

# **Bankruptcy and Gambling: Is There a Connection?**

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### **Background**

No single factor can explain the increasing number of consumer bankruptcies in the booming U.S. economy. The changing attitudes and practices of many groups -- borrowers, lenders, retailers, lawyers, educators, and policy makers -- have created an environment where increasing numbers of financial failures are possible. A more casual attitude towards credit has become prevalent. Many lenders aggressively market new and complex financial products to borrowers who lack credit management knowledge and skill. In this environment, a new profile of those filing for bankruptcy has emerged over the last two decades. Debtors are no longer concentrated among blue collar, marginally employed or unemployed, who experience financial difficulties because of unexpected financial emergencies.

Filing for bankruptcy makes economic sense since it relieves debtors from most of their debts. However, dynamics of the debtors' decision to file bankruptcy are far more complex than the maximization of economic utility. Although the process to file bankruptcy is easy, quick and simple, studies have shown that controlling for economic variables, all families who would benefit from bankruptcy actually do not file. If all debtors who would benefit from filing bankruptcy were to file, the numbers would be much higher.

In light of current policy discussions on bankruptcy law it is important to address the following questions: what is the role of bankruptcy in the current credit environment? Should the bankruptcy system serve as an official debt collection agency for creditors or should it provide unconditional relief to debtors by wiping out all debts? Should the focus of policy be on preventing financial failures or should the focus be on intervening after the failures have occurred?

To find answers to these questions we must first understand: who is filing bankruptcy? What factors lead to bankruptcy including the role of gambling debt in filing bankruptcy? Who influences decisions on filing bankruptcy specifically the role a lawyer plays in a debtor's decision to file and choice of the type of bankruptcy chapter? What are the short-term and long-term consequences of bankruptcy?

### **Procedures**

Data for this study was collected in early Spring, 1998. A questionnaire was mailed to 1250 debtors who were currently in debt-repayment plans under Chapter 13 bankruptcy in Iowa. A small number of questionnaires (150) were returned undelivered due to inaccurate addresses. The response rate for this study is approximately 21% (N=236). This is fairly high as compared to other studies reporting a response rate between 2-10%. Due to limited funds it was

not possible to send multiple reminders as is recommended by mail survey experts to increase response rate.

Several objectives of the study include: to develop a socioeconomic profile of the debtors in Chapter 13 bankruptcy, to determine how debtors with gambling debt differ from those without gambling debt, to identify factors leading to financial problems and the extent to which gambling debt lead to bankruptcy, to identify sources of influence on decisions to file bankruptcy, and to determine why debtors selected Chapter 13. This study also explores debtor's assessment of bankruptcy experience and their recommendation for change in current bankruptcy procedures.

### **Profile of lowans in bankruptcy**

Slightly over one-fourth (28%) of the respondents identified themselves as gamblers. Males and females were equally represented in this study. Most of the debtors filed bankruptcy jointly with their spouses. Gamblers were slightly older (mean age 41 years) than non-gamblers (mean 39 years). A majority were married (70%), with a three member household on average. A large majority were also fully employed (81% non-gamblers and 70% of gamblers), and they represented an array of occupations such as professional, managerial, technical, administrative, support, sales, services. Mean years of education for both gamblers and non-gamblers was the same (13 years).

The mean take home annual income for gamblers was significantly lower (\$20,340) than for non-gamblers (\$30,384). Mean total debt for gamblers was significantly higher (\$41,342) than for non-gamblers (\$34,636). A large majority of both gamblers and non-gamblers owed their debt to credit cards (73% and 64% respectively). The size of monthly debt payments did not significantly differ between the two groups (gamblers \$1,247 and non-gamblers \$1,503). A majority of debtors carried credit card and bank debt (see Appendix Table 3 and 4). On average, debtors in this study had five credit cards. However, 21% had between 5 and 10 credit cards, and 11% had more than 10 credit cards. The average number of credit cards was slightly higher among gamblers (7) than non gamblers (5).

The view of the debtors as concentrated among blue collar, marginally employed or unemployed, facing a financial emergency has no foundation. Debtors in bankruptcy now represent a group of middle-class Americans. (See Appendix Table 1.)

### **Factors leading to financial problems and bankruptcy**

A large majority (70%) of the debtors filed bankruptcy because they had too much debt. A regression model was applied to identify significant predictors of total debt for the two groups. This model significantly explained 30% of variation in total debt for non-gamblers and 62% of the variation in total debt for gamblers. However, significant predictors of size of total debt varied between the two

groups. Among non-gamblers three variables that explained most of the variation in total debt were: number of credit cards (beta .287 significant at .001), monthly income (beta .206 significant at .007 level), and marital status (beta -.15 significant at .04 level). Among gamblers two variables that were significant in explaining variation in total debt were: number of credit cards (beta .549 significant at .0003 level), and monthly income (beta .363 significant at .008 level).

