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British Columbia Business Indicators

December 1996

Bankruptcies Rise with Self-Employment and Mounting Consumer Debt

Business bankruptcies in British Columbia rose a moderate 8% in July year to date, floating up with a 15% rise in the number of self-employed.

Consumer bankruptcies jumped 44%, as record high levels of consumer debt combined with the continuing shortage of good jobs to force more households into insolvency.

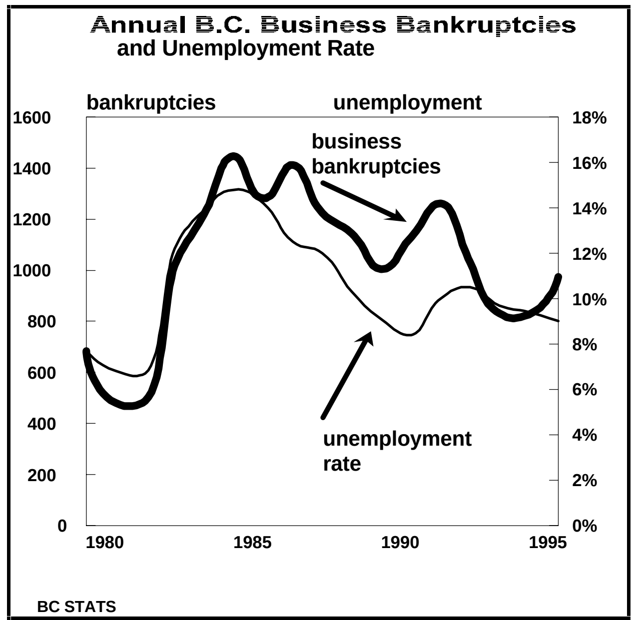
The distinction between business and consumer bankruptcy is based on whether insolvency is mainly the result of business or consumer debts. Business bankrupts can be corporations, partnerships or individuals.

Business Bankruptcies and Self-Employment

Self-employed people account for most potential business bankrupts, so that growth in self-employment provides a good indication of growth in the base for business bankruptcies.

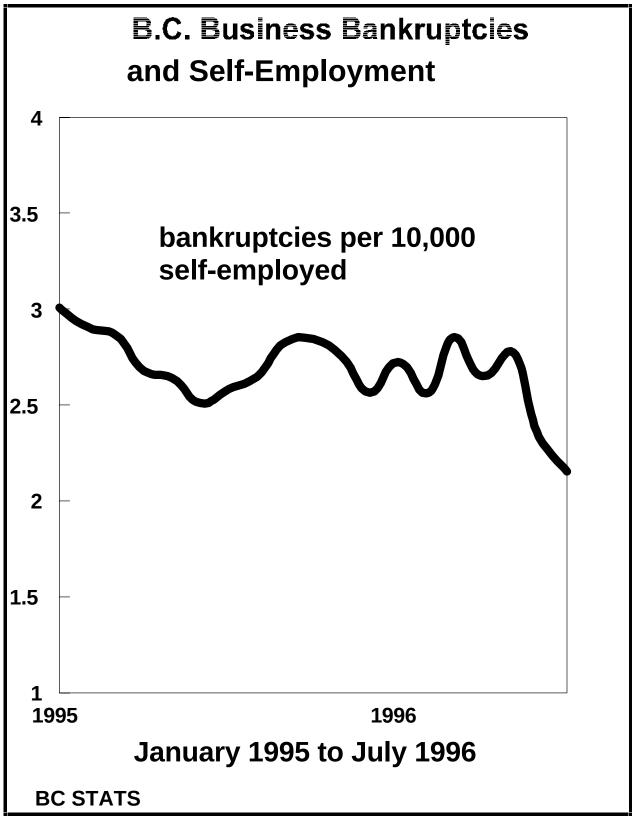
The steady rise in numbers of self-employed, from 159 thousand in 1980 to 296 thousand in 1995 explains much of the 102% increase in business bankruptcies between these two years.

However, growth in the number of business bankruptcies has been anything but steady. Superimposed on the long-term rise have been massive swings up and down, marking periods of recession and recovery. In most of the 16 years since 1980, business bankruptcies have either been rising strongly or falling sharply.



