximum	7.8	4.7	-
N	377	429	1,241

Source: ^a Sullivan et al. (1989)

- a) Debt-income ratios are determined by dividing applicant debt figures by their average annual income.
- b) Mean (All) refers to the mean value for the SIO sample for whom a value could be identified.
- c) Conventions employed in determining debt and income of SIO applicants are included in Appendix A.
- d) As 15 applicants reported partners but did not respond regarding partner income, average household income may be understated.
- e) The United States bankruptcy debt-income ratio is understated as 47 applicants listing zero income were excluded. United States bankruptcy debt-income ratios include both Ch7 and Ch13 debtors.

Outgoing²⁸

In addition to the flow and stock of resources, the extent to which debt causes a problematic financial situation is dependent on the degree to which income is required for other commitments. Table 4.10 reveals average reported weekly outgoing is \$240, ranging from \$49 - \$730. This figure compares to Wilson et al.'s (1995) budget advice clients with an average of \$330 in weekly outgoing. For the general New Zealand

²⁸ Outgoing pertaining to two SIO applicants were excluded from the analysis as the applicants reported business, rather than personal, outgoing.

population, average weekly household was \$610 in 1991 (Statistics New Zealand, 1992)

Table 4.10: Distribution of Outgoing for SIO Applicants

Distribution	Outgoing	Bundle of Essentials	Rent/Mortgage
Mean (All)	\$238	\$179	\$104
Standard Deviation	111	78	42
Minimum	49	29	18
25 th Percentile	157	117	74
Median	230	184	98
75 th Percentile	294	229	134
Maximum	725	450	245
N	424	306	311

- a) Mean (All) refers to the mean value for the SIO sample for whom a value could be identified.
- b) Conventions employed in determining the outgoing of SIO applicants are included in Appendix A.
- c) The bundle of essentials measures outgoing for food, accommodation, gas and power.

Divergence of detail in reporting outgoing in SIO files limits the validity of comparisons between applicants. While some individual applicants list all household expenses, others only include the bills for which they are responsible. In some cases, basic essentials of food, power and phone are not included but instead weekly commitment to debt repayment is reported. Also, if the applicant wishes to avoid bankruptcy there is incentive for the applicant to understate expenses where income is insufficient to meet the repayment of debt within three years.

In response to the inaccuracy of weekly outgoing, a bundle of essentials is established to enable comparisons to be made. The bundle of essentials is defined as food, power, gas and accommodation costs. Clearly, this is not intended to be an all-encompassing measure of survival expenses.

Bundle of essentials expenses averaged \$196 for Wilson et al.'s (1995) budget advice clients and \$250 for the average New Zealand household in 1991 (Statistics New Zealand, 1992). This compares to SIO applicants whose bundle of essentials averages \$179. On average, SIO bundle of essentials expenses account for 75% (N=305) of total outgoing. Further, 66% (N=292) of the average SIO applicant's income is required for food, accommodation, power and gas expenses alone.

Accommodation expenses constitute the largest proportion of the bundle of essentials, accounting for 54% in Wilson et al.'s (1995) analysis and 51% (N=236) for the SIO analysis. Average accommodation costs were \$106 for Wilson et al.'s (1995) budget advice clients, and \$127 for the average New Zealand household in 1991 (Statistics New Zealand, 1992). For SIO applicants, average accommodation expenditure is \$100. However, as this figure includes 69 applicants who are boarding this is not directly comparable²⁹. In isolating expenditure on accommodation alone by solely considering applicants who rent or own their own home, an average cost of \$104 is found for 340 applicants.

Accommodation costs account for 32% of average total expenditure and 34% of average total income for Wilson et al.'s (1995) budget advice clients. Since both outgoing and income are lower in SIO applications, accommodation costs account for a slightly more substantial proportion of the average SIO applicant's total expenditure and income.

The NZFFBS Chairperson, Raewyn Nielsen, relays an incidence whereby a volunteer budget adviser agreed to assist another client on condition that the client did not own a car. For the SIO sample, the average car maintenance cost accounts for 1.9% of average total debt, and 3.9% of average unsecured debts. For the 28% (N=440) of applicants reporting car maintenance debt, the average debt is \$723 (N=440). The maximum car-maintenance debt reported is \$3350. For this applicant, car maintenance debt accounts for 46% and 49% of total debts and unsecured debts respectively.

²⁹ As boarding may encompass food, power, and phone expenses, this is not purely an accommodation cost.

4.3 Summary

In terms of demographic profile, SIO applicants mostly coincide with the profiles of indebted individuals identified in current literature. Though the even mix of males and females is contrary to research that identifies debtors are more likely to be women, younger applicants correspond with both previous literature and the life-cycle hypothesis. In addition, the finding that the divorced and separated are over-represented, that applicants are largely beneficiaries or in low income employment, and that applicants have, on average, larger families, coincides with prior literature. Finally, applicants mostly reside in rented accommodation.

Financially, SIO applicants are heavily indebted. Unsecured and secured debts make a relatively equal contribution to overall total debt reported for the SIO sample. For 57% of applicants, however, zero secured debts are reported. Credit card and charge card debt constitute 10% of total debt, accounting for 7% of the 3820 debts reported in this SIO sample.

For 15% of applicants, zero assets are reported. Combined with debt figures, this comprises a debt-asset ratio averaging 5.5. Only a third of SIO applicants have a debt-asset ratio of less than one; only one-third of applicants have a positive net worth. The debt-income ratio, however, averages below one. On average, just over 9 months of an applicant's income is committed to debt repayment. Average household income of SIO applicants is less than half the New Zealand average household income received in the year ending March 1992³⁰. For the SIO sample, the majority of this is derived from a government transfer.

The average SIO applicant requires 66% of weekly income for food, accommodation, gas and power expenses. Accommodation expenses constitute a large fraction of this and account for 34% of total outgoing. Compared to the general population, the SIO sample report less commitments in terms of essential expenditure and outgoing.

³⁰ Statistics New Zealand. (1992).

5. REASONS FOR FINANCIAL DIFFICULTY

It is nonsensical to discuss the reasons for bankruptcy or repayment plan usage. The reason is self-evident: Debt (Sullivan et al., 1989). Yet the reasons contributing to financial demise resulting in bankruptcy or repayment plan use may be determined, and it is here the analysis of SIO applicants now focuses.

Employing the traditional micro-economic assumptions: that individuals have preferences between alternative market baskets, that these preferences are consistent and non-contradictory, and that more is preferred to less, a two-period model can be used to graphically illustrate factors contributing to financial difficulty. In this intertemporal model, the individual is able to borrow or lend to achieve their preferred combination of current and future consumption. Consumption choices are constrained, however, by the individual's budget line, the position of which is determined by their initial endowment.

Figure 5.1: Consumption Choice

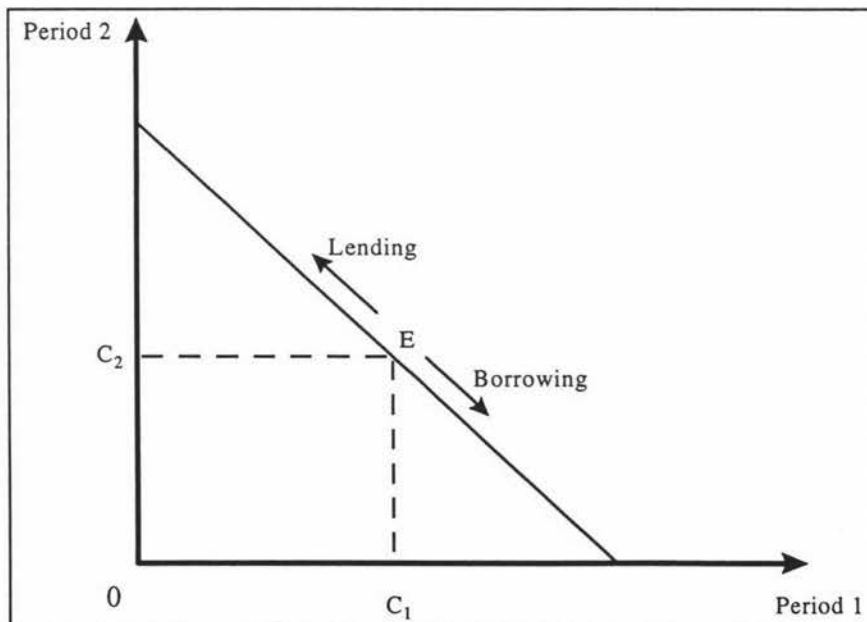


Figure 5.1 illustrates consumption choice graphically. The individual's endowment point at E corresponds with OC_1 consumption in period one and OC_2 consumption in period two. From this endowment point, the individual is able to borrow or lend along their budget line to achieve higher consumption in the current or future periods respectively.

Since a dollar received tomorrow is not equivalent to a dollar received today, there is a rate of interest associated with borrowing and lending activities. If the individual opts to borrow \$X in period one, they must repay \$X with interest in period two. Alternatively, if the individual decides to lend \$X in period one, they receive \$X with interest in period two. Given this, if the individual chooses to consume all of their endowed wealth ($OC_1 + OC_2$) in period one, consuming where the budget line meets the horizontal axis, the individual consumes $W = OC_1 + (OC_2 / (1 + r))$ in period one. That is, the individual receives period one consumption plus period two consumption discounted by the interest rate. Alternatively, if the individual chooses to consume all of their endowed wealth in period two, consuming where the budget line meets the vertical axis, the individual consumes $W = OC_2 + OC_1(1 + r)$ in period two. That is, the individual receives period two consumption and period one consumption plus interest.

While graphically an individual through borrowing or lending may consume any C_1C_2 combination subject to their budget line constraint, in reality points of intersection with the horizontal and vertical axis are infeasible. The assumption of non-negative consumption adopted by Karatzas, Lehoczky, Sethi, and Shreve (1986) in their consumption-investment problem enables combinations whereby consumption in period one and two equate to zero. It is intuitive, however, that a given subsistence level of consumption is required for survival. That is, that:

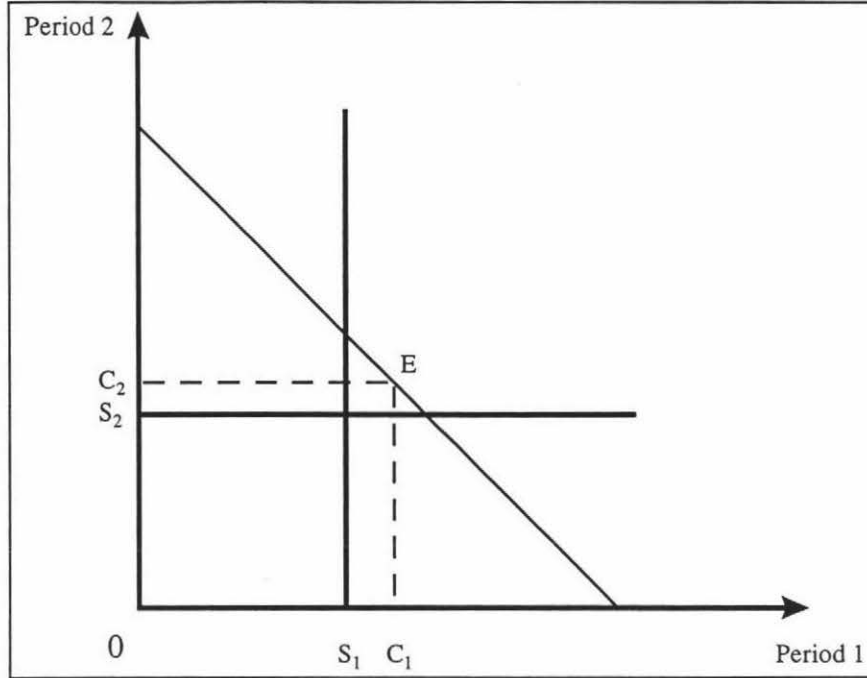
$$\text{Consumption in Period 1} \geq S_1$$

$$\text{Consumption in Period 2} \geq S_2$$

Graphically, consumption is constrained by the vertical and horizontal lines, S_1 and S_2 in Figure 5.2. An individual with a combination of period one and two consumption to the

left of S_1 or below S_2 has insufficient consumption to survive both periods. In the north-eastern quadrant, however, the individual's consumption combinations enable survival.

Figure 5.2: Consumption Choice with Survival Constraints



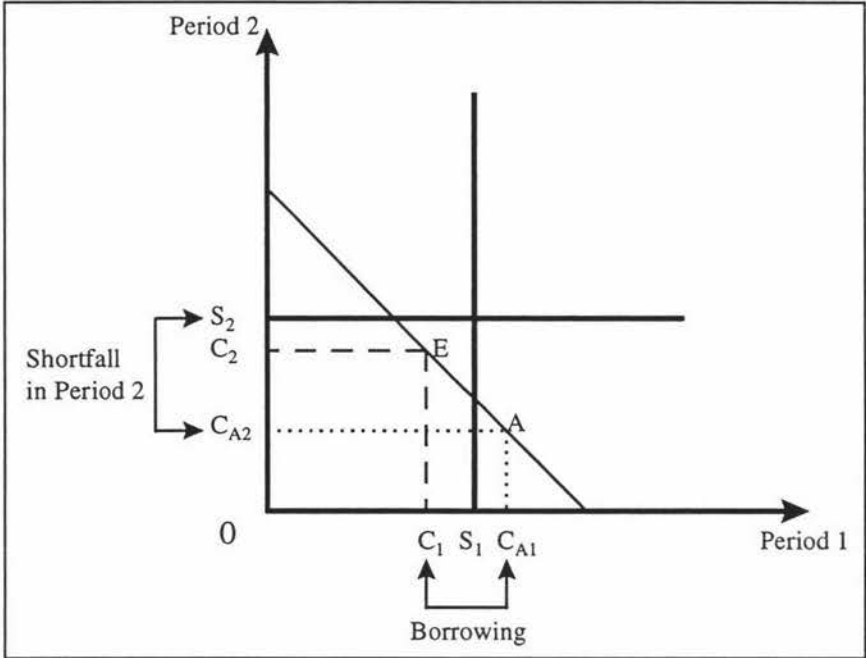
5.1 Inadequate income

Figure 5.3 represents the situation experienced by an individual with inadequate income. As stated, the individual's endowment point influences the position of their budget line. In Figure 5.3, the initial endowment, E , is such that the individual experiences consumption below the subsistence level in both time periods.