A majority in both groups (70%) identified "collection calls" as the most important factor in making the decision to file bankruptcy. Because most of the respondents were unable to reschedule their debt payments, collection calls were very stressful. Many used bankruptcy to solve their debt problems. Reasons for too much debt were similar for both groups: marital problems (34% both groups), medical problems (non-gamblers 35%, gamblers 29%).

On a scale of 1-5, where 5 is most important, respondents identified three factors as important contributors to their financial problems leading to bankruptcy filing. These included large amounts of credit card debt (score = 3), collection efforts of creditors (score = 3), and overspending (score 2.8). These scores did not differ between gamblers and non-gamblers. Other factors that were identified by a smaller proportion of respondents and had lower scores on the scale included unemployment, marital problems, and medical expenses. One third of the respondents in this study filed bankruptcy within 1-2 years of having financial problems, and a majority filed jointly with a spouse. (See Appendix, Table 2.)

Even though 28% of respondents identified themselves as gamblers, a slightly lower proportion (19%) indicated that gambling debt was an important factor causing financial problems leading to bankruptcy. It must be noted that (as reported in a previous section), gamblers had significantly larger amounts of debt (gamblers \$41,342, non-gamblers \$34,636).

The majority (over 60%) of respondents indicated that their financial difficulties were effecting their marriage and their health. Slightly less than half indicated that financial problems effected their performance at work and their relationship with their children. However, a large majority (82%) indicated that financial problems were effecting their emotional stability (75%). Before filing bankruptcy, 33% of gamblers and 37% of non-gamblers tried to solve their debt problems by working with credit counseling services, and by seeking help from their families (gamblers 35%, non-gamblers 25%).

#### **Who influences decision to file and under which chapter to file?**

In response to a question, "how did you learn about bankruptcy?" a large majority of the respondents identified two sources - friends/family, and lawyers. Lawyers were identified as a significant source of influence not only on the decision to file bankruptcy but also on when to file and under which chapter to file. Many respondents commented on the advertisements by lawyers in the

media. Some also referred to lawyer's hot lines, and direct phone calls to debtors (similar to telemarketing calls). The following quote is representative of comments by many respondents, "the radio and television airwaves are saturated with lawyers' ads on bankruptcy." The increased effort on the part of the legal community to make overextended debtors aware of the solution which is easy and quick has a significant impact on the increase in bankruptcy numbers.

It is also clear from the following quotes that many debtors were concerned about the completeness or objectiveness of the information that was provided by the lawyers.

"There should be strict guidelines for lawyers as to inform clients about the consequences of bankruptcy filing."

"The lawyers should be made to explain details instead of taking the money and moving you through like cattle."

"Lawyers who do not give written explanation of procedures and give inadequate advice and mess things up should not be allowed to collect fees and should pay the court costs."

It is clear from these comments that attorneys influenced decisions on filing for bankruptcy and the chapter under which to file. However, many debtors indicated that they chose to file chapter 13 rather than chapter 7 because they wanted to pay back the debt they owed. These feelings are reflected in the following quotes:

"Chapter 13 provides an honorable way out of a very difficult situation."

"We wanted to pay our debts."

"I had too much pride."

"To raise my self esteem."

### **Consequences of filing bankruptcy**

The most appealing aspect of filing Chapter 13 bankruptcy included: relief from creditors' collection calls (gamblers 37%, non-gamblers 41%), and ability to repay some debt (17% both groups). Other advantages identified by a smaller proportion of respondents included "new start" and "kept from losing everything." The following comments are reflective of the appealing aspects of filing bankruptcy: "it stops families from breaking apart, "no more phone calls from creditors", "relief from debt", "it's fairly easy", "a chance to start all over."

Responses to the questions "what are the worst things about bankruptcy ranged from "can't think of anything", "was not as bad as I imagined", to "feelings of failure", "horrible feelings of loss of self worth", "embarrassment and shame", "stigma attached to it", "ruined credit", "the games lawyers play with your life".

It appears that most respondents were pleased with the short-term consequences of filing bankruptcy in terms of relief from collection calls and relief from some debt. However, great surprise and frustration were expressed by many respondents when they experienced difficulty in obtaining credit a few years after their bankruptcy. They indicated they did not fully understand the long-term consequences of filing bankruptcy at the time of filing.

### **Assessment of bankruptcy experience**

A large majority of respondents, both gamblers (76%) and non-gamblers (83%) indicated that they understood what happened during the process of filing. And, a significant proportion of respondents found the bankruptcy process to be very easy (40% gamblers, 46% non-gamblers). About half of the respondents in both groups indicated that they will use the bankruptcy process again if needed. Furthermore, a large majority (78% of gamblers, and 74% non-gamblers) would advise others in similar circumstances to file bankruptcy.

