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Jackpot Winners Just as Likely to Go Bust

by Laura Rowley

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In the new movie "Lottery Ticket," the rapper Bow Wow plays a sneaker salesman from a poor part of town who has to survive a three-day weekend after his neighbors find out he's holding the winning numbers.

But for financially troubled consumers, the size of the jackpot may not matter: Five years out, people who win $150,000 are just as likely to declare bankruptcy as those who win less than $10,000.

That's according to a new study by researchers at the University of Kentucky, the University of Pittsburgh and the Vanderbilt University Law School. The paper appears in a forthcoming issue of the Review of Economics and Statistics.

"I've always been interested in whether you could solve people's problems to some extent by giving them additional cash," says Mark Hoekstra, assistant economics professor at Pittsburgh, who co-authored the paper with Kentucky's Scott Hankins and Vanderbilt's Paige Marta Skiba. "And anecdotally you always hear these things about lottery winners -- someone wins a bunch of money and the story doesn't end very well. But we weren't aware of any real empirical evidence on whether this was true."

The researchers identified 35,000 people who won between $600 and $150,000 in Florida's Fantasy 5 lottery game from April 1993 through November 2002. (They eliminated the 153 people who won more than $150,000). They cross-referenced that list with people who filed Chapter 7 or Chapter 13 petitions in Florida five years prior to winning the lottery and five years afterward. Then they compared people who received $50,000 to $150,000 to those who won less than $10,000.

They found 1,943 winners -- or 5.5 percent -- declared bankruptcy within five years of taking home the jackpot. While the bigger winners were 50 percent less likely than small winners to file for bankruptcy within 24 months, they were *more* likely to file for bankruptcy three to five years after winning. The net result is that within five years, large winners were just as likely to file for bankruptcy as small winners.

'Found Money'

Moreover, when people who won $25,000 to $150,000 did file for bankruptcy, their net assets were just $8,000 higher than those who had won less than $1,500. Bottom line: The median big winner took home $65,000 in cash. That would be enough, on average, to pay off all unsecured debt or to boost the equity in new or existing assets. Instead, the big jackpots simply evaporated.

"The fact that winning a large sum of money only postponed bankruptcy rather than prevented it didn't surprise me too much," says Hoekstra. "But I was struck by the fact that when the recipients of large sums did file for bankruptcy, they didn't have much of anything to show for the winnings they had received. It didn't go toward a house, paying down debts or buying assets that were worth something a few years later. We couldn't find any evidence that five years earlier, these people had received what would be, for many people, a life-changing amount of money."

What happened? Hoekstra says he can only speculate. "We know quite a lot about lottery winners' finances once they file for bankruptcy, but we certainly don't know what they were thinking when they won the money," he says. "It's possible that people in our sample weren't used to dealing with large sums of money, and thus they may not have used it wisely."

Mental accounting may also play a role. "We treat 'found money' differently than money we earn. So if you find $20 on the sidewalk, you may decide to blow it on a nice dinner, whereas if you earned it you wouldn't have done that," Hoekstra says. (And lottery winnings are the ultimate "found money.") Other possible suspects: A lack of financial literacy or a surplus of impatience -- some people would rather have fun today than be financially secure five years in the future.

The researchers also found that while large winners lived in somewhat more expensive houses than small winners, they were no more likely to own a home outright, and had no more equity in their homes than small winners. This suggests that larger winners were not strategically planning their bankruptcies and gaming the homestead exemption in Florida bankruptcy law, which allows filers to keep their primary residence. If this were the case, winners would have bought a home for cash or paid off their existing mortgage prior to filing, in order to keep some of their assets out of bankruptcy.

What Policy Makers Can Learn

The study has policy implications for governments deciding how to help heavily indebted people who are struggling during economic downturns, Hoekstra says. It appears the simplest solution -- giving them cash -- doesn't enhance longer-term financial stability, and only postpones, rather than avoids, bankruptcy. The lottery findings are consistent with a 2007 research paper that showed consumers initially used their 2001 federal rebate checks to reduce debt, but eventually debt returned to its pre-rebate level.

"Our research suggests that perhaps there is something more systematic about the types of people who get themselves into financial trouble -- and the appropriate policy prescription for helping them out is going to be considerably more complex than giving them additional resources," says Hoekstra.

In addition, the findings challenge the assumption that bankruptcy is caused primarily by major financial shocks.

"Winning the lottery undid any negative shock (that previously occurred) for the large winners, and they still ended up filing for bankruptcy," Hoekstra says. "That is inconsistent with the idea that the only people who file for bankruptcy are those with negative shocks such as divorce, job loss or health issues."

Finally, if you're one of those people who fantasizes that winning the lottery will fix your financial woes, it's time to stop dreaming and get a real handle on your money. "Our results suggest that people in financial trouble shouldn't expect that winning $100,000 will cause a lasting impact in their finances," Hoekstra says. "On average, that doesn't appear to happen."