Since the individual will clearly be concerned with current survival, the individual will select a consumption combination point between S_1 and the horizontal intercept of the budget line. Assuming the individual's revealed preference is point A , the individual will borrow OC_{A1}, OC_1 to achieve this consumption. In doing so, period one consumption, at OC_{A1} , exceeds S_1 , hence the individual survives period one. In borrowing to achieve this consumption level in period one, however, the shortfall between period two

consumption and S_2 is increased as repayment of OC_{A2} , OC_2 must be made. At consumption level OC_{A2} , the individual is unable to survive period two.

Figure 5.3: Inadequate Income



The applicant's initial endowment, E , determines the position of their budget line. The individual is able to borrow or lend along their budget line to achieve higher consumption in the current (Period 1) or future (Period 2) periods respectively. Survival in both periods, however, requires consumption in the north-eastern quadrant of the survival requirement lines.

Though the Proverb states, "better to go to bed supper-less than to rise in debt", the Canadian Welfare Council (1970) and Berthoud and Kempson (1992) provide evidence that some people do both. Payment of accumulated bills was the third most common reason for borrowing in the Canadian Welfare Council's (1970) sample of 235 low income families, and in Berthoud and Kempson's (1992) research it was found that 8% of one off advances were to make ends meet. Fortin (1966) refers to a vicious cycle whereby future income is required to satisfy immediate needs. If we considered that in each period the individual in Figure 5.1 borrowed to make repayment and to survive in that period, it is clear that more and more income would be devoted to debt repayment, spiraling the individual deeper and deeper into debt.

The New Zealand Federation of Family Budgeting Services (NZFFBS) Chairperson, Raewyn Nielsen (1997), acknowledges income inadequacy among Porirua budget advice clients in New Zealand. Identifying that many clients are struggling to cope with the basics, she states that “most people know how to budget, they just don’t have the money”. Evidence of income inadequacy is also apparent in SIO applications. Lynne Wyman, a long-serving SIO supervisor, cites income insufficiency and rent and power costs as contributing factors towards SIO application (Lynne Wyman, 1997). This assertion corresponds with the finding that average income of SIO households is less than half the average New Zealand household income received in the year ending March 1992 (Statistics New Zealand, 1993). Also, since on average 66% of this income is required for food, accommodation, power and gas expenses alone, it is clear that for some applicants, income inadequacy may have contributed to their financial difficulty. Indeed, this assertion is supported by the finding that 3.0% (N=234) of applicants reporting a reason for application cite rent costs.

To determine the extent to which income inadequacy may have been a contributing cause to financial difficulty for SIO applicants, ‘inadequate income’ applicants are isolated in three ways: by self-reported reasons for the SIO application, by the amount of income received relative to the New Zealand poverty line, and by the amount of income remaining after the bundle of expenses is deducted.

In self-reported reasons for application, many applicants cite insufficient income to meet outgoing as a reason underlying SIO application. Insufficient income to meet outgoing, however, is self-evident in the application for the SIO and is the plight of all SIO applicants. Instead, SIO applicants with inadequate income to meet survival requirements are identified by their reference to low income, either directly or indirectly. In terms of the latter, applicants reporting their reason for application as “I only get a benefit” are considered to be implying that low income is the cause of their difficulty. Of the 234 applicants reporting a reason for application, 34 state directly or indirectly that they have inadequate income (14.5%). In terms of the whole sample, 7% (N=462) report inadequate income as a reason for their application.

Since 50% of applicants fail to report a reason for their SIO application, self-reported reasons for application will clearly understate the number of 'inadequate income' applicants. A second means of identifying 'inadequate income' applicants for this research is through analysing applicant incomes directly. 'Inadequate income' is defined as income which lies beneath the poverty level as outlined by Waldegrave, Stephens, and Frater (1995). Waldegrave et al. (1995) define the poverty line as 60% of median, equivalent, household income. Since the median income of New Zealand households was not available for this analysis, mean household income in 1991 is employed³¹. In 85% (N=333) of applications, the equivalent income of the applicant is less than the \$353 poverty line³².

While the second means of identifying 'inadequate income' SIO applicants focuses on the absolute income of applicant's, a further way of identifying applicants who have inadequate income to meet survival requirements is through considering their income relative to their commitments³³. Though 15% (N=405) of applicants list outgoing in excess of income, outgoing may include repayment of debts for items not essential to survival. As such, this does not provide a measure of income inadequacy.

The bundle of essentials consists of accommodation, food, gas and power expenses. On average this bundle demands 66% of the SIO applicant's income. For some, however, it

³¹ In the presence of extreme high or low household income levels, mean household income may be skewed upwards or downwards. Where this is the case, mean household income is not a viable substitute for median household income. Since the distribution of household income on which average household income was determined is not provided, determination of whether the use of mean household income is an appropriate substitute for median household income can not be established.

³²

- a) While earlier SIO analysis defines average household income as the applicant's income when a partner's income is undisclosed, this analysis gives a missing value figure to applications where partner contribution is undisclosed. This classification reduces the sample from 438 to 398 applicants.
- b) The equivalent income of the applicant is determined by adjusting average household income by Jensen's (1978) equivalence scales. The purpose of equivalent income is to take into account the family size. The household average income is adjusted to a two adult equivalent according to the number of adults and dependents in the household.
- c) The 1991 average household income figure from Table 1.6 of the Consumer Expenditure Statistics (Statistics New Zealand, 1991) is adjusted to the net income equivalent using the average tax rate of wage and salary earners for 1991 (Statistics New Zealand, Accessed 1997). The figure is also adjusted to 1993 prices using CPI figures (Statistics New Zealand, Accessed 1997).

³³ Previous analysis employed solely the applicants income where partner income was not specified. Here, if partner income is unspecified a missing value is used in determining inadequate income applicants.

requires more. For 4% (N=270) of applicants for whom the bundle of essentials could be determined, weekly income is insufficient to meet bundle of essentials expenses. For a further 23% of applicants, less than \$50 remains after food, accommodation, gas and power expenses are met. Since these applicants must fund personal, transport, health, legal, insurance, phone, education, and other household expenses out of this \$50, and given these expenses average \$70 for budget advice clients after assistance (Wilson et al., 1995), these applicants are deemed to have inadequate income to meet survival requirements³⁴.

Combining SIO applications that meet one or more of the above criteria for 'inadequate income', 68% (N=460) of financial predicaments may be caused by inadequate income. For 14% of applicants, two criteria are met defining their income as inadequate. Two percent of applicants meet all three inadequate income criteria³⁵.

In focusing on the flow of resources to the applicant, the inadequate income category does not take into account the applicant's stock of resources. An applicant may meet an inadequate income criteria yet have a positive net worth. To identify inadequate income applicants with a positive net worth, assets-less-housing are matched against the applicant's total debt less housing debt³⁶. As 16% of inadequate income applicants are identified, these are eliminated from the inadequate income group³⁷. The remaining 52% of applicants are considered 'inadequate income' applicants for further SIO analysis.

5.2 Current Consumption Preference

Dutta (1993) highlights the presence of different consumption objectives when distinguishing between survival and utility maximisation. Survival maximisation corresponds to a revealed preference for consumption combinations within the north-

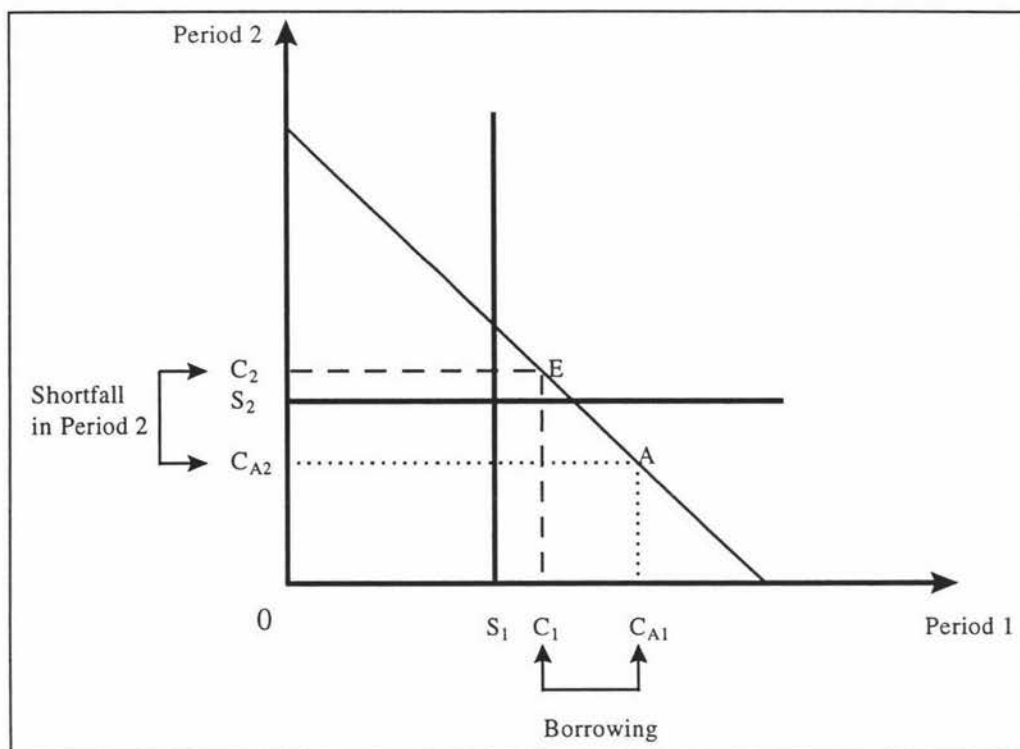
³⁴ Though a household may contract their spending below this \$50 level in the short-term, this level takes into account longer term expenses encountered by a household.

³⁵ Given only 50% of applicants report a reason for application and since only 72% and 58% could be tested for the second and third criteria respectively, these figures are likely to understate the possible impact of insufficient income in causing financial difficulty.

³⁶ Where unsecured or secured debt less housing figures are available, these are employed if a non-value was entered for debt-less-housing.

eastern quadrant in Figure 5.2. By contrast, utility maximisation may occur at any point, subject to the individual's budget constraint. That is, utility maximisation occurs independent of whether S_1 and S_2 are attained.

Figure 5.4: Current Consumption Preference



The applicant's initial endowment, E, determines the position of their budget line. The individual is able to borrow or lend along their budget line to achieve higher consumption in the current (Period 1) or future (Period 2) periods respectively. Survival in both periods, however, requires consumption in the north-eastern quadrant of the survival requirement lines.

In Figure 5.4, the individual's revealed preference is for an OC_{A1}, OC_{A2} consumption combination. Though the initial endowment corresponds to consumption in excess of subsistence in both periods, utility maximisation at A reduces consumption to OC_{A2} in period two. Since OC_{A2} is less than S_2 , current consumption is at the expense of future survival.

³⁷ Only applicants identified as having assets-less-housing in excess of debt-less-housing are eliminated. Applicants for whom this can not be calculated remain in the inadequate income group.

Cognitive dissonance, lack of understanding of credit, and addiction to credit use are explanations provided for current consumption at the expense of future survival. Evidence supporting these explanations is apparent among budget advice clients and SIO applicants.

The NZFFBS Chairperson affirms the presence of cognitive dissonance among Porirua budget advice clients. Identifying that many clients fail to report their full financial situation initially, she states, “it is not that they are really trying to deceive us, it is because they obviously haven’t mentally coped with it” (Raewyn Nielsen, 1997). Indeed, combined with clients who have genuinely forgotten about their debts, cognitive dissonance is so prominent that trainee budget advisors are cautioned that they will seldom learn the full extent of the debt on the first visit (ibid.). For SIO supervisor, Lynne Wyman, SIO applicants screen unwanted information to such an extent that they often provide her with bills in unopened envelopes (Lynne Wyman, 1997).

The Ministry of Consumer Affairs (1988) states, “the issues surrounding credit are complex and not always well understood by consumers” (p.1). The NZFFBS Chairperson, Raewyn Nielsen (1997), supports this assertion. She states, “people think that they understand about credit, but they don’t understand about the *wise* use of credit”. Lack of understanding of credit has contributed to the need for budget advice and SIO relief.

While addiction is not as easy to identify as cognitive dissonance and a lack of understanding, self-reported reasons for the SIO application reflect that addiction may have been a contributing factor to financial difficulty. Indeed, one 29 year old radio announcer states, “I have no money management skills and I need help by way of a tag put on my wages so I can’t touch it”. The applicant’s lack of control implies they are addicted.

Lack of control regarding financial matters is common to both addiction and cognitive dissonance. Literature identifies that addicts experience less awareness of personal

financial matters³⁸. Since cognitive dissonance results in individuals filtering the extent of their debt, this factor is also common to both explanations for a current consumption preference. While a direct measure of current consumption preference is not available, individuals who are potentially a 'current consumption preference' applicant may be identified by distinguishing applicants with a lack of control and awareness regarding financial matters. These applicants may be identified through: self-reported reasons for application, uncertainty or mistakes in the completion of the application, and disparity between figures entered.

Dessart and Kuylen (1986) found that an external locus of control was the most discriminating personality factor among problem debtors. Evidence of external control may be seen in one SIO application where the 31 year old female reported her reason for application as "My lawyer told me to do it". In most applications, however, the external locus of control is not as explicit. Rather, the external locus of control underlies the self-reported reasons for SIO application. For this reason, it is not possible to identify individuals with an external locus of control from self-reported reasons for application. Instead, self-reported reasons for application are employed to identify applicants for whom mismanagement or overcommitment is a factor causing their financial predicament. Candidates are identified by explicit reference to mismanagement or overcommitment. Of those reporting a reason for application, 12.4% (N=234) fall into this category. For the sample as a whole, 6.3% (N=460) report overcommitment or mismanagement as a reason for their financial predicament.