Responses to the question "how in your opinion the current bankruptcy process might be improved" provide further insight in to how debtors view the filing process. They suggested: "explain laws and terms in plain English", "give information about other options", and "explain the consequences of filing bankruptcy before filing".

The current bankruptcy process does not include an opportunity for debtors to participate in any educational experience. However, a large majority of respondents (over 70%) indicated they would participate in credit rehabilitation and money management programs if they had been available. Over 60% would participate in sessions explaining the bankruptcy process and the consequences of filing bankruptcy. A smaller proportion (27%) indicated they would participate in an educational program that deals with gambling and compulsive buying behavior. Following are some sample quotes: "provide more training on handling money to avoid future money problems", and "have participation in such courses count towards getting credit back." (See Appendix Table 7.)

Responses to the question, "what is the most important thing you learned through the bankruptcy experience?" included: "the importance of staying on budget, paying bills on time, not to spend money you don't have, and using cash only." One respondent wrote, "I learned credit cards were the worst thing I could ever get involved, just when I would get caught up it was too easy to use again and again." (See Appendix Table 5.)

### **Suggestions to change current bankruptcy procedures**

Participants in this study made several suggestions to change the bankruptcy process. These included: change how lawyers get paid, treat chapter 13 filers differently than chapter 7 filers, before providing relief under bankruptcy consider reasons for financial problems, and help reestablish credit after filing bankruptcy.

A majority of respondents (65%) suggested that the bankruptcy process should require participation in educational sessions, and completion of those sessions should be counted toward re-establishing positive credit history. The following quote is a sample of this view: "they should provide more training on handling money to avoid future problems and count participation towards getting credit back". (See Appendix Table 7)

However, about 20% of respondents among both groups - gamblers and non-gamblers did not see the need to make any change in the current bankruptcy process. In their view, the problem was easy access to credit, "creditors keep increasing your debt limits until you have a problem, then they forget how friendly they were when lending you money."

### **Conclusion**

In this study almost one third of the respondents (28%) indicated that they were gamblers, and 19% reported that most of their debt was owed to credit cards and was for gambling expenses. Results of this study show that the two groups of debtors--gamblers and non-gamblers--did not differ significantly from each other in most of the socio-demographic characteristics. However, among gamblers the proportion of divorced, single, and unemployed was relatively higher than non-gamblers. On average, the gamblers had slightly lower monthly incomes, larger numbers of credit cards, and higher mean debt. Since 19% indicated that most of their debt was for gambling, it may be implied that gambling debt is playing an important role in increasing numbers of bankruptcy filings. Other reasons for large debt included too much spending, medical expenses, marital problems, and unemployment.

The majority of debtors in both groups reported that their bankruptcy was a result of spending beyond their means. However, some of them spent to sustain a life style, while others gambled. Both groups used multiple credit cards, accumulated large unpaid balances on their cards and were not able to keep up with their debt payments. Collectors' calls created stress leading most to file bankruptcy. Due to the increased competition, most lenders are aggressively targeting credit card solicitation to high risk groups of the population including younger and lower-income consumers. Today credit is easy to get and more and more businesses accept credit cards. Malls and gambling facilities are abundant in every community. It is socially acceptable to overspend and gamble since both are identified and encouraged as essential for economic development.

It is easy to have multiple credit cards and carry large balances on them. Many consumers lack basic financial management knowledge and skills to understand the long-term consequences of making minimum payments only, and the high costs of using multiple cards with large outstanding balances. Most overextended debtors have information about an easy solution to their problems -bankruptcy. Most of the participants knew some one in their family or in their social environment who had filed bankruptcy. Many of them also indicated that they learned about bankruptcy as solution to their problem from advertisements by lawyer, which are fairly abundant.

### **Policy implications**

The bankruptcy process must focus on understanding underlying causes of financial failure and emphasis should be shifted from "fresh start" to "rehabilitation" in order for the bankruptcy solution to be effective. Under the current bankruptcy system, a standard discharge is granted to most debtors without assessing the ability to repay and need for rehabilitation. Many debtors themselves do not understand the cause of their bankruptcy as most file bankruptcy to protect themselves from collectors' calls. The bankruptcy process must include a step where assessment is made and debtors are advised about other suitable options to their debt problems. Unconditional and full discharge should not be granted automatically to all that apply. Similarly, current and future income -- an important variable when the credit is granted -- should be a consideration before a discharge is granted. To encourage debtors to pay part or all of their debts by selecting chapter 13, it is crucial that creditors treat these debtors favorably for consideration of future credit.

