Intergenerational Effects of Debt Relief: Evidence from Bankruptcy Protection

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Abstract

Using bankruptcy filing information on parents matched with administrative data on their children, along with judicial leniency as an instrumental variable, we examine the effect of parental bankruptcy protection on children's income, intergenerational mobility, and homeownership. We find that children whose parents receive Chapter 13 bankruptcy protection experience a significant increase in lifetime income. For every dollar of debt relief granted, these children gain two dollars in adjusted present value of lifetime earnings. Furthermore, they are more likely to rank in the top tercile of the income distribution, driven by increased intergenerational upward mobility, and are over five percentage points more likely to own a home by age thirty. Our findings suggest that bankruptcy protection and debt relief play an important role in fostering intergenerational mobility for low-income distressed households. Our results are most consistent with three mechanisms: protection of assets (e.g., house), higher investment in children's education and skill-development, and avoiding forced geographic mobility.

Motivation

- In a typical year, a million households seek bankruptcy protection and are offered $189 billion in debt forgiveness. One in ten households has filed for bankruptcy.

- Costs and benefits of bankruptcy are hard to quantify.

- Our question: **What are the long-term effects of bankruptcy protection that spillover to the children of recipients, if any?**
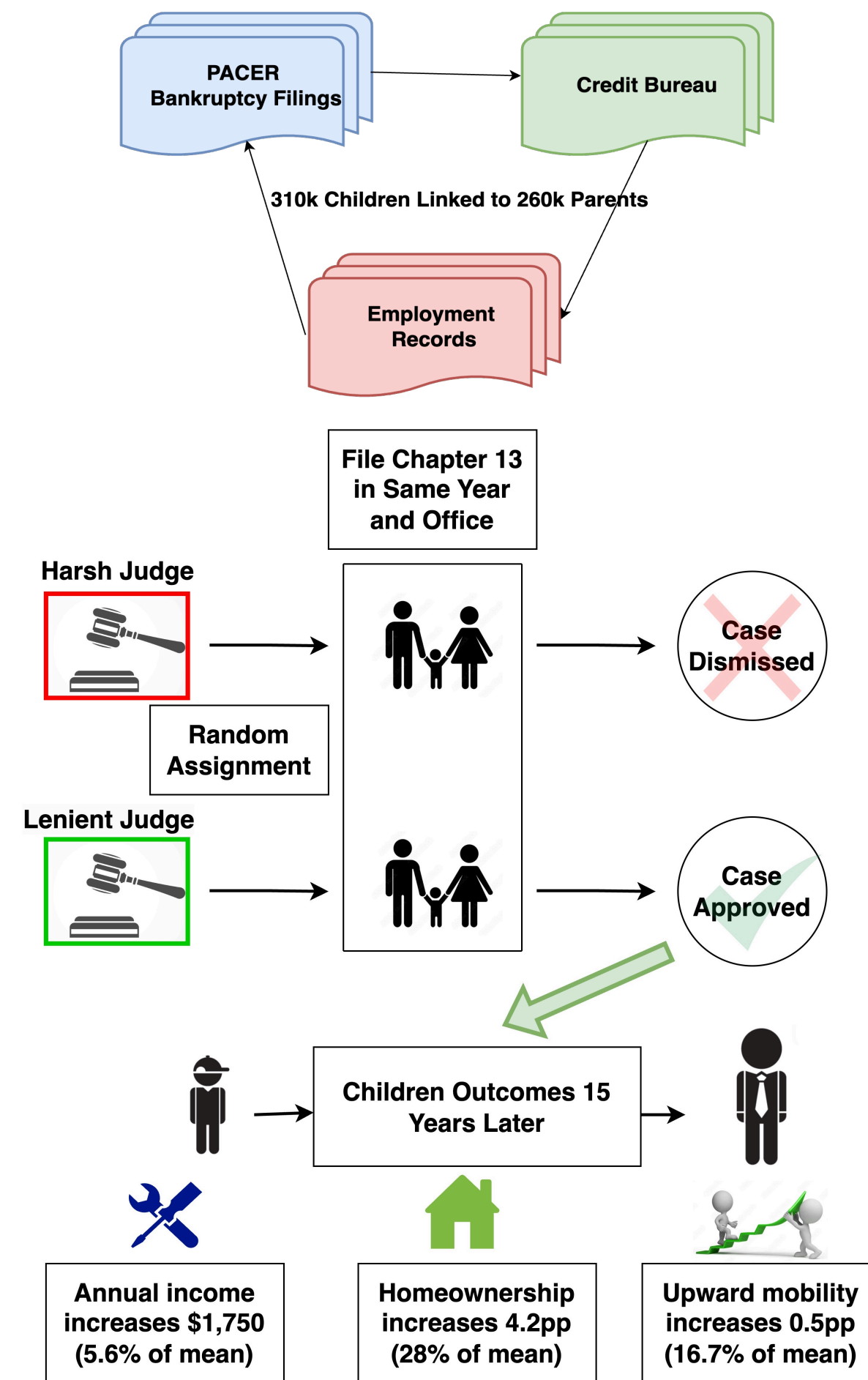
Methods