Uncertainty or mistakes in the SIO application indicates a lack of awareness regarding the applicant's personal financial matters. Where creditors are listed with no corresponding debt, questions marks entered instead of figures, debts reported under the wrong section, or where there is other indication of uncertainty or mistakes, the applicant is identified. In sum, 71 out of 462 (15.4%) applicants are identified. Because this measure excludes miscalculations when summing debts and assets, this figure is likely to be understated.

³⁸ See: Dessart, W.C., & Kuylen, A.A.A. (1986) and Tokunaga, H. (1993).

Both the 'Application by a Debtor for a SIO' (Form 3) and the 'Statement of Affairs' (Form 4) was collected for SIO analysis. Both forms required the applicant to enter their unsecured and total debts: the former form requiring unsecured and total debts and the latter, unsecured and secured debts. Between Form 3 and Form 4, \$152,000 and \$1,190,000 disparity was entered under unsecured and secured debt respectively. This is equivalent to an average of \$330 in unsecured debts and \$2,580 in secured debts for the SIO sample.

Disparity between figures entered in Forms 3 and 4 may indicate a lack of awareness regarding personal financial matters. The level of disparity at which to infer that an individual applicant actually has a lack of awareness, however, is subjective³⁹. SIO applicants for whom disparity on their files may indicate a lack of awareness are identified by disparity in excess of their net weekly income and greater than 20% of their total debt figure⁴⁰. Using this definition, 96 (N = 376) applicants have disparity which infers a lack of awareness. This figure is likely to be understated, however, as 4.33% of applicants failed to report total and unsecured debts in Form 3.

Combining applications where disparity infers lack of awareness with those featuring uncertainty or mistakes, and those reporting mismanagement or overcommitment, 36.8% (N=462) of applications reflect lower control or less awareness of personal financial matters in some form⁴¹. Since lower levels of control and less awareness of personal financial matters is associated with cognitive dissonance and addiction, cognitive dissonance and addiction may contribute to a SIO applicant's financial demise.

³⁹ Individuals lacking awareness may be defined as those outside a confidence interval of average disparity or those with disparity in excess of an arbitrary amount. Both of these definitions of 'lacking awareness' are flawed, however. Though identifying those outside a confidence interval will capture extreme disparity, the average level of disparity in itself may be indicative of individual's lacking awareness. In addition, the selection of a subjective and arbitrary level defining disparity fails to take into account the size of disparity in relation to the applicants total debt and income. Clearly a \$500 disparity is more substantial for a \$1000 debtor than a \$10,000 debtor.

⁴⁰ Disparity is identified for unsecured and secured debts individually. Those identified displaying disparity in either category are combined.

⁴¹ This figure is understated since it excludes 50% of applicants that fail to report a reason for application.

While previous analysis sought to determine the presence of cognitive dissonance and addiction through distinguishing associated factors, a more direct measure of addiction among applicants is to identify credit card junkies. Sullivan et al. (1989) defined credit card junkies as individuals: with credit card debts exceeding half their annual income, with a high proportion of unsecured debts in credit cards (>75%), with in excess of \$US100 in credit card debt, and within the upper 15% of the absolute amount of credit card debt in their sample. In total, 3.7% (N= 427) of the SIO sample meet these criteria, 8.2% of those reporting credit card debt.

Though 3.7% of applicants are candidates to be considered credit card junkies, Sullivan et al. (1989) cautions that unforeseen circumstances may have required debtors to unwillingly accumulate credit card debt. The SIO analysis extends Sullivan et al.'s (1989) analysis to identify 'credit card junkies' reporting an unanticipated event in their SIO application. Though 81% (N=16) do not report the occurrence of an unanticipated event, 38% of these potential credit card junkies do not report any reason for their application. Identifying applicants that report a reason for application and the occurrence of an unanticipated event, 1.6% (N=462) of the SIO sample may be credit card junkies according to Sullivan et al.'s (1989) definition⁴². The NZFFBS Chairperson states that credit cards are not very easy to obtain in New Zealand, but chattel loans and hire purchases are (Raewyn Nielsen, 1997). Given this, addiction is likely to play an even greater role in the financial difficulty of SIO applicants.

Figure 5.4 illustrates a situation whereby an individual has sufficient resources to survive both periods but a current consumption preference jeopardizes future survival. Cognitive dissonance, lack of understanding regarding credit, and addiction are provided as explanation for this current consumption preference. In SIO applications, less awareness of financial matters, lower levels of control, and evidence of credit card junkies suggest cognitive dissonance and addiction may have been contributing factors to financial difficulty. Combining applicants that reflect lower levels of control or less awareness of personal financial matters with potential credit card junkies, 36.7%

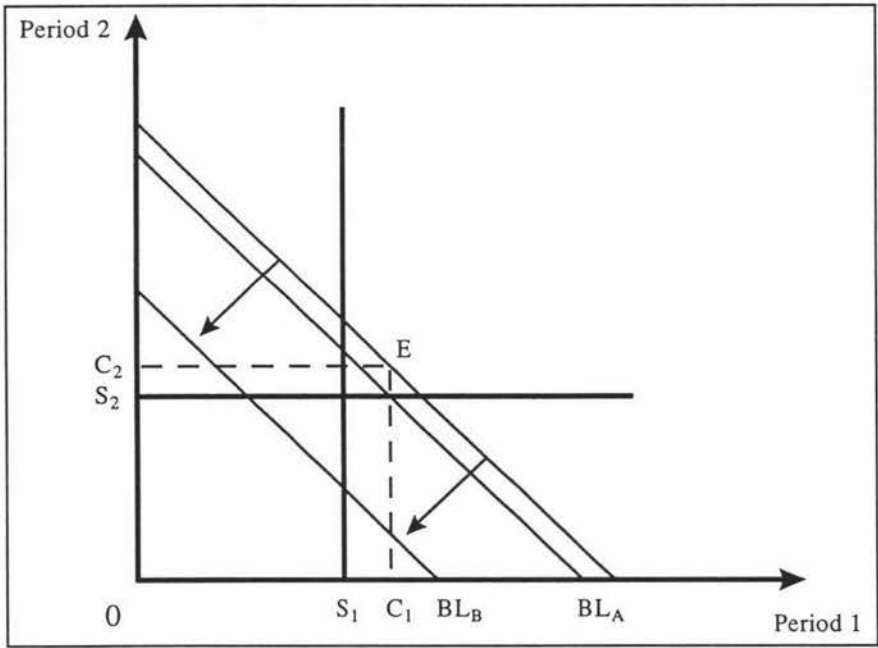
⁴² This figure is understated since it excludes applicants that have not reported a reason for application.

(N=461) of the SIO sample are candidates to be considered current consumption preference applicants⁴³.

5.3 Occurrence of an Unanticipated Event

Figures 5.5 and 5.6 illustrate the impact of an unanticipated event on a household's financial situation. In both cases the initial endowment is such that survival consumption can be achieved in both periods. The household is free to borrow or lend along the budget line subject to these survival constraints.

Figure 5.5: Unanticipated Event: Shift of the Budget Line



The applicant's initial endowment, E, determines the position of their budget line. The individual is able to borrow or lend along their budget line to achieve higher consumption in the current (Period 1) or future (Period 2) periods respectively. Survival in both periods, however, requires consumption in the north-eastern quadrant of the survival requirement lines.

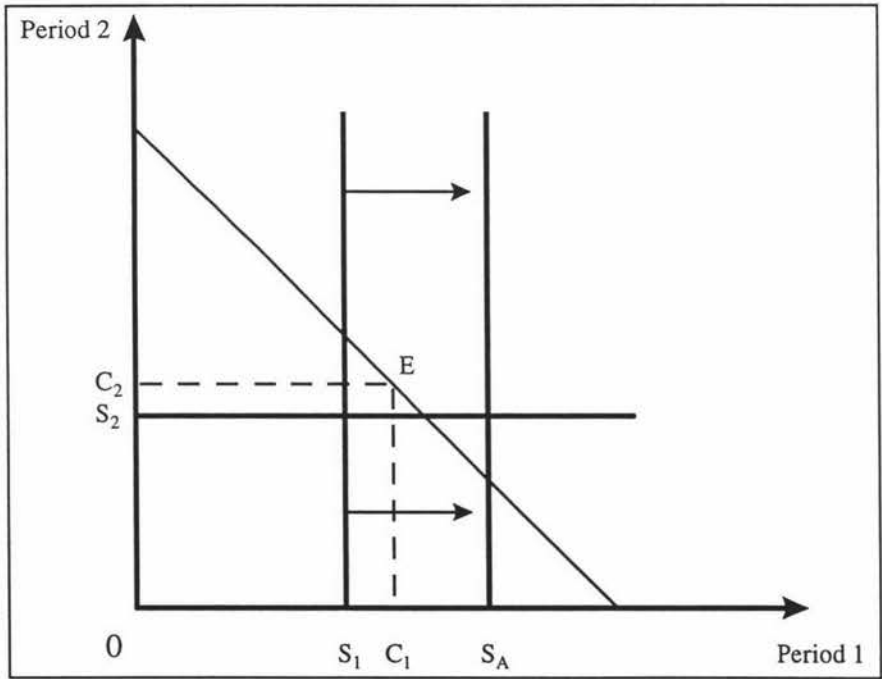
In Figure 5.5, an unanticipated event occurs which affects the financial status of the household. This event causes an inward shift of the budget line. The extent of the inward shift and the OC₁,OC₂ combination selected prior to the event's occurrence

⁴³ This figure is likely to be understated since 123 values are missing in identifying credit card junkies and those lacking awareness, and since 50% of applicants do not cite a reason for application.

determines the impact of the unanticipated event on the household’s financial situation. If the household did not borrow in the initial period, an inward shift to BL_A would not jeopardize future consumption. A shift to BL_B , however, would result in failure to meet survival consumption in period two independent of whether the household borrowed or not.

An unanticipated event that affects the subsistence level of consumption required by the household is illustrated in Figure 5.6. An outward shift of S_1 , S_2 , or both S_1 and S_2 , dependent upon the extent of the shift, results in previously sufficient combinations of C_1 and C_2 becoming inadequate. Unexpected bills, medical costs, expenses of an additional child, and increased rent are examples of factors that can influence the level of subsistence consumption required. In Figure 5.6, an event has caused an outward shift of the survival requirement line in period one. Though the initial endowment is such that survival could be maintained in both periods, this outward shift has jeopardized survival.

Figure 5.6: Unanticipated Event: Shift of the Survival Requirement Line



The applicant’s initial endowment, E , determines the position of their budget line. The individual is able to borrow or lend along their budget line to achieve higher consumption in the current (Period 1) or future (Period 2) periods respectively. Survival in both periods, however, requires consumption in the north-eastern quadrant of the survival requirement lines.

Evidence of both types of unanticipated events causing financial difficulty has been identified throughout literature. In SIO applications, these can be identified also. SIO supervisor, Lynne Wyman, states “There are a lot of people who because of a change in circumstances, because of broken relationships etc., have genuinely never been in debt before and have never had to deal with so little money...” (Lynne Wyman, 1997). Unanticipated events have contributed to their financial predicament.

Applicants whose financial situation was influenced by an unanticipated event are identified primarily through self-reported reasons for application. These self-reported reasons, however, fail to indicate the extent to which an event is unforeseen. In 1% of files, for example, the applicant referred to pregnancy as the reason for application. If the pregnancy was expected, adjustment of spending and accumulation of reserves could be undertaken in prior periods to avoid financial difficulty. Where unexpected, this preparation may not have taken place. In SIO applications, five explanations for financial difficulty can be considered as entirely unexpected: business failure, misconduct, redundancy, relationship failure, or unexpected bills. These are outlined in Table 5.1.

Table 5.1: Self-Reported Reasons for Application

Reason for SIO Application	Percentage reporting (N=462)
Business Failure	7.6
Misconduct	2.0
Redundancy	2.2
Relationship Failure	4.8
Unexpected Bills	2.0

- a) As 50% of applicants fail to report a reason for application, the extent to which these unanticipated events have contributed to the applicant’s financial difficulty is understated.
- b) Misconduct is a catchall phrase for financial problems arising from another person’s misdeeds. Misconduct is therefore outside the applicant’s control.

Business failure was one of two variables with a significant positive relationship with debt arrears in both years of Cameron and Golby's (1991b) study. In SIO applications, business failure has also had a sizable impact in causing financial difficulty. For one applicant, establishing a business was an attempt to get off the unemployment benefit. Business failure therefore served to exacerbate a strained financial situation.

I wanted to get off the unemployment benefit. Nobody was prepared to help me, so I got a personal loan from BNZ. I sold my caravan and got another loan from the family to buy a fishing boat. The boat cost me a lot of money to start with, but my family helped out to get me going. Just as I was going to go off the unemployment benefit my boat sunk to the bottom of the ocean taking everything I owned with it. I couldn't afford insurance for the boat as I wasn't making any money yet. The personal loan from the BNZ was leaning on my section...so now they are threatening to sell my section. So now I am in debt badly for just trying to get a job.

In total, 8% (N=462) of applicants state business failure as a cause of their financial demise. This equates to 15% of those reporting a reason for their SIO application.

Misconduct is employed as a catchall phrase to include the 2% (N=462) of applications where financial problems are reported to have arisen from another person's actions. Applications arising from misconduct are therefore outside the applicant's control. Misconduct includes reasons such as flatmates not contributing to expenses, and being presented with cheques that bounced. In one application, the applicant's only debt was \$7,700 to American Express. The applicant explained, "I anticipated an ACC claim so used my American Express to live, but when my ACC claim was paid, my ex-wife spent it and didn't pay the American Express". In another application, the separated machinist had accumulated debts to a hire centre, food stores, and for a port-a-loo. Her reason for application, "Money promised for my son's 21st was never deposited".