Data for the past year and a half suggest this may have been one of the rare periods of relative calm. Between early 1995 and mid 1996, numbers of business bankruptcies generally rose at close to the same rate as numbers of self-employed. The result was that, over most months, there was little change in the ratio of business bankruptcies to self-employed.

A sudden drop in the number of business bankruptcies for June and July produced a sharper decline in mid-year. It is not uncommon for business bankruptcies to fall during the summer months. However, the April to July drop was particularly sharp, suggesting that lower interest rates may be providing some relief for businesses in financial difficulty.



The limited statistics available for incorporated businesses suggest that this part of the business community has not been growing as rapidly or as steadily as the self-employed. Nor is there any indication that business corporations have experienced a notable increase in bankruptcy rates. This tends to confirm suspicions that, since early 1995 at least, business bankruptcies have grown largely because the numbers of self-employed have grown.

But the rise in self-employment could be as much the result of long-term employment problems, as of economic growth. People venture into self-employment for reasons other than optimism about the state of the economy. Some may be driven to it by long term unemployment or scarcity of good jobs. Many who are forced half-heartedly or reluctantly into self-employment will be ill equipped to succeed, increasing the likelihood that they will find themselves bankrupt.

To the extent that this has been part of recent experience in British Columbia, it has been fortunate for the unemployed that self-employment has provided an option. It is not necessarily a positive sign that so many have felt obliged to take it.

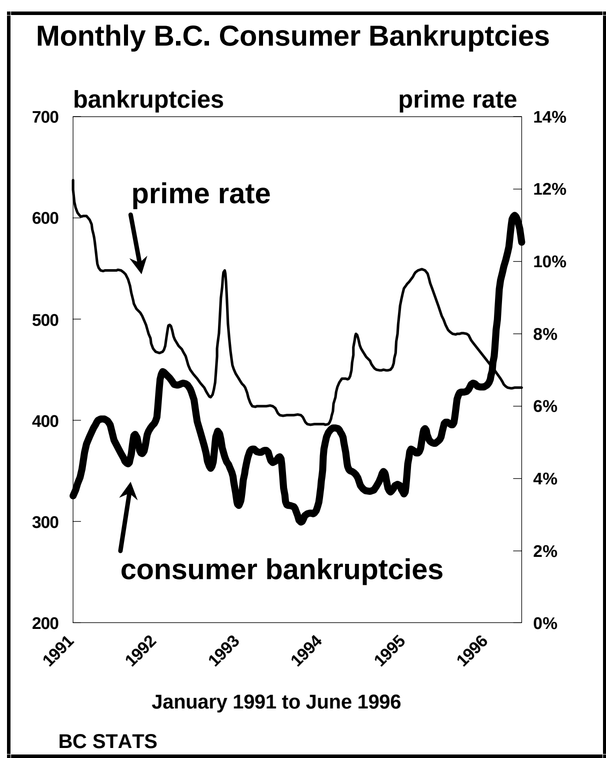
Consumer Bankruptcies Rise With Chronic Employment Problems and Mounting Debt Loads

The number of individuals declaring bankruptcy for household debts has been climbing at an alarming rate since early 1995. The trend threatens many businesses, but small businesses are particularly vulnerable.

Richard Allen, Chief Economist with the B.C. Credit Union Central notes that, 'Small businesses suffer more from consumer bankruptcies because the individual debts owed to them are often too small to be worth the expense of collection action. They have less resources to pursue delinquent debtors, and are less able to absorb the losses associated with bad debts.'

Consumer bankruptcies are filed when individuals become unable to cope with debts accumulated for personal, rather than business expenses. Divorce or job loss can sometimes precipitate the event, but in many cases it is simply that debt has accumulated to a level that can no longer be sustained.

Like business bankruptcies, consumer bankruptcies rise and fall according to the general state of the economy. Also like business bankruptcies, they can be expected to grow naturally as an expanding base increases the number of potential bankrupts. In the case of consumer



bankruptcies, the adult population provides a good measure of the base.

Over the past ten years the numbers of consumer bankruptcies in British Columbia have grown much faster than the population. From 2,773 cases registered in 1986, they rose through a cyclical pattern to 4,747 in 1995 – a 71% increase. Population growth over this period was 25%.

More recently, consumer bankruptcies have accelerated sharply, rising 83% from 988 in the fourth quarter of 1994, to 1,808 in the second quarter of 1996.