- Chapter 13 judge leniency as instrumental variable
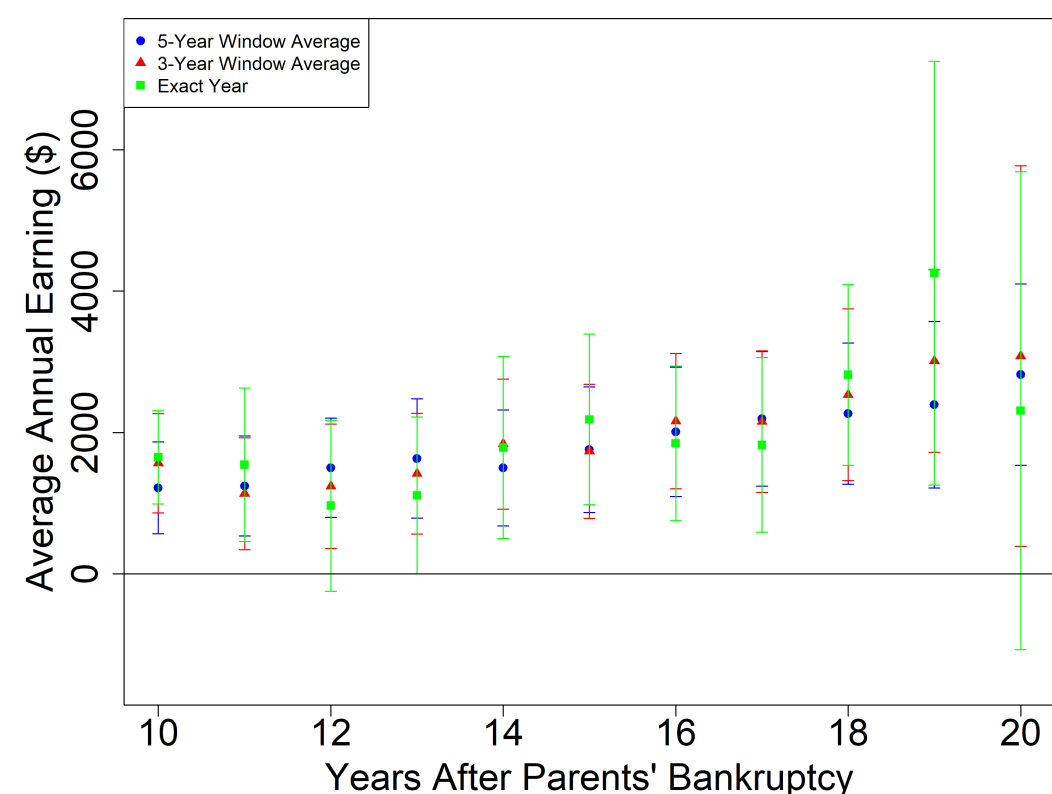- Fixed effects: year x office, parents and children filing age

1st $Stage$: $ParentalBankruptcyProtection$
$= \gamma * Judge\ Leniency + FEs + \eta$

2nd $Stage$: $Children\ Outcomes = \beta *$
$\widehat{ParentalBankruptcyProtection} + FEs + \epsilon$

Results

310k Children Linked to 260k Parents

File Chapter 13 in Same Year and Office

Harsh Judge — Random Assignment — Case Dismissed

Lenient Judge — Case Approved

Children Outcomes 15 Years Later

Annual income increases $1,750 (5.6% of mean)

Homeownership increases 4.2pp (28% of mean)