Though 43% (N=426) of applicants were currently experiencing unemployment, indicated unemployment in the past, or cited unemployment as a reason for their application, in some cases financial difficulty may have arisen from a long spell on the

unemployment benefit rather than an employment shock. In 9% (N=459) of applications, however, there is an identifiable employment shock. Of these applications, almost a quarter are caused by redundancy.

In 5% of applications, relationship failure is cited as a reason for financial difficulty. Food, power, accommodation and other related household expenses are generally less for a couple than for two individuals. Relationship failure therefore causes an outward shift of the survival requirement line in addition to a contraction of the budget line. Further, as accounts are often listed under one persons name, relationship failure may increase the indebtedness of an individual. Relationship failure therefore contributes to financial difficulty through increasing expenses, reducing income, and increasing indebtedness,.

Even the best of budgets is vulnerable to collapse under the weight of unexpected bills. For 2% of SIO applicants, and 4% of those reporting a reason for application, unexpected bills are cited as a reason for financial demise. One couple state that plumbing problems, a new cylinder, and a new aerial for the television underlie their application. Further, 121 applicants list an average of \$720 in car repair costs in their application. In some cases, repairs may have been unforeseen. The inability to foresee unexpected bills cause these to be an unwelcome shock to the budget.

Evidence that unanticipated events contribute to financial difficulty is apparent in SIO applications. Of the 234 applicants that record a reason for application, 98 (42%) report business failure, misconduct, unanticipated unemployment, relationship failure, or unexpected bills, and 7% report more than one of these. In one application, the unemployed male experienced redundancy, relationship failure, and business failure within a 2 ½ year period.

As 'unanticipated event' applicants are solely those reporting business failure, misconduct, unanticipated unemployment, relationship failure, or unexpected bills, the analysis clearly understates the impact of unanticipated events in contributing to financial difficulty. Sickness is reported in 7% of applications, 1% of applications cite moving and 9% report reduction in income as a reason for application. Included in the

former group will be applicants for whom financial difficulty arose as a result of unexpected, rather than long-term illness. A 30 year old female applicant diagnosed with a serious illness and forced to leave her employment is an example of unexpected sickness. An example of unexpected moving is given by a 32 year old female applicant who is forced to move to escape a violent ex-partner. Finally, reduction of income may also be unanticipated.

In addition to self-reported reasons for application, debts reported in SIO applications suggest an unanticipated event has occurred. Debts such as vet expenses in excess of checkup costs, large solicitor costs, car accident expenses, and funeral expenses are included in an 'other events' category. In 16% (N=457) of applications, there is evidence that applicants had experienced an additional event. Further, 29% (N=457) of applicants report healthcare costs in excess of the normal checkup charge.

To ensure analysis solely captures applicants experiencing an unanticipated event, factors aside from business failure, misconduct, unanticipated unemployment, relationship failure, or unexpected bills are excluded when identifying 'unanticipated event' applicants. The impact of unanticipated events in contributing to financial difficulty is therefore understated.

5.4 Combination of Reasons for SIO Application

The NZFFBS Chairperson states that although unexpected events are most significant in causing a Porirua budget advice client's financial difficulty, this compounds with being on a low income. In addition, she asserts that "for some people it has been unwise spending, but this usually goes along okay until either their income drops or something unexpected happens to trigger them off" (Raewyn Nielsen, 1997). Clearly factors of inadequate income, current consumption preference, and unanticipated events combine to exacerbate financial difficulty.

Table 5.2 indicates that in approximately three-quarters of applications evidence of an inadequate income, current consumption preference, or an unanticipated event is

apparent. For the 28% of applicants where two of these exist, the combination of inadequate income and current consumption preference is most common⁴⁴. Finally, 4% of applications are influenced by inadequate income, a preference for current consumption, and the occurrence of an unanticipated event.

Table 5.3: Reasons for Financial Difficulty

Number of Categories.	N=462 (%)
One Category	42.0
• Inadequate Income	54.1
• Current Consumption Preference	30.9
• Unanticipated Event	15.0
Two Categories	28.1
• Inadequate Income & Current Consumption Preference	62.3
• Inadequate Income & Unanticipated Event	28.5
• Unanticipated Event & Current Consumption Preference	9.23
Three Categories	4.33

- a) The table above outlines applicants potentially meeting one, two, or three of inadequate income, current consumption preference and unanticipated event reasons for SIO application.
- b) Non-values in determining applicants with inadequate income, current consumption preference, or an unanticipated event limit these findings.

Sullivan et al. (1989) state that we can never know the incident that triggered the decision to file for bankruptcy. In the same way, we can never know the incident resulting in the SIO application. Yet reasons contributing to the financial demise resulting in SIO use may be ascertained. Inadequate income to meet survival requirements, a preference for current consumption, and the occurrence of an

⁴⁴Missing values and the narrow definition of what constitutes an unanticipated event may cause the importance of unanticipated events to be understated.

unanticipated event, in isolation and in combination appear to have contributed to the financial demise of SIO applicants.

6. EVALUATION OF THE SIO PROGRAM

In 1967, when the SIO was introduced, the Minister of Justice hailed the SIO's merits. Describing it as a bold and fresh approach to insolvency, the Minister of Justice stated that "it is new, and I think it is good" (New Zealand Parliament, 1967, p.739). Today, the SIO continues to be heralded as an excellent option for overcommitted debtors. Lynne Wyman, SIO supervisor, states that creditors and debtors alike are generally pleased with the scheme. Indeed, "most applicants view the order as a second opportunity, a chance to repay without the undue hardship and pressure they are often forced into by creditors" (Lynne Wyman, 1997). The NZFFBS Chairperson also supports the SIO. She holds, "it is a really good scheme, and one we quite often suggest" (Raewyn Nielsen, 1997).

Since the time of its institution, no evaluation has been conducted to determine whether support for the scheme is justified, and whether applicant enthusiasm continues as time progresses. As the SIO was introduced as an experiment, it is both surprising and unfortunate that evaluation has not been undertaken to determine whether initial objectives have been achieved. By analysing whether bankruptcy is deterred and a fresh start attained, Chapter 6 seeks to fill this void.

6.1 Deterrence of Bankruptcy

The SIO was introduced as a means by which an overcommitted debtor could "short-circuit bankruptcy proceedings so that that step...need not necessarily be taken" (New Zealand Parliament, 1967, p.738). For 448 of the 502 SIO applicants traced against the National Insolvency Database, this bankruptcy step was not taken in the 4-6 years following their SIO application. For the remaining 10.8% of applicants, application for a SIO failed to short circuit the filing for bankruptcy.

Conclusions regarding the extent to which the SIO enables applicants to short circuit bankruptcy proceedings requires comparison to the number of applicants that would have continued to bankruptcy in the SIO's absence. Unfortunately, this comparison is

not possible. At the extreme, one may argue that 100% of SIO applicants would file for bankruptcy in the SIO's absence. A court-administered repayment plan is substituted for budget advice assistance where creditors are unwilling to negotiate (Sullivan and Worden, 1990). Where the court-administered repayment program is unavailable, therefore, applicants are doomed to bankruptcy since creditor demands are unable to be met.

An assumption in the foregoing conclusion is that applicants do not have the means to hedge against bankruptcy. The negative social stigma associated with bankruptcy and constraints imposed upon a bankrupts behaviour, however, may incite greater resolution from a debtor warding off bankruptcy verses one threatened with a SIO. That is, applicants may have the means to hedge against bankruptcy, but since the SIO may not be considered in the same light, these means have not yet been employed.

The more obvious means of hedging against bankruptcy is through the sale of assets. In 32% (N=296) of applications for the SIO, the applicant has a positive net worth. Assuming the applicant is able to liquidate their assets, the applicant would be able to hedge against bankruptcy. The applicant essentially undertakes the role of the Official Assignee in bankruptcy, however avoids the stigma and constraints associated with bankruptcy.

While the ability to hedge against bankruptcy through sale of assets may be determined through SIO applications, in many ways the SIO applications provide snapshot and myopic information in regard to the debtor's ability to avoid bankruptcy. Applications fail to reveal that: the unemployed debtor has high earning capacity and the potential for high-wage employment in the near future, the DPB beneficiary has been too proud to ask her family for financial assistance but would do so if the financial situation deteriorated, the plant and machinery operator would be so determined to avoid bankruptcy they would be willing to take on a second job to make required payments, the student would be willing to forego independence and shift home to avoid being declared a bankrupt. Though 32% of applicants have a positive net worth and hence 68% could potentially go bankrupt in the absence of the SIO, in excluding means of hedging against bankruptcy that are unidentifiable in SIO applications, this figure is

likely to overestimate those continuing to bankruptcy. Factors unidentifiable in the SIO may have been employed by some of the 98 applicants whose applications were terminated or withdrawn and application for bankruptcy not filed. For some of these applicants, however, their time on the SIO may have been critical to the avoidance of bankruptcy.

As stated, conclusions regarding the extent to which SIO applicants short-circuit bankruptcy proceedings requires comparison to the number of applicants who would have filed for bankruptcy in the SIO's absence. Unfortunately, this comparison is unable to be made. Given that applicants who filed for bankruptcy in the SIO's presence would also file in the order's absence and assuming assets can be liquidated to avoid bankruptcy, however, we can infer that between 11%-68% of applicants would continue to bankruptcy in the absence of the SIO⁴⁵.

6.1.1 Who are the bankrupts?

In 10.8% of applications the SIO fails to transport people off the road to bankruptcy. Instead the application for a SIO is just another step on the applicant's journey of financial demise. Evaluation of the SIO in transporting people off the road to bankruptcy requires analysis of those who continue down that path. Bankruptcy applications reveal: that this group has a debt-income ratio of 1.7 (N=29) and an average net worth of -\$11,400⁴⁶, that they are highly mobile in terms of accommodation, with an average of 3 homes in the last two years (N=49)⁴⁷, that 20% (N=46) do not have a bank account and 44% (N=45) have court fines owing, and that only 39% have a solicitor and 7% have an accountant.

⁴⁵ SIO supervisor, Lynne Wyman (1997), holds the proportion of her SIO applicants that would continue to bankruptcy in the absence of the SIO scheme is approximately 20%. If this estimation is true for all SIO applicants, approximately 10% of SIO applicants may be prevented from continuing to bankruptcy by their participation in the SIO scheme.

⁴⁶ In 93% (N=29) of applications the applicant has a negative net worth.

⁴⁷ On application, 44% (N=47) of applicants had lived in their present accommodation for less than 3 months and 81% (N=47) had lived there for less than a year. On one application, the applicant reported 10 places of residence within 2 years.

Though bankruptcy applications provide insight regarding the bankruptcy group, a comparison of this group's SIO applications to the SIO sample and to those successfully completing the plan without bankruptcy application is required to determine whether those continuing to bankruptcy are an identifiable group.

Demographic Profile: SIO Applications

In terms of age, the percentage in active employment, the proportion of couples, and the number of applicants with dependents, the bankruptcy group is indistinguishable from the SIO sample. Considering gender, marital status, number and age of dependents, the percentage unemployed, and the accommodation status, the bankruptcy group are identifiably different.

Age

In the SIO sample there is an even mix of male and female applicants. The bankruptcy group, however, consists of 57% (N=44) males and 34% females. Employing a test for the differences of two means, the difference in the proportion of males and females successfully completing the SIO and avoiding bankruptcy verses the proportion that file for bankruptcy is significant at a 99% level ($t = 2.920$). That is, we can reject the hypothesis that there is similarity between the two groups in terms of gender with a 99% confidence.

Marital Status

In terms of the proportion of applicants that are in marriage or defacto relationships, the SIO sample and the bankruptcy group are similar. Considering the marital status of applicants not in a marriage or defacto relationship, however, these groups differ. In SIO applications, 23% (N=377) of applicants are separated or divorced. For the bankruptcy group, 30% (N=37) are in these categories. In addition, 91% (N=11) of separated or divorced applicants are separated in the bankruptcy group, while 81% (N=377) are separated in the bankruptcy group.

Dependents

The number of SIO applicants reporting dependents is slightly lower compared to the bankruptcy group. In addition, the number of SIO applicants with three or more

children is considerably higher. Explanation for the latter finding is obtained when considering the age of dependents. The bankruptcy group report double the proportion of SIO applicants with a single child under two. Though one would have expected that in stretching limited resources further larger families would be more likely to continue to bankruptcy, costs associated with providing for a first child appear to have greater bearing on the bankruptcy decision. Explanation for the higher proportion of the SIO sample reporting dependents may lie in the large proportion of male applicants in the bankruptcy group.

Occupation

Though the proportion of applicants in active employment is similar between the SIO sample and the bankruptcy group, the status of those not in active employment is not. One third of the SIO sample report unemployment as their occupation or an unemployment benefit as their main source of income. This constitutes 47% (N=427) of those who are homemakers or for whom a government transfer is their primary source of income. For the bankruptcy group, however, 46% (N=41) are unemployed; this constitutes 66% (N=29) of homemakers or government beneficiaries.

Accommodation Type

The proportion of SIO applicants that board is nearly half the proportion of bankruptcy group applicants in this accommodation. Though SIO applicants that board pay on average \$22 less per week on accommodation, the proportion of the bankruptcy group that board is almost 30% (N=37).

Financial Profile: SIO Application

As expected, the bankruptcy group has higher debt, lower assets, and less income in their SIO applications when compared to the SIO sample. In terms of outgoing, however, bankruptcy group analysis uncovers a surprising finding. Bankruptcy group applicants have lower outgoing and bundle of essentials expenses.