What is particularly disturbing about the recent rise is that it has occurred as interest rates have been falling.

No obvious explanation is to be found in unemployment rates, which have been more or less stable. However, unemployment rates and levels of unemployed do not tell the whole story regarding difficulties in the employment market. When jobs have been scarce for a long time, some people will cease to look for work and no longer be recorded as unemployed. Others may accept low paying ‘dead-end’ jobs or part-time employment.

Low quality employment of this sort is unlikely to provide people with the means to work their way out of debts, debts that may have been accumulated in the expectation of eventually finding good jobs. The dilemma is particularly familiar for the age group now in their late 20’s, who are sometimes labelled ‘generation X’.

Shortages of good paying jobs are not unique to British Columbia, or even to Canada. They are reflected in the growing number of part-time employees. Between 1988 and 1995 the number of part-time workers in British Columbia grew 5% faster than full-time workers. Even more telling, is the number of people who accepted part-time work because it was all they could find. Growth in this group jumped 32% between 1988 and 1995.

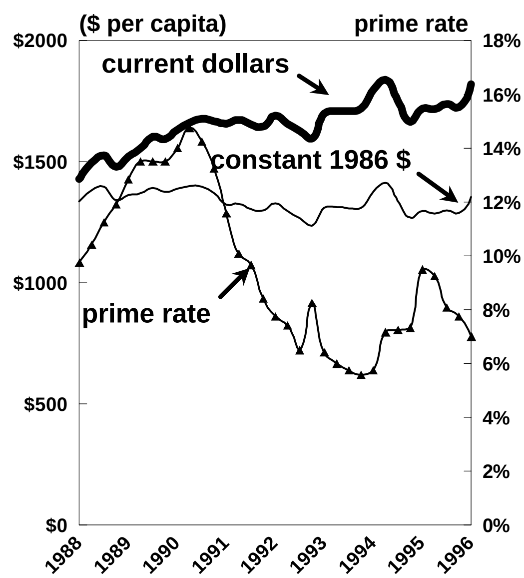
Conditions have been particularly bad for those in the youngest age groups. While there was a 25% jump in the number of full-time jobs for people aged 25 and older between 1988 and 1995, full-time jobs for 15 to 24 year olds actually fell 5%.

Widespread and chronic employment difficulties have driven many people to rely more on credit than they might otherwise have done. This, in turn, has produced mounting levels of consumer debt.

Debt levels faced by consumers can be estimated as per capita debt. This is calculated by dividing the total value of all personal (i.e. not business) credit borrowed from major financial institutions, by the total population. Major financial institutions include chartered banks, trust companies, credit unions and mortgage companies. Debts owed directly to retailers (buy now-pay later plans, retailer credit cards, etc.) are not included because no comparable statistics are available.

For the most discretionary form of spending, money spent on consumer goods, British Columbians have managed to keep debt levels down. **Per capita debt incurred to purchase consumer goods** came to $1,800 in the first quarter of 1996. This was virtually unchanged from the same quarter of 1988, after inflation is taken into account.

B.C. Personal Loans for Consumer Goods, Held By Major Financial Institutions



1st quarter 1988 to 1st quarter 1996

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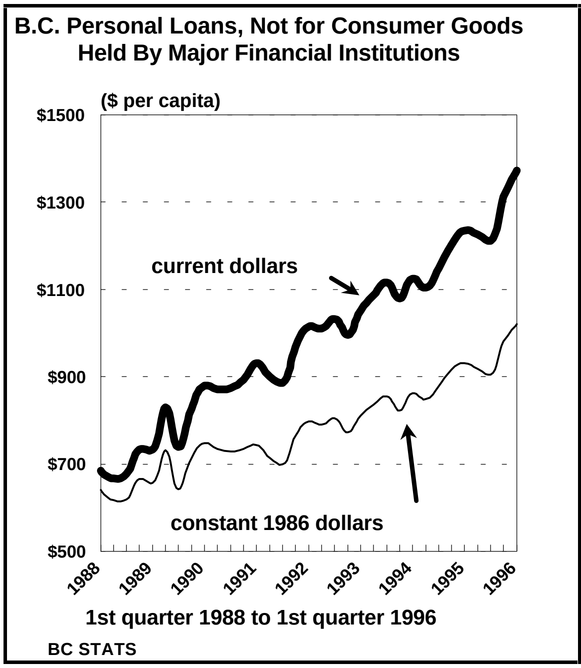
It has been a different story for debt incurred through loans for less discretionary forms of spending.