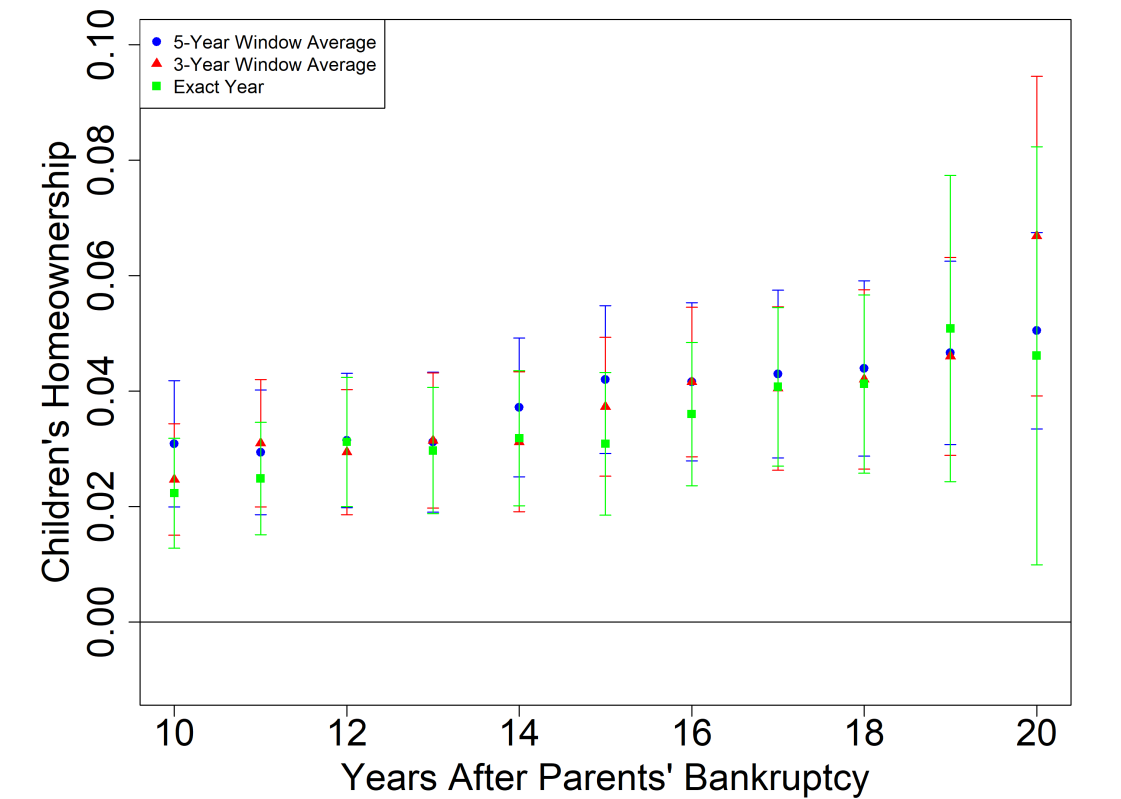Upward mobility increases 0.5pp (16.7% of mean)

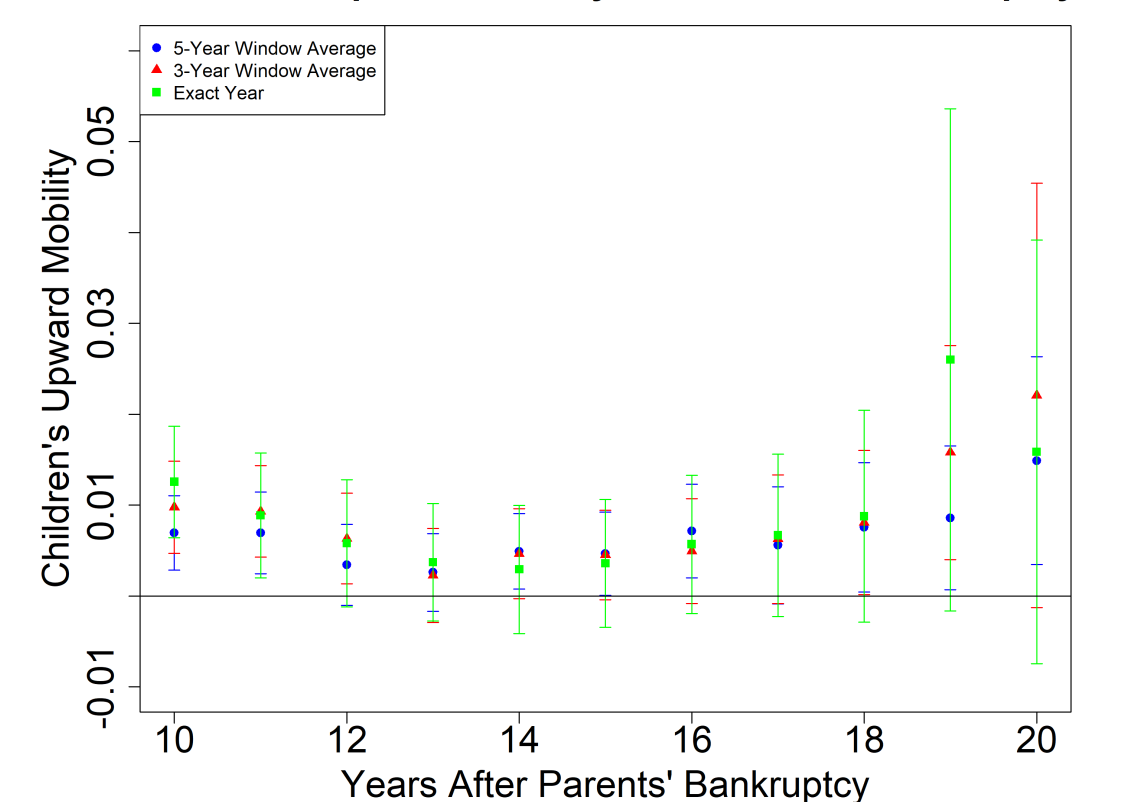Children's Annual Income After Parents' Bankruptcy

Results

Children's Homeownership After Parents' Bankruptcy

Children's Upward Mobility After Parents' Bankruptcy

Implications

- We precisely measure Chapter 13 debt relief by parsing 350k "Trustee's Final Reports" from PACER

- Back-of-the-envelope calculation: **$1 debt relief leads to $2.45 higher children's income**