Debts

Like all SIO applicants, the bankruptcy group is chronically indebted. The bankruptcy group, however, has average total indebtedness almost \$2000 in excess of the average

SIO applicant⁴⁸. In terms of mean unsecured debts, the difference between the bankruptcy group and applicants who completed the repayment plan without bankruptcy application is statistically significant at the 95% level ($t = 2.143$). Though the proportion of unsecured to total debt is relatively similar, average unsecured debt for the bankruptcy group is 1.2 times the average unsecured debt reported by the SIO sample.

Net Worth

In addition to increased indebtedness among the bankruptcy group, average assets of the bankruptcy group is 95% ($N=35$) of assets held by the SIO sample. Those reporting zero assets are over-represented in the bankruptcy group. Just over one quarter of this group report zero assets compared to approximately 15% ($N=399$) of the SIO sample⁴⁹.

Given the increased indebtedness and lower assets associated with the bankruptcy group, a lower net worth results. The mean debt-asset ratio for the bankruptcy group (8.7) is 1.6 times the SIO sample's mean debt-asset ratio (5.5). Comparing the bankruptcy group to those completing the plan and not applying for bankruptcy, this difference is more pronounced. Those completing the plan without applying for bankruptcy have a ratio of 4.1, less than half the debt-asset ratio of the bankruptcy group. Indeed, with a t -statistic of 1.730, the difference between these means is statistically significant at the 90% level.

The median debt-asset ratio in these samples indicate that a few applicants at the top of the asset-ratio range pull up the mean for the entire sample. In the SIO sample, the maximum debt-asset ratio is 83.2, double that of the bankruptcy group (41.4). Since the median debt-asset ratio is higher for the bankruptcy group, this reveals that there are more bankruptcy group applicants at the top of the debt-asset ratio distribution compared to the SIO sample.

⁴⁸ Given the range of indebtedness is less among the bankruptcy group compared to the SIO sample, this difference can not be solely attributed to a few bankruptcy group applicants.

⁴⁹ Considering that those with lower assets have less to lose in filing for bankruptcy, this finding is not surprising. Indeed, this may potentially be a moral hazard dilemma as applicants with no assets but with capacity to repay have incentive to file for bankruptcy.

Income

Income of the bankruptcy group is on average approximately \$25 less per week than that of the SIO sample and of those completing the plan while avoiding bankruptcy. As a result, the debt-income ratio is higher, with 9 months of income devoted to debt repayment in the latter group compared to 10 months for the bankruptcy group. Since unsecured debts are significantly higher for the bankruptcy group, the unsecured debt-income ratio is consequently greater.

In terms of the source of income, 58% of income reported by the bankruptcy group is government issued benefit. This compares to 50% for those who completed the plan and avoided bankruptcy, and 53% for the SIO sample. Wages constitute a further 31% of the bankruptcy group's income. This compares to 33% and 35% for the SIO sample and those completing the plan and avoiding bankruptcy, respectively. Since it was found that the bankruptcy group and the SIO sample have a relatively similar mix of beneficiaries and homemakers compared to those employed, it follows that the average income of wage earners must be lower among the bankruptcy group.

Outgoing

Since higher outgoing is associated with increased pressure on financial resources, one would expect that the bankruptcy group experiences higher outgoing. Mean outgoing is lower among the bankruptcy group, however, compared to the SIO sample and those completing their plan without application for bankruptcy. Indeed, the difference between means is statistically significant at the 95% level in comparing the bankruptcy group to applicants who complete their repayment plan while avoiding bankruptcy.

Bundle of essentials expenses are also lower among the bankruptcy group compared to the SIO sample and to those completing their plan without application for bankruptcy. On average, the bankruptcy group pays approximately \$14 less per week for their food, power, gas and accommodation costs than the general SIO sample. Compared to those completing their plan without application for bankruptcy, this difference is even more pronounced. Those completing the plan without a bankruptcy application pay on average \$34 more per week than the bankruptcy group. With a t-statistic of 1.715, this difference between means is statistically significant at the 90% level.

One explanation for the surprising finding outlined above becomes apparent as 18% (N=44) of the bankruptcy sample are home owners at the time of their SIO application, compared to 20% (N=459) of the SIO sample, and 23% (N=77) of those completing their plan without a bankruptcy application. Homeowners have more to lose in an application for bankruptcy and housing expenses are generally higher than other forms of accommodation. As such, it is apparent as to why outgoing and bundle of essentials expenses are higher for the SIO sample and for those completing the plan without bankruptcy application. Indeed, for those completing their plan without a bankruptcy application, average accommodation cost at \$105 is statistically significant at the 90% level when compared to average accommodation cost for the bankruptcy group ($t = 1.884$).

In addition to accommodation differences, the finding that the bankruptcy group has less children on average may also explain why outgoing and bundle of essentials expenses are lower among the bankruptcy group. While there are large expenses associated with setting up for a newborn first child, most of the expense is one-off rather than on-going⁵⁰. By contrast, outlays for a child are likely to be ongoing, contributing to food and medical expenses and potentially requiring a family to shift to larger accommodation. The tendency for the bankruptcy group to have less children therefore results in lower outgoing and bundle of essentials expenses relative to the SIO sample⁵¹.

Reasons for SIO Application

Inadequate income, current consumption preference, and the occurrence of unanticipated events provide explanation for financial deterioration leading to SIO application. In terms of the bankruptcy group, inadequate income and unanticipated events appear more frequently than in the SIO sample. The percentage of applications

⁵⁰ Outlays for a pram, bassinet, or a high chair are examples of one-off expenses.

⁵¹ Differences in accommodation expenses and the number of dependents account for the occurrence of lower outgoing and bundle of essentials expenses among the bankruptcy group. These differences do not provide explanation for SIO applicants with lower outgoing and bundle of essentials expenses continuing to bankruptcy, however. Instead, reasons underlying application for bankruptcy solve this mystery. Denial of the SIO, inadequate income, current consumption preference, and the occurrence of unanticipated events cause applicants to continue to bankruptcy even though outgoing is lower compared to the SIO sample.

who identify a potential current consumption preference, however, is relatively similar to the SIO sample.

While 51% of the SIO sample with a negative net worth meet one or more inadequate income categories, 59% (N=44) of the bankruptcy group are identified as potential 'inadequate income' applicants. In terms of self-reported reasons for application, the SIO sample cite inadequate income to meet survival requirements 1.6 times as often as the bankruptcy group. Identifying inadequate income through analysing incomes directly, however, a larger proportion of the bankruptcy group meet the inadequate income criteria compared to the SIO sample⁵².

The proportion of bankruptcy group applicants reflecting a potential current consumption preference is similar to that of the SIO sample. Self-reported reasons for application that acknowledge mismanagement or overcommitment and evidence of uncertainty or mistake within the application is slightly higher among the bankruptcy group. By contrast, the SIO sample boasts approximately 1.6 times the number of credit card and charge card junkies and disparity applicants compared to the bankruptcy group.

The mean number of unanticipated events reported by bankruptcy group applicants is significantly higher than that of the SIO sample⁵³. With 39% (N=44) of applicants experiencing an unanticipated event compared to 21% (N=462) in the SIO sample, bankruptcy applicants report an unanticipated event as a reason for their application 1.8 times more frequently than that of the SIO sample. Since 70% (N=44) of the bankruptcy group report a reason for application compared to 51% (N=462) in the SIO sample, this difference may be overstated. As a proportion of those reporting a reason for application, 55% (N=30) of the bankruptcy group and 42% (N=234) of the SIO sample cite an unanticipated event as their reason for application. Further, 19% (N=31) of the bankruptcy group and 7% (N=234) of the SIO sample who cite a reason for

⁵² In the SIO sample, 85% (N = 333) report income below the poverty line. This compares to bankruptcy group SIO applications where 91% (N =32) report income below the poverty line.

⁵³ The difference between means is statistically at the 99% level.

application give more than one unanticipated event in explanation for their financial difficulty.

Table 6.1: Unanticipated Events: As a Proportion of those Reporting a Reason for Application

Unanticipated Event	SIO Sample (N=234)	Bankruptcy Group (N=31)
Business failure	15.0	19.4
Misconduct	3.9	16.1
Redundancy	4.3	6.5
Relationship Failure	9.4	12.9
Unexpected bills	3.9	3.2

a) Misconduct is a catchall phrase for financial problems arising from another person’s misdeeds. Misconduct is therefore outside the applicant’s control.

Table 6.1 compares the proportion of SIO sample and bankruptcy group applicants citing each unanticipated event. The most notable difference identified is the proportion of applicants reporting misconduct as a reason for application. Indeed, for those reporting a reason for application, the percentage reporting misconduct is more than four times greater in the bankruptcy group than in the SIO sample.

In addition to the unanticipated events outlined above, comparison of applications listing some unemployment, other unanticipated events, or health expenses reveal that these feature more often among the bankruptcy group. Further, a test for the difference between two means reveals a t-statistic of -1.76 when comparing the proportion of applicants citing moving as a reason for application. Finally, the proportion of applications citing reduction in income or sickness is slightly higher among the bankruptcy group.

The extent to which an event is unanticipated is difficult to determine. While it is recognised that other factors influencing application may be unanticipated, unanticipated events are limited to business failure, misconduct, unanticipated

unemployment, relationship failure, and unexpected bills within this research. The difference between the SIO sample and the bankruptcy group in respect to the impact of unanticipated events in causing the financial predicament is therefore likely to be understated.

The percentage of the bankruptcy group meeting one, two, or three of the inadequate income, current consumption preference, or unanticipated event categories is outlined in Table 6.2. For those meeting one category, inadequate income is the most common. Indeed, the percentage of applicants citing inadequate income is approximately twice that of those citing current consumption preference, the next most common reason. For those meeting two categories, inadequate income and unanticipated events is the most common combination. This contrasts with SIO applications where the percentage of applicants with inadequate income and a current consumption preference is double those citing inadequate income and unanticipated events. Finally, the proportion of bankruptcy group applicants meeting three categories is notably higher than the proportion of SIO sample applicants meeting three categories in explanation for their financial quagmire.

Table 6.2: Reasons for Financial Difficulty

Number of Categories	SIO Sample (%)	Bankruptcy Group (N=49) (%)
One category	41.1	30.6
Two categories	26.6	34.7
Three categories	5.2	12.2

- a) The table above outlines applicants potentially meeting one, two, or three of inadequate income, current consumption preference and unanticipated event reasons for SIO application.
- b) Non-values in determining applicants with inadequate income, current consumption preference, or an unanticipated event limit these findings.

Profile of Bankrupts: Summary

Males feature more often among the bankruptcy group, as do the separated and divorced. The bankruptcy group has a larger proportion of households citing a new

baby and first child. While having a similar percentage in active employment as the SIO sample, a much larger proportion of those who are not in active employment are unemployed. Finally, the bankruptcy group has almost double the proportion of the SIO sample citing boarding as their accommodation type.

Financially, bankruptcy group applicants are more indebted, have lower net worth and income, and lower outgoing than the SIO sample. For the bankruptcy group, the debt-asset ratio is twice that of those completing the plan and not filing for bankruptcy, and an additional month of bankruptcy group income is committed to repayment of debt compared to this group. The bankruptcy group derives a larger proportion of income from a government benefit, and those receiving a wage or salary as their main source of income have, on average, lower income. While bankruptcy group applicants report lower outgoing and bundle of essentials expenses, less homeowners and the lower number of dependents account for some of this difference.

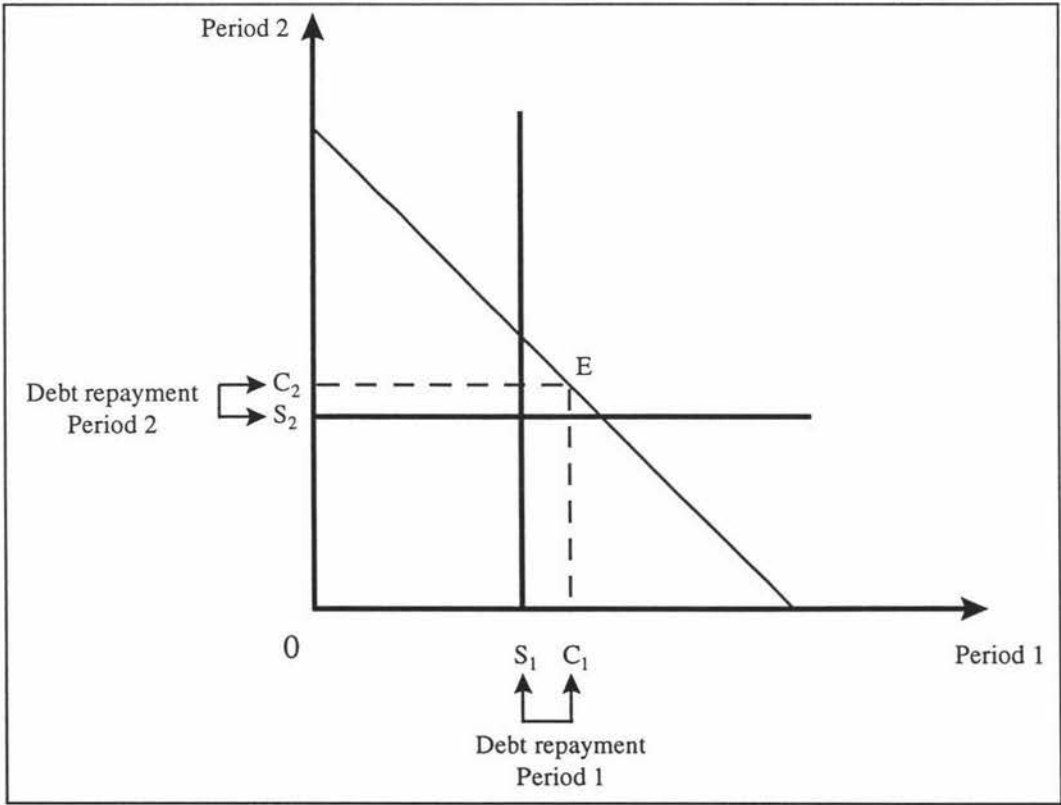
Among bankruptcy group applications, indication of inadequate income to meet survival requirements is more common than among the SIO sample. The proportion of current consumption preference applicants is similar, however the number of bankruptcy group applicants reporting mismanagement or overcommitment is slightly higher. In terms of unanticipated events, the bankruptcy group reports significantly more events than the SIO sample⁵⁴. Misconduct boasts the most marked difference, with a 400% increase compared to the SIO sample. In addition to self-reported reasons for application, bankruptcy group applications reveal more unemployment, other unanticipated events, and health problems. Combining evidence of unanticipated events with evidence of inadequate income and a current consumption preference, bankruptcy group applicants meet more than one category more often than the SIO sample. Indeed, more than twice the proportion of SIO applicants meet all three categories in the bankruptcy group.