Per capita debt for expenditures on items other than consumer goods (excluding mortgage debt) has been increasing steadily for at least eight years in British Columbia and across Canada. British Columbia per capita debt for non-consumer good items doubled from about $700 in the first quarter of 1988, to

$1,400 in the first quarter of 1996. After allowing for inflation, the increase over the eight year period was 59%.

Borrowers have remained committed to spending in this category, continuing to accumulate debt, regardless of changes in interest rates. Annual jumps in per capita debt mark seasonal draws on student loans and payments for RRSP's.



Student loans owed to the federal or provincial governments account for a large part. The average debt carried by fourth year student loan borrowers in British Columbia rose to $22,000 in the 1995 - 1996 school year. For some individual students debt burdens have reached as high as $80,000.

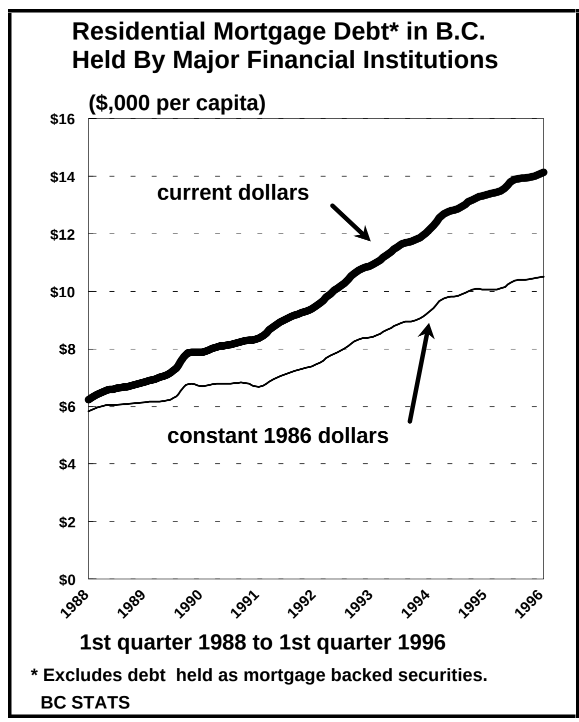
Mr. Harry Atkinson, Director of British Columbia's Orderly Payment of Debts Branch estimates that 20% or more consumer bankruptcies include student loans as an important part of the problem. 'Personal bankruptcy appears to be losing its stigma,' he says, 'and many are driven to consider it by relentless pressure from private collection agencies.'

Mr. Atkinson emphasizes that debt held by the poorest Canadians is generally at interest rates well above those available to people with greater financial resources. 'The only forms of credit available to most low income people are retail credit plans and credit cards. These typically demand rates of around 30% or more, double those available to people with enough income to qualify for personal bank loans.'

This component of household credit is not well represented in figures presented here because much of it is not obtained through major financial institutions. However, it is likely to be a significant part of total household debt; and it could be growing faster than others.

According to Mr. Atkinson, these high risk (from the point of view of the lenders) loans are becoming even riskier with recent high rates of delinquent payments and consumer bankruptcies. He feels that this tends to force lenders to keep interest rates up for these forms of credit, even as rates for more conventional loans have been falling.

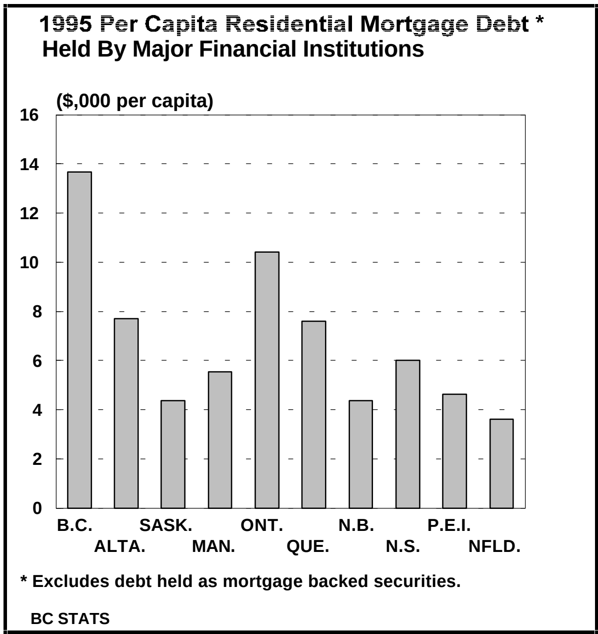
The most persistent rise in personal debt carried by British Columbians has been for **residential mortgages.** The increase since 1988, after allowing for inflation, has been 80%. Since 1994 the rise has been less rapid, slowed by falling house prices. Nevertheless, between first quarter 1994 and first quarter 1996, per capita residential mortgage debt rose 16%, after inflation.