Problems which result from gambling debt and other debt contribute significantly to the decision to file for bankruptcy. Although debtors with gambling debt do not differ significantly from those who have other consumer debts, those who choose to gamble have more credit cards and larger debt loads. It appears easy access to credit cards, and wide acceptance of these cards, plays a critical role in overspending resulting in too much debt for all groups.

To prevent future financial failures, it is important that we develop a multifaceted approach to solve the debt problems of a growing number of Americans. Before granting credit, lenders should assess consumers' ability to handle the amount granted. During the life of loan debt re-payment patterns should be monitored and credit counseling should be provided to those in danger of default. Parents and schools must take responsibility for teaching their children necessary skills to manage money and credit. Credit education should be included in the core curriculum of educational programs at various levels. In addition, adult education courses in personal finance should be available for those currently not in school. Among other topics these courses should focus on how to establish a good credit history, how to recognize indicators of financial problems, and how to handle over-indebtedness.

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## Appendix

**Table 1. Socio-demographic characteristics**

Characteristics	Gamblers (n = 63)		Non-Gamblers (n = 158)	
	n	Percent	n	Percent
Monthly Income (Mean)	61	\$1,692	152	\$2,532
Education Level (Mean in years)	63	13.3	156	12.8
Employment Status				
Employed Full-time	44	69.8	128	81.0
Employed Part-time	10	15.9	13	8.2
Others	9	14.4	16	10.1
Occupation				
Professional/Managerial	7	11.1	22	14.0
Technical	9	14.3	26	16.5
Administrative support	9	14.3	26	16.5
Sales/Service	15	23.8	43	27.2
Others	16	25.4	34	21.5
Marital Status				
Married/Living as Married	43	68.3	113	71.5
Widowed/Divorced	12	19.1	30	30.7
Single, never married	8	12.7	15	9.5
Family Size (Mean)	63	3.0	157	3.1
# of Dependents (Mean)	59	1.8	152	2.2
Age (Mean)	63	41.1	158	39.1
Gender				
Males	33	52.4	80	50.6
Females	30	47.6	78	49.4
Ethnicity				
White	59	93.7	149	94.3
Others	4	6.4	9	5.7

**Table 2. Factors leading to financial problems and to filing bankruptcy**

Factors leading to bankruptcy filing	Gamblers		Non-Gamblers	
	n	Mean	n	Mean
Business Failure	60	1.7	144	1.7
Overspending	63	2.8	149	2.8
Credit card debt	63	3.0	149	3.0
Marital problems	61	1.9	142	2.0
Medical expenses	62	2.2	150	2.2
Disability of head of household	62	1.5	143	1.3
Unemployment of head of household	62	2.0	144	1.8
Reduced hours at work for head of household	62	1.9	140	1.8
Collection efforts by creditors	63	3.0	152	3.0
Gambling Debt	62	1.7	143	1.0

**Table 3. Most common sources debt**

Sources of consumer debt	Gamblers		Non-Gamblers	
	n	Percent	n	Percent
Family	10	15.9	21	13.3
Friends	6	9.5	7	4.4
Banks	31	49.2	83	52.5
Credit Union	15	23.8	37	23.4
Employer	2	3.2	3	1.9
Credit Cards	46	73.0	101	63.9
ATM Cards	7	11.1	4	2.5

**Table 4. Sources to which most debt was owed**

Sources of consumer debt	Gamblers		Non-Gamblers	
	n	Percent	n	Percent
Family	3	4.8	2	1.3
Banks	13	20.6	33	20.9
Credit Union	6	9.5	7	4.4
Credit Cards	21	33.3	63	39.9
*Others	18	28.6	40	25.3

\*

**Table 5. Assessment of bankruptcy experience**

Perceptions of bankruptcy	Gamblers		Non-Gamblers	
	n	Percent	n	Percent
Bankruptcy was very easy	40	39.7	108	46.2
I understood what happened in the bankruptcy process	48	76.2	131	82.9
I know my options to choose Chapter 7 or Chapter 13	57	90.5	150	94.9
If needed I will use the bankruptcy process again	31	49.2	79	50.0
I will advise the bankruptcy process to someone else	49	77.8	117	74.1
I participated in educational experiences regarding bankruptcy	4	6.3	4	2.5

**Note: Percentages given are those who responded “yes” to the above questions.**

**Table 6. If available what type of educational programs would you participate in?**

Type of program	Gamblers		Non-Gamblers	
	n	Percent	n	Percent
Money management/ Budgeting	39	61.9	102	64.6
Credit rehabilitation	46	73.0	112	70.9
Addictive behavior	19	30.2	36	22.8
Bankruptcy: process, impact	32	50.8	93	58.9