⁵⁴ The difference between means is statistically at the 99% level.

6.1.2 Reason for Continuation into Bankruptcy

A repayment plan, whereby debts are apportioned to manageable payments over time, provides an individual receiving income in excess of survival with a means to avoid bankruptcy while maintaining subsistence consumption. Graphically, the institution of the repayment plan is illustrated in Figure 6.1. The individual's consumption endowments at 'E' are such that in the absence of debt repayment, consumption in excess of survival could be maintained. Institution of a debt repayment plan requires the overcommitted individual to pay this excess in debt repayment each period. In period one, $C_1 - S_1$ is repaid, and in period two $C_2 - S_2$ is repaid. Figure 6.1 illustrates a two-period model, yet in reality payment of excess over survival requirement continues reducing the debt owing until the debt is cleared or discharged and bankruptcy avoided.

Figure 6.1: Repayment Plan



The applicant's initial endowment, E, determines the position of their budget line. The individual is able to borrow or lend along their budget line to achieve higher consumption in the current (Period 1) or future (Period 2) periods respectively. Survival in both periods, however, requires consumption in the north-eastern quadrant of the survival requirement lines.

In 10.8% of applications, bankruptcy is not avoided. For these applicants, there is a statistically significant increase in mean unsecured and total debts between bankruptcy and SIO applications⁵⁵. Evaluating the SIO in terms of transporting people off the road to bankruptcy, reasons contributing to a SIO applicant taking on additional debt leading to bankruptcy must be determined.

Denied Access to a SIO

A more obvious reason for an application for bankruptcy is that the SIO has been denied. Where information contained in the 'Application by a Debtor for a Summary Instalment Order' and the 'Debtor's Statement of Affairs' does not conform to the SIO rules outlined in the Insolvency Act 1967, the application may be rejected. Where rejected, the SIO applicant fails to receive the protection from creditors arising from a SIO application. As such, the debtor is vulnerable to application for bankruptcy.

While in 52% (N=215) of applications the SIO was terminated, the extent to which these result from the SIO application being denied is undetermined. In this study, the only indication of a lack of access to the SIO is through bankruptcy group self-reported reasons for application. In 6% (N=47) of bankruptcy group applications there is evidence that the SIO was not granted.

Inadequate Income

By definition, application for a repayment plan requires an excess of income over survival requirements. Analysis conducted in Chapter 5, however, identifies that 52% (N=462) of applicants have a negative net worth and meet at least one criteria defining inadequate income as a reason for their financial difficulty. In the bankruptcy group, 59% (N=44) meet one or more criteria defining inadequate income as a reason for their initial financial difficulty.

⁵⁵ The difference between means is statistically at the 98% level. While 40% (N=30) of applicants have decreased debt between SIO and bankruptcy applications, some of the decline may be owing to relationship failure whereby the applicant's partner is responsible for some of the SIO debt. The average difference in indebtedness of \$1,800 (N=30) is therefore potentially understated.

Dividing the difference in indebtedness by the time period between SIO and bankruptcy applications, average accumulation per month is \$570 (N=30) for applicants who experience an increase in debt between SIO and bankruptcy applications. One applicant accumulated an average of \$3700 per month in the 7.4 months between their SIO and bankruptcy application.

Similar to Sullivan et al.'s (1989) analysis determining liquidation bankrupts with and without the potential to repay, this analysis inspects bankruptcy group income, outgoing, asset level and required repayment to determine repayment capacity on the initial SIO application. While 91% (N=32) of bankruptcy group applicants receive equivalent income below the poverty line⁵⁶, income inadequacy can also be identified by considering income relative to outgoing. Prior to debt repayment being deducted, 24% (N=29) receive less than \$50 in income net of food, accommodation, gas and power expenses. After deducting debt repayment, this figure doubles to 48% (N=29) of the bankruptcy group. One applicant has a weekly loss of \$16 net of food, accommodation, gas, power and debt repayment.

In addition to evidence that bankruptcy group applicants are unable to fund essential expenditures in their SIO application, self-reported reasons for continuation into bankruptcy provide evidence of inadequate income. In 4% (N=47) of bankruptcy applications, applicants make direct reference to their inadequate income as a reason for taking this step.

Combining applications where inadequate income is explicitly stated as reason for bankruptcy with those inferred in SIO applications, 91% (N=35) of the bankruptcy group meet one or more of the three criteria. Again, as in Chapter 5, applicants for whom assets-less-housing exceed debts-less-housing are eliminated from this group; 77% (N=35) still remain⁵⁷.

By definition, application for a repayment plan requires an excess of income over survival requirements, yet for approximately three-quarters (N=28) of the bankruptcy group, repayment may not be possible. Whether resulting from optimism on the part of the debtor or oversight on the part of the judicial system, SIO applications are made by debtors with inadequate income.

⁵⁶ The same proportion of bankruptcy group applicants report income below the poverty line in their SIO application on deduction of SIO repayment.

⁵⁷ Applicants are only excluded when identified as having assets-less-housing exceeding debt-less-housing.

Current Consumption Preference

A repayment plan is an alternative to bankruptcy for an individual with income in excess of its survival requirement. Adherence to repayment requirements results in the reduction and eventual elimination of the individual's debt. A requisite, however, is that the applicant complies with repayment requirements. Where the applicant maintains a current consumption preference, the applicant's indebtedness will increase rather than decrease.

The NZFFBS Chairperson identifies that approximately 10-20% of Porirua budget advice clients accept additional credit after signing their budget advice agreement. She states, "it is a reaction, 'I have got all these financial problems, I'll go to the budget service and give them to them, and when my affairs are in order I'll be able to take on some more credit' " (Raewyn Nielsen, 1997). For the bankruptcy group, identification of those that have accepted additional credit, in itself, does not imply a current consumption preference. Inadequate income or an unanticipated event may have required the applicant to involuntarily increase indebtedness. Determining applicants for whom increased indebtedness arose out of a current consumption preference therefore requires exclusion of those meeting an inadequate income category or citing a new unanticipated event⁵⁸. While 26% (N=47) of applicants fall in this category, this is, at best, an approximation since the criteria for inadequate income and unanticipated events are incomplete, and because these are not mutually exclusive.

A better means of determining bankruptcy group applicants with a current consumption preference is through their self-reported reasons for application. In one bankruptcy application, the 22 year old male states:

"My own stupidity is to blame because I have overcommitted myself and left it too late to try and get myself out of it. I became very materialistic in the beginning of 1993 and got a large loan to buy a new car and I booked up a lot of things: fridge, microwave, video, and so on with no real way of paying it back".

⁵⁸ Applicants are only excluded when identified as 'inadequate income' or 'unanticipated event' applicants.

While in SIO applications, 6% (N=462) of SIO applicants and 7% (N=44) of the bankruptcy group report mismanagement or overcommitment as a reason for their financial predicament, 17% of the bankruptcy group cite mismanagement or overcommitment as the reason underlying their bankruptcy application: this constitutes 21% of those citing a reason for application.

Since lack of awareness of personal financial matters and lack of control are associated with addiction and cognitive dissonance, these are identified in SIO files to determine applications that may have resulted from a current consumption preference. Disparity between debt figures reported in the files could be considered indicative of lack of awareness and control regarding personal financial matters. While 41% of SIO applicants identify disparity in their SIO, in bankruptcy files the majority of applicants did not complete the final section of their application requiring restatement of indebtedness. Disparity within bankruptcy applications therefore can not be determined. Evidence of uncertainty or mistakes in the bankruptcy application, however, can be identified. In 22% (N=46) of bankruptcy applications there is evidence of these factors. This compares to 15% (N=462) of SIO applications featuring uncertainty or mistakes.

Sullivan et al. (1989) hold that it may be difficult to live below income levels on an involuntary basis. Evidence of current consumption preference among the bankruptcy group affirm this assertion. Evidence of current consumption preference is identified in 37% (N=461) of SIO sample applications and 36% (N=44) of bankruptcy group applications for the SIO. While it was hoped that the SIO repayment program would rehabilitate debtors and remove this current consumption preference, there is also evidence that current consumption preference contributes to bankruptcy applications.

Combining applications with evidence of current consumption preference, 45% (N=47) of the bankruptcy group are potentially 'current consumption preference' applicants. While 45% are identified as *potential* 'current consumption preference' applicants, self-reported reasons for application provides a concrete measure of *actual* current consumption preference. In 6% (N=44) of SIO applications, the applicant cites mismanagement or overcommitment as a reason for their application. Since 17%

(N=47) of bankruptcy applications cite mismanagement or overcommitment, it is evident that current consumption preference has caused applicants to disregard repayment requirements and accumulate additional debt. This eventually resulted in bankruptcy.

Unanticipated Events

The repayment plan is an alternative to bankruptcy given an individual has income in excess of its survival requirement. In Figure 6.1, this requires an individual's consumption endowment to be within the north-eastern quadrant of the survival requirement lines. An unanticipated event may jeopardize the applicant's carefully apportioned repayments over time such that adherence to the plan is no longer possible. The event shifts survival requirement lines outward or contracts the budget line such that the endowment point is no longer within the north-eastern quadrant.

While 53% (N=47) of the bankruptcy group cite an unanticipated event as the reason for their bankruptcy application, some of the reasons cited may have been provided in explanation of their SIO application⁵⁹. To identify SIO applicants unable to continue their SIO as a result of an outward shift of their survival requirement line or a contraction of their budget line, new unanticipated events need to be identified. Where both SIO and bankruptcy applications are available for comparison, 38% of applications cite a new unanticipated event and 8% cite more than one.

In addition to explanation provided for the bankruptcy application, other indications of unanticipated events are available when comparing the SIO and bankruptcy applications. Comparison of average income between SIO and bankruptcy applications provide evidence of a contraction of the budget line. Indeed, in 56% (N=38) of applications, applicants experienced a fall in weekly income. This fall exceeded \$100 per week in approximately one-quarter of applications⁶⁰. While the self-reported reasons for application of business failure and unanticipated unemployment may include some of these applicants, 79% (N=19) of applicants experiencing a fall in income, and

⁵⁹ Of bankruptcy group applicants, 17 (N = 44) report unanticipated events in their SIO applications.

88% (N=8) of applicants experiencing a reduction in excess of \$100, did not cite one of these events.

Through the outward shift of the survival requirements line or the contraction of the budget line, an unanticipated event may jeopardize the applicant's ability to meet required repayments. Identification of unanticipated events is difficult, however, as the extent to which an event is unanticipated can not be determined. For this research, applicants citing business failure, misconduct, unanticipated unemployment, relationship failure, or unexpected bills in their self-reported reasons for application are considered to have experienced an unanticipated event. In 38% of bankruptcy applications, self-reported reasons for application reveal a new unanticipated event.

Reasons for Application: Summary

Evaluating the SIO in terms of transporting people of the road to bankruptcy, reasons for continuation into bankruptcy must be determined. Where the reason for bankruptcy application is exogenous to the SIO, then the SIO scheme can not held be responsible for continuation into bankruptcy. Unanticipated events are an example of a reason exogenous to the SIO scheme. While it is hoped that the SIO scheme provides education and rehabilitation such that an applicant has the skills to deal with an unanticipated event, the occurrence of the event is outside the influence of the SIO scheme. Where an unanticipated event occurs, the applicant is encouraged to contact their supervisor for re-negotiation or freezing of repayment. If the event causes a long-term contraction of the budget line or an outward shift of the survival requirement line, however, the program is powerless to assist.

While 38% of the bankruptcy group cite a new unanticipated event, there is no evidence of an unanticipated event alone causing a bankruptcy application. Instead, applications suggest current consumption preference and inadequate income may also be contributing factors. The impact of an unanticipated event in contributing to bankruptcy group applications, therefore, can not be isolated from the impact of current

⁶⁰ Increased income between SIO and bankruptcy applications is experienced by 44% (N=34) of the bankruptcy group. Approximately one quarter of the bankruptcy group experience an increase of \$100 or more.

consumption preference or inadequate income. At the extreme, one may argue that 38% of applications for bankruptcy may have been outside the SIO scheme's control. Though an applicant has a current consumption preference or a precarious income, they may have been able to sustain payments in the absence of the unanticipated event. If this is the case, 6.3% of applicants continue to bankruptcy as a result of the program's failure, as bankruptcy applications citing a new unanticipated event or resulting from denial of the SIO can not be considered SIO failure.

The above analysis assumes that current consumption preference or inadequate income in isolation would not have resulted in continuation into bankruptcy. In reversing the reasoning above, however, an applicant may experience an unanticipated event yet in the absence of a current consumption preference or a precarious income, may have been able to sustain payments. The extent to which the SIO fails in transporting people of the road to bankruptcy, therefore, can not be accurately identified as the contribution of an unanticipated event to any bankruptcy application can not be determined. Subtracting applicants denied their SIO application from the 10.8% continuing to bankruptcy, the SIO is answerable for between 6.3%-10.2% of applications for bankruptcy.

6.2 Provision of a Fresh Start

Dr. Finlay, MP for Waitakere at the time of the SIO's institution, stated:

"it is an accepted principle and is recognised as being in the interests of the community that a person who... has allowed himself to get into a position where he is unable to meet his debts, should be rehabilitated and put back into circulation".