A significant part of this growth is linked to other forms of household credit.

Mr. Atkinson notes that, 'A factor in the rapid growth of residential mortgage debt has been the rolling over of consumer (unsecured debt) into secured debt, as lenders overlend and secure themselves against higher risk. Another factor is that many homeowners who bought ten years ago have been accessing their equity to subsidize their cost of living. Real estate sales have declined or been flat in the past two or three years, yet the average residential mortgage debt load has continued to grow.'

Although many British Columbians have seen the market value of their homes decline in recent years, they still carry the highest per capita mortgage debt in Canada. Per capita mortgage debt in British Columbia was 32% higher than Ontario in 1995, and 78% higher than Alberta.

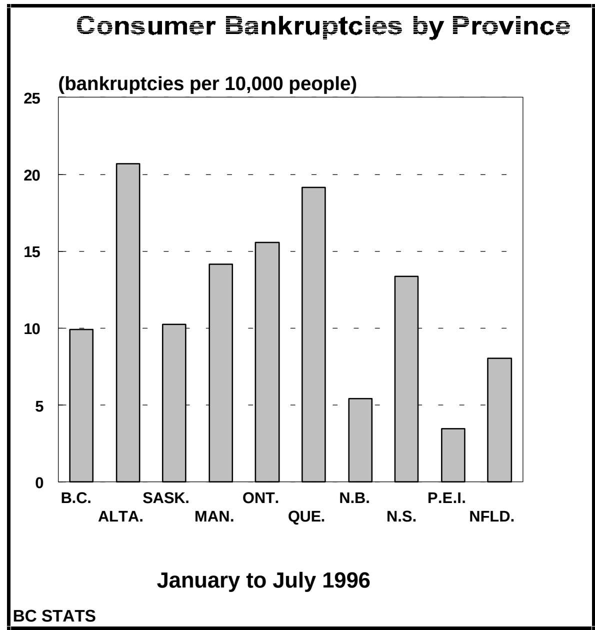


But apart from residential mortgages, British Columbians do not carry particularly high levels of debt by comparison with other provinces.

The province's $1,700 per capita debt in personal loans for consumer goods (with major financial institutions) was about the same in the rest of Canada except the Maritimes, where it was much higher. British Columbia's $1,250 per capita debt for personal loans spent on non-consumer good items was also close to the Canadian average, and considerably less than the $1,430 owed in Ontario.

Overall, British Columbia does not appear to be facing more of a consumer debt crisis than other provinces, particularly when account is taken of its relatively high level of personal income. Personal per capita income in the province was $24 thousand in 1995, about matching Ontario, and higher than all other provinces.

There are striking differences in per capita rates of consumer bankruptcies between the provinces, but these do not provide a good indication of the relative levels of financial difficulties faced by consumers in each province. Per capita bankruptcy rates are strongly affected by provincial bankruptcy regulations, which differ from province to province and largely determine people's willingness to declare bankruptcy or to settle their debts by some other route.



For example, the value of personal assets that can be retained after bankruptcy is $2,000 in British Columbia, while in Alberta the amount can be ten times that much. It should not be surprising that there are more than twice as many consumer bankruptcies per capita in Alberta as in British Columbia.

Debtors in British Columbia have also had better alternatives available to them to avoid bankruptcy. The province's Debtor Assistance Program has arranged about 1,000 consolidations of debt each year. Its appeal to debtors is to bring the total debt load to a level that can be settled within a reasonable period of time. The rate of interest on consolidation orders is 5%.

For creditors, it encourages full repayment of the amount owed, over an extended period of time.

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