(New Zealand Parliament, 1967, p.2191)

One of the purposes of insolvency legislation is to provide this rehabilitation and fresh start on return to circulation.

6.2.1 Drop-Out Rate

SIO applications have a high dropout rate. Of 215 applications for which an outcome could be identified, 38% continued to completion⁶¹. On the optimistic side, the SIO applicant may have received income or assets whereby they felt they could settle the debt without the court's assistance. Alternatively, inadequate income, current consumption preference, or the occurrence of an unanticipated event may provide explanation for the applicant's failure to complete the plan's requirements.

Sullivan and Worden (1990) found that budget advice is a substitute for a court-administered repayment plan where budgeting assistance is available and creditor action is halted. Because budget advisory services are widespread in New Zealand, applications for the SIO imply that creditor action persists. Given this, if a SIO application is terminated or withdrawn, re-commencement of creditor action will result. Where income or assets have not been received with which to service debt, applicants will be unable to appease their creditors. For these applicants, a fresh start is not achieved.

6.2.2 Refile

For the two courts where information regarding refile was collected, 30 out of 208 applicants (14%) could be identified as having filed for the SIO prior to, or following their 1991-93 application in that court⁶². The period between applications enables us to make inferences regarding the reason for reapplication.

Refile: Within Three Years

Applicants reapplying within the three year period clearly failed to complete their initial SIO application. The 42% (N=31) of re-applications occurring within the three year

⁶¹ Lynne Wyman (1997), SIO supervisor, estimates that approximately 60% of her SIO applicants continue their repayment plan to completion. The vast majority of these applicants repay via attachment order, whereby repayment is deducted directly from the applicant's income.

⁶² Reapplication is identified through tracing the applicants name against the court register. Reapplication is therefore only identified in the court where the applicant's initial application is made. Given the high mobility of indebted individuals, reapplication of the SIO is likely to be understated.

period provides potential explanation for what befell terminated and withdrawn applicants.

Refile: Three Years

In 48% (N=31) of refile cases, refile of the SIO is just over 3 years from the initial application. This implies that the initial application may have been completed in full. For applicants who have inadequate income to meet their debts within the three year period but who are adamant that they will not file for bankruptcy, refile is the only option for applicants who have no additional income or assets to draw upon. In some cases, a single debtor made three applications for SIO's. If each order is continued for the three year term, these applicants, determined not to file for bankruptcy, are effectively sentenced to a financial 'slammer' for the equivalent years of a New Zealand manslaughter charge⁶³.

In multiplying proposed weekly repayment by the number of weeks in the three year period, 57% (N=389) of applicants are identified as unable to repay their total debt less mortgage costs within the three year term⁶⁴. In 40% (N=424) of applications, repayment at the proposed rate would not even ensure unsecured debts are repaid. For 26% (N=391) of applicants a minimum of another year is required to service debt. For 15% (N=391) of the SIO sample, a minimum of a further three year term is required to repay total debt less mortgage costs in full.

While workable budgets were achieved for their budget advice clients, Jones et al. (1993) found some of these budgets stretched beyond the client's lifetime. In the same way, it appears that the SIO prolongs the financial agony of some of its applicants. In one bankruptcy application, the 30 year old female states, "I chose to go bankrupt because if I didn't I would still be paying off my debts when I am 60", and for one 27 year old sickness beneficiary repaying at \$3.04 cents per week, 74 years are required to clear his debt.

⁶³ Three applications for the SIO had been made in 27% (N=31) of applications where refile had occurred.

⁶⁴ Mortgage costs are excluded as repayment is generally long-term and therefore not expected to be repaid within the three year period. In addition, mortgage repayment is generally included as accommodation outgoing.

Since court approval of SIO applications can not be established from the debtor's application for the SIO, the extent to which the court accepts repayment plans which can not be serviced within the three year period can not be identified. In 46% (N=82) of SIO repayment plans continued for the three year term, however, total debt less mortgage costs are unable to be repaid within the three year timeframe. In addition, in one bankruptcy application the applicant states, "we had an unsatisfactory supervisor who made a budget for us but we were still in the red". Courts are therefore administering SIO's which can not service the debt within the three year term.

Though 57% (N=389) of applicants can not clear their total debt less housing within a three year period, the option is available for these applicants to receive relief through repaying their debt at less than 100 cents in a dollar. Ironically, however, few applicants make use of this provision. Indeed, 95% of applicants elect to repay their debt in full. Further, for those applicants identified as refiling for the SIO, 100% (N=28) opted to repay their debt in full. These applicants therefore have unrealistic expectations of their ability to service their debt.

Refile: After Five Years

In 10% (N=31) of applications where refile is identified, over 5 years had elapsed between SIO applications. In these cases, the application may potentially be new debt. Combining this possibility with evidence that 10% (N=44) of bankruptcy group applicants completed their SIO plan and did not experience an unanticipated event, the extent to which the SIO meets the objective of rehabilitating debtor's may be questioned.

The NZFFBS Chairperson believes that the SIO does not educate applicants. Instead, a mindset is produced whereby there is a dependency upon someone else. Through routinely giving money each week for the SIO, applicants can essentially forget about their debt problems. In doing so, they fail to learn how to manage their finances themselves and are liable to get back into debt (Raewyn Nielsen, 1997). Lynne Wyman, SIO supervisor, supports the assertion that the SIO is not an educational process. She

states that while the idea of voluntary budgeting is educating people, with the SIO she does not have that control (Lynne Wyman).

While refile and signs of current consumption preference suggest that education and rehabilitation may not have been achieved, signs of chronic indebtedness among SIO applicants accentuates its need. In addition to evidence of refile for the SIO, 21% (N=47) of applicants in the bankruptcy group made two applications for bankruptcy⁶⁵. Though these applications may have been contributed to by an unanticipated event or inadequate income, education and rehabilitation may have provided financial skills such that application was not necessary.

6.2.3 Provision of a Fresh Start: Summary

One of the purposes of insolvency legislation is to provide rehabilitation and a fresh start for applicants on their return to circulation. For the large proportion of SIO applicants who do not complete the program, creditor collection activities will resume and many will not experience this fresh start. Evidence of refile for the SIO within a three year period suggest reapplication may be a response to this.

Evidence of refile for the SIO near the completion of the three year period also indicates the absence of a fresh start. Inadequate income to service repayments within the three year period requires the applicant to reapply for the SIO if bankruptcy is to be avoided. Analysis of proposed weekly repayment indicates that 26% (N=391) of applicants require at least an additional year, and 15% (N=391) require at least three additional years to service their debt.

In applications that are contributed to by a current consumption preference, in the absence of rehabilitation a fresh start is not attained. Traces of current consumption preference among 45% (N=47) of bankruptcy group applicants is evidence of the SIO's failure to rehabilitate applicants. In addition, the SIO's failure to rehabilitate applicants is evident in the large proportion of applicants that do not complete the program.

Finally, refile 5 years after SIO application suggests applicants are struggling with new debt, reenacting their financial demise. This evidence that SIO applicants have not been rehabilitated suggests the intended fresh start has gone stale.

6.3 Evaluation of the SIO Scheme: Summary

The SIO was instituted as a program whereby applicants could “short-circuit bankruptcy proceedings” (New Zealand Parliament, 1967, p.738) and be rehabilitated and provided with a fresh start. In terms of the former objective, 10.8% of applicants continued to bankruptcy, 6.3%-10.2% of which can be attributed to SIO failure.

Though in transporting applicants off the road to bankruptcy support for the SIO scheme may be founded, SIO support may not be justified in terms of its provision of rehabilitation and a fresh start to applicants. A large proportion of applicants fail to complete their plan, there is evidence of refile and inability to service debts within three years, and there is indication that rehabilitation has not been achieved. As such, support for the SIO may be questioned in terms of its provision of a fresh start.

Conclusions in evaluating the SIO scheme requires policy makers to weigh the importance of the scheme’s objectives. If the avoidance of bankruptcy is foremost, support for the scheme may be justified. Conversely, if rehabilitation and fresh start is considered as vital, support may be unfounded. While a value judgment is required in concluding regarding the program’s effectiveness, there is clearly room for improvement of the SIO scheme. The next chapter will suggest ways of improving the SIO scheme.

⁶⁵ As the second National Insolvency Database search does not include applications prior to 1991, this figure is likely to be understated.

7. POLICY RECOMMENDATIONS

Denial of the SIO, inadequate income, current consumption preference, and unanticipated events provide potential explanation for termination of applications, refile, and continuation into bankruptcy among SIO applicants. The following recommendations are suggested in contending with factors contributing to SIO failure.

7.1 Denial of the SIO

Denial of a SIO application is not considered a failure of the program unless the applicant would have successfully serviced their debts if the SIO had been granted. Since only three applicants continuing into bankruptcy were identified as having their SIO denied, detailed recommendations can not be made. Nonetheless, the following recommendations are suggested.

Acceptance of the SIO based upon the ability to service debt rather than on the absolute value of debt

SIO rules (1970) impose a \$12,000 limit on unsecured debts for a SIO application to be granted. A weekly repayment of \$77 is required to repay \$12,000 in unsecured debts within a three year term. Given that most SIO applicants have low income, repayment at this rate is infeasible. The low income of the SIO sample, however, may result because higher income applicants that could have achieved repayment at this rate have been denied their application due to their unsecured debts exceeding the \$12,000 limit. Rather than a focus on the absolute value of debt, emphasis should therefore be placed on the ability to service the debt.

Acceptance of the SIO based upon creditor benefit rather than creditor consent

Where an applicant has no resources to hedge against bankruptcy, creditor objection to the SIO application will result in bankruptcy. While creditor acceptance is generally required for a SIO application to be granted, the criteria for granting a SIO application should be that creditors receive more than in a bankruptcy application.

7.2 Inadequate Income

By definition, application for a SIO requires income in excess of survival requirements. For half of the SIO sample and three-quarters of the bankruptcy group, however, evidence of inadequate income is identified.

Inadequate income to service SIO debt within the three year term has also been identified. Repayment at the proposed rate in many cases would require the applicant to reapply for a SIO. Evidence of reapplication among the SIO sample supports this.

In attempting to reduce and eliminate the termination of applications, refile, and continuation into bankruptcy resulting from inadequate income, the following is recommended.

Improved screening regarding eligibility for a SIO

Examination of income, basic needs and proposed repayment is required to ensure that the applicant's income is sufficient to sustain proposed repayment, and that SIO debts will be serviced within the required three year term.

Increased utilization of the option to repay debts at less than 100%

Where debts can not be serviced within the required three year term, repayment at less than 100% should be accepted where creditors receive more than obtained in a bankruptcy application.

Ensuring applicants are receiving their full entitlement of income

In 43% (N=46) of bankruptcy group applications, budget advice assistance had not been sought prior to the application for SIO and bankruptcy. Since one of the functions of budget advisory services is to ensure clients are receiving income they are entitled to, applicants may not be receiving all income due to them. A focus upon ensuring applicants are receiving their full entitlement of income is suggested.

7.3 Current Consumption Preference

Current consumption preference arises from cognitive dissonance, addiction, and a lack of understanding of credit. Evidence of these among those continuing into bankruptcy, in addition to termination and refile among the SIO sample, suggest that these applicants may not have been rehabilitated from their current consumption preference. The following actions are recommended to reduce and eliminate the termination of applications, refile, and continuation into bankruptcy resulting from current consumption preference.

Investigation regarding the appropriateness of instituting compulsory budgeting assistance

Though NZFFBS Chairperson states that compulsory budgeting does not work in the absence of client commitment (Raewyn Nielsen, 1997), research undertaken in Canada in regard to compulsory budget advice reveals that most bankrupts receiving mandatory counseling felt that they gained considerable benefit, though trustees had a more modest outlook (McGregor & Berry, 1997). In addition, a survey of Ch13 applicants required to attend a money management class revealed that "people can and will change their money-management practices given the proper motivation and instruction about how to make improvements" (Stokes, 1995). Indeed, a United States credit re-establishment program educating Ch13 applicants on how to determine whether or not they could afford new debt experienced less than a 1% default rate within seven years in Columbus and Ohio (Olson, 1993).

Owing to the failure of the SIO to fully rehabilitate applicants, and to the successful institution of compulsory budgeting in Canada and the United States, investigation of the appropriateness of requiring SIO applicants to receive budget advice assistance should be undertaken.

Provision of increased information to applicants regarding their progress in repayment of debt

Previous literature has identified that enthusiasm for repayment schemes wane after 6 months. The termination of 52% (N=215) of SIO applications reveals that enthusiasm

may also diminish in SIO applications. Since SIO applications are subject to a biannual review, applicants could be provided with this information. Applicants may be motivated and empowered in remedying their financial situation upon learning the status of their debt repayment.

Recommendation of services to applicants identifying their need for professional assistance

Referral of applicants to counseling or other relevant services should be undertaken where applicants identify that their problematic debt situation resulted from compulsive spending or addiction to credit use.

Examination of the outcome of applicants repaying via attachment order

SIO supervisor, Lynne Wyman (1997), reports a higher proportion of applicants successfully completing their repayment plan compared to the SIO sample. The vast majority of these applicants repaid via attachment order. Whether indicative of attachment order success or a product of Lynne Wyman's supervision, further investigation of the attachment order should be undertaken. The long-term rehabilitation of applicants employing the attachment order should also be considered.

Advising applicants of costs associated with a bankruptcy application

Applicants should be made aware that the SIO is the only obstacle between them and their application for bankruptcy. Informing applicants of the costs associated with an application for bankruptcy should create increased commitment to the SIO. In addition, where repayment is granted at less than 100%, the loss of relief may act as an incentive to adhere to the plan.

Encouraging creditors to be more responsible

Sullivan et al. (1989) identify that United States bankruptcy applications include reluctant creditors. Similarly, failing SIO applicants enlist reluctant creditors when unable to repay arrears or bills for services rendered. Increased indebtedness between the bankruptcy group's SIO and bankruptcy application, however, does not solely consist of arrears or outstanding bills. Some creditors have provided applicants with new lines of credit.

Applicants are required by law to inform creditors of their SIO application when accepting credit in excess of \$100. Whether applicants receiving new credit are guilty of not complying this requirement can not be ascertained. In the absence of this admission, however, creditors should still be able to determine the SIO applicants financial status. The low income and assets combined with the applicant's demographic profile should encourage creditors to conduct a credit check. New Zealand's nationwide credit investigator, Baynet, informs creditors of an individual's SIO application. As such, creditors are responsible for the provision of new credit to a SIO applicant, even in the case where the SIO application was not admitted.

As creditor irresponsibility contributes to termination of applications, refile, and continuation into bankruptcy, creditors should be encouraged to act responsibly. In addition, creditors should be provided with information regarding the profile of applicants to enable determination of *potential* credit risks. Finally, the identification and monitoring of creditors consistently featuring in SIO and bankruptcy applications is recommended.

7.4 Unanticipated Events

The extent to which an unanticipated event contracts applicant income or increases outgoing determines an applicant's ability to continue repaying their debts on a SIO. Where the unanticipated event causes income to be below survival requirements, the SIO is powerless to assist in servicing debts. Where income continues to exceed survival requirements however, continuation of repayment under the SIO may be possible through the freezing or reduction of repayments, or the lengthening of the repayment term. To ensure that the termination of applications, refile, and continuation into bankruptcy does not occur where income exceeds survival requirements, the following is recommended.

Encouraging increased communication between the SIO applicant and their supervisor

Where required repayments are not adhered to, in the absence of a valid explanation SIO supervisors assume the applicant is refusing to make repayment. As a result, creditors are notified and the SIO is annulled. To ensure this does not arise, applicants should be encouraged to approach their SIO supervisor when an unanticipated event occurs.

7.5 Summary

Since denial of the SIO, inadequate income, current consumption preference, and unanticipated events may contribute to termination of applications, refile, and continuation into bankruptcy among SIO applicants, revision of these is required to increase the effectiveness of the program. Suggested revisions are outlined above. Having made these suggestions to increase the effectiveness of the program, the following recommendations focus on the availability and on-going effectiveness of the SIO.

Increased accessibility to the SIO

The NZFFBS Chairperson states that some courts effectively deny the SIO to indebted individuals through their lack of support to potential applicants (Raewyn Nielsen, 1997). Though perceived as a large commitment of time, SIO supervisor, Lynne Wyman (1997), states that once the SIO is set up and functioning less work goes through the courts as debtors are not returning all the time. District Courts should therefore be encouraged to provide support to potential SIO applicants.

Continued monitoring of the effectiveness of the program

Continued effectiveness of the SIO requires on-going monitoring and revision to the program. To assist in this task, increased accuracy should be required in SIO application forms, and nationwide statistics should be collected.

8. CONCLUSIONS

With growth of overcommitment coinciding with expansion of the credit economy, the SIO was instituted to provide relief to individuals through protecting them from creditor action while apportioning their debt over a three year period. Though a new and experimental approach to insolvency legislation, in the three decades following its institution no analysis was conducted to determine whether the intended relief had been attained. By selecting a random sample of SIO applicants this research sought to attain a profile of SIO applicants and determine the reasons for their SIO application. Through tracing these applicants to see if they applied for bankruptcy, a measure of the effectiveness of this experimental court-administered repayment plan was sought.

Applicants are found to mostly coincide with previous literature in terms of their demographic and financial profiles. Compared to the general population, applicants are younger, beneficiaries or in low-income employment, have larger families, and are more likely to be divorced or separated. In addition, applicants mostly reside in rented accommodation and the sample boasts an even mix of male and female applicants. Financially, applicants are the heavily indebted. With minimal assets, only a third of applicants have a positive net worth. In addition, though experiencing lower outgoing than the general population, there is little discretionary income as a high proportion of the average applicant's low income is required for accommodation, food, gas and power expenses.

According to conventional economics, credit contributes to poverty solely in the presence of unsuccessful risk-taking. While unanticipated events are reported by 42% (N=234) of applicants citing a reason for their application, inadequate income and current consumption preference also play a role. With average SIO household income at less than half the New Zealand household income in 1992, it is not surprising that inadequate income is identified as a potential cause of financial difficulty. Indeed, more than half of the SIO sample are potentially 'inadequate income' applicants. Current consumption preference is identified as a potential contributor to financial demise in 37% of applications. For SIO applicants meeting two categories explaining financial

difficulty, current consumption preference and inadequate income is the most common combination. Finally, in 4% of applications there is evidence inadequate income, current consumption preference, and the occurrence of an unanticipated event have contributed to financial demise.

The SIO was introduced with the objective of deterring bankruptcy and providing a fresh start to applicants. Tracing SIO applicants to determine whether they filed for bankruptcy, 89.2% of applicants had avoided bankruptcy in the 4-6 years following their SIO application. Denial of the SIO and the occurrence of unanticipated events is identified as contributing to some applicant's continuation into bankruptcy. As such, the SIO may be even more effective in preventing applicants under its control from continuing into bankruptcy. The extent to which prevention of bankruptcy can be attributed to the SIO scheme, however, can not be accurately identified. As applicants that continue to bankruptcy are not distinguishable from the SIO sample, the SIO has not failed for any one particular type of applicant.

Current consumption preference among applicants continuing into bankruptcy, the large proportion of applicants failing to complete their plan, and evidence of refile and the inability to service debts suggest SIO applicants have not been rehabilitated. One of the objectives of the SIO is to provide applicants with a fresh start. In the absence of rehabilitation, however, a fresh start is not achieved.

Denial of the SIO application, inadequate income, current consumption preference, and unanticipated events contribute to the termination of applications, refile and the continuation into bankruptcy. In identifying this, suggestions are made for revision to the SIO scheme to eliminate or reduce these factors. Acceptance of an application based on the ability to service debt and on creditor benefit was recommended in regard to the granting of SIO applications. In terms of inadequate income: better screening, increased use of discharge and investigation into whether applicants receive the income they are entitled to was suggested. Suggestions regarding current consumption preference include: investigation into compulsory budget advice and the success of applicants repaying via attachment order, educating applicants regarding costs associated with bankruptcy, providing applicants with details of their repayment

progress, recommending appropriate services where applicants identify a need for assistance, and encouraging creditor responsibility. In terms of unanticipated events, recommendations include encouraging applicants to approach their supervisor if an unanticipated event occurs. In addition to these recommendations to increase the effectiveness of the program, increased accessibility of the SIO and monitoring to ensure on-going success, was recommended.

At the time of its institution, the Minister of Justice stated that though the SIO represented a bold and fresh approach to insolvency, “only experience [would] determine how useful it [would be]” (New Zealand Parliament, 1967, p.2190). In 1997, three decades following the SIO’s institution, a profile of its applicants, the reason for their application, and a measure of the effectiveness of the SIO has finally been determined.

8.1 Suggestions for Future Research

In addition to researching into the effectiveness of compulsory budget advice and the attachment order, as recommended above, the following areas for future research are suggested.

1. Econometric analysis to distinguish factors associated with bankruptcy verses the successful completion of the plan.
2. Analysis of the application’s six monthly reviews to determine the stage at which applications are terminated.
3. A qualitative survey to determine applicant explanation for termination or continuation into bankruptcy.
4. Analysis of bankruptcy applications to determine the extent to which applicants who file for bankruptcy have the capacity to repay their debts under a SIO scheme.
5. Evaluation of the SIO scheme in terms of creditor benefit.

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APPENDICES

APPENDIX A

The following conventions were employed to minimise inaccuracy and to ensure consistency in SIO and bankruptcy applications.

Demographics

- A missing value was entered for applicants with a gender-inclusive name.
- For joint applications, the age of the oldest applicant was entered⁶⁶.
- For joint applications, the occupation of the highest income earner was entered.
- The occupations of filers who derive the majority of their income through paid employment were classified using the New Zealand Standard Classification of Occupations (Statistics New Zealand, 1995).
- Where an applicant listed dependents but did not specify their ages, the total number of dependents was entered and a missing value given for the dependent's age.
- No dependents were entered where an applicant listed dependents living at a different address or made reference to child support payments.
- If the applicant stated that they had lived at their current address for more than two years and then listed other addresses where they had lived within two years, the applicant was assumed to have lived at the current address for more than two years.

Debts

- If an unsecured creditor was listed but a corresponding debt value not given, the creditor was excluded from the analysis⁶⁷.
- If a secured creditor was listed but a corresponding debt value not given, or if there was evidence of a secured debt yet the debt was absent in the debt schedule⁶⁸, a non-value was entered for secured debts⁶⁹.
- Files including secured debts with unsecured debts and vice versa, were adjusted such that debts were reported under the appropriate category.

⁶⁶ This is based on the assumption that money management skills increase over time.

⁶⁷ This convention provides justification for the higher debt value being employed where the SIO Forms 3 and 4 did not correspond.

⁶⁸ E.g. mortgage payment implies the debtor has a mortgage.

⁶⁹ Secured debts are treated differently from unsecured debts since secured debts are generally more substantial, and hence their absence may dramatically understate the level of secured debts.

- Where the application required the applicant to sum their debts to attain a total value for secured and unsecured debts, the applicant's value was employed.
- Debts entered in terms of another currency were converted to the New Zealand currency equivalent based on the average exchange rate on the month of application.
- In reporting car maintenance debt, CNG conversions were excluded. In addition, applicants involved in managing a taxi service were not included.
- If an applicant included a debt yet expressed a desire to keep the debt separate from the application, the debt was excluded from the analysis.

Number of Debts

- Where the filer had more than one debt owing to a single creditor, each of these debts were considered separate for the purpose of establishing the degree of indebtedness.
- Where the filer had more than one debt owing to a single credit or charge card merchant, these debts were considered as one debt to determine the concentration of credit or charge card debt among creditors, since credit or charge card debts do not refer to specific goods.
- If debts were named under a collection agency and no details provided in regard to each individual debt, the debt was considered one debt.

Debt Conventions Specific to the SIO

- Where secured and unsecured debts reported in the Application by a Debtor for a SIO and the Debtor's Statement of Affairs did not correspond, the larger figure was employed unless alterations had been made to the file indicating the lower figure was more accurate.
- For the Application by a Debtor for a SIO, secured debts was calculated by subtracting unsecured debt from total debt.
- For applications suggesting the amount of repayment would change after a certain period of time, a convention of using the initial repayment rate was employed.
- Conversion of a monthly repayment to its weekly equivalent was achieved by multiplying the monthly amount by the number of months in a year and dividing by the number of weeks in a year.

Debt Conventions Specific to Bankruptcy

- Where values for total liabilities are not given, these were determined by summing unsecured and secured debt.
- SIO debts were added to debts listed in the bankruptcy application where the applicant stated to include debts listed in the SIO.

Assets

- A missing value was entered where secured debts or mortgage payments were reported but a value not included.
- Where an applicant reported solely the equity on an secured asset, the secured debt was added to the equity value to attain the value of the asset. Where the amount of secured debt was not reported, a missing value was entered⁷⁰.
- Where a single applicant reported a joint bank account, the balance of the account was divided by the number of individuals sharing the account.
- If an applicant listed the cost of an asset when valuing assets, this value was employed.
- In bankruptcy applications, a zero value was entered if assets were listed with no corresponding values and would be unlikely to raise more than \$100 if sold.
- Where values for total assets were not provided, these were determined by summing assets listed in the application.

Income

- Wage was defined as a dominant portion of income derived from one source of paid employment.
- SIO applicants with secondary employment, or those who had some paid employment but who derived most of their income from another source, had these figures included under part-time employment.

⁷⁰ The rationale is that since the debt would be included under liabilities, an inaccurate picture of net worth would be obtained.

- Other income included income that did not fall into an earlier category. For joint filers, income aside from family support or a DSW benefit was included in this category.
- In SIO applications, government transfers include ACC compensation and DSW benefits. Family support is excluded.
- In SIO applications, where DSW benefits were provided net of housing costs, this figure was adjusted where information on housing expenses were provided.
- Tax was deducted at a rate applicable to an applicant's yearly income where gross income was reported.

Bundle of Essentials/Outgoing

- Accommodation expenses refer to expenses relating to the accommodation the filer resides in. Any additional accommodation was considered an investment rather than a necessity.
- Where the applicant is an owner-occupier, rates expenses were included in accommodation expenses.
- In the SIO applications, if the applicant's partner is responsible for accommodation expenses, a zero value was entered.
- If accommodation, food, gas or power expenses were not provided or if the applicant was boarding, a missing value was entered for the bundle of essentials.
- In establishing outgoing, a convention of subtracting SIO repayment was employed.

Reason for Application

- Business collapse was determined from both the self-reported reasons for application and from debts listed.
- Applicants reporting inadequate income in their application were identified by their reference to low income or income inadequate to meet basic needs. Reference to insufficient income to meet debt obligations was not considered indicative of inadequate income as it is essentially the plight of all applicants.
- Misconduct encompasses a range of events where the accumulation of debt has been a result of another persons dishonest actions and has been outside the applicant's

control. Included in this category are factors such as theft, deliberate misleading by a creditor, and unpaid debts to the filer.

- While reduction in income is not independent of other reasons for application, this reason was limited to those who explicitly cited this in explanation for their application.
- 'Other events' included items such as vet bills, funeral costs, excessive lawyer costs, or payments relating to a car accident.
- Applicants with health problems were identified as those reporting a doctors bill in excess of \$40 (the maximum cost for a general visit) or those with health problems prohibiting a household income-earner from working.
- Unanticipated unemployment is defined as unemployment resulting from an unforeseen shock. Redundancy or sickness are examples.
- 'File Wrong' applications include those applications failing to report a value for a creditors debt, listing a debt in the wrong place, featuring question marks, or including other factors indicating lack of financial understanding or control.