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THE INTRODUCTION OF PERSONAL BANKRUPTCY LAW IN CHINA: A COMPARATIVE ANALYSIS

By

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Abstract

This thesis is a comparative research study looking at the question of whether China is an exception when considering the lack of necessity for the introduction of laws relating to personal bankruptcy. Firstly, this thesis discusses the function of a personal bankruptcy system and considers how personal bankruptcy law functions as a form of social insurance from a theoretical perspective. Then, the thesis discusses how different jurisdictions design the framework of personal bankruptcy law. Countries embrace the insurance function of insolvency law differently. In addition to describing the institutional framework in different jurisdictions, it also explores how the law is shaped and what Chinese policymakers can learn from the experiences of the legislative process in other jurisdictions. After learning from experiences from other countries, this thesis discusses the necessity for the introduction of personal bankruptcy law in China. It argues that the growth of consumer credit will lead to individual over-indebtedness. Accordingly, Chinese policymakers should think about the response to over-indebtedness in advance. Then, the thesis demonstrates that current solutions to overindebtedness are not effective so that a personal bankruptcy system is necessary. However, introducing personal bankruptcy law is not an easy task in the Chinese context and this thesis discusses the obstacles to introducing a personal bankruptcy system in China. It focuses on whether there are any obstacles relating to infrastructure and cultural factors likely to be encountered when introducing the personal bankruptcy law. In the last chapter, this thesis analyses the institutional framework of personal bankruptcy regulation at local level. It discusses how lawmakers in China embrace the insolvency law's insurance function.

List of Abbreviation

US	United States
UK	United Kingdom
DRO	Debt Relief Order
IVA	Individual Voluntary Arrangement
IMF	International Monetary Fund
IP	Insolvency Practitioner
OECD	Organization for Economic Co-operation and Development
NPC	National People's Congress
CBRC	China Banking Regulatory Commission
EOAPS	Employee Old-Age Pension System
URPP	Urban Residents Pension Program
BPIURR	Basic Pension Insurance for Urban and Rural Residents
UEBMIS	Urban Employee Basic Medical Insurance Scheme
RCMS	Rural Cooperative Medical System
NCMS	New Cooperative Medical System

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Any mistakes and defects in this thesis remain my own responsibilities.

Contents

CHAPTER 1 INTRODUCTION

1.1 Introduction

Compared with the long history of China, the story of bankruptcy law is relatively short and recent. Before 1949, three pieces of legislation related to bankruptcy had been enacted by previous rulers. When the Communist Party took power in 1949, the new government abolished all laws legislated by the previous government and the Communist Party started to establish its own legal system. Unfortunately, the occurrence of the Cultural Revolution pressed the pause button on the development of the Chinese legal system. However, by the late 1980s, China had relaunched its modernisation of legal systems. In the 1990s, fierce debates about whether a bankruptcy law should be enacted had begun. Some representatives in Congress considered the introduction of a bankruptcy law too hasty, though they admitted the need for a law.[1] Some thought the phenomenon of bankruptcy only occurred under capitalism because all assets in China belonged to the nation at that time.[2] As the economic transition deepened, some enterprises would fail but some would prosper. How to deal with those failed enterprises became urgent in policymakers' agenda. Although lawmakers have tried some alternatives to bankruptcy, such as a takeover, the bankruptcy process was still necessary.[3] Eventually, despite ideological conflicts and the nascent stage of the Chinese legal system, the first Chinese bankruptcy law was introduced in 1986. However, given that most

[1] Feng Chen, 'Chinese Bankruptcy Law: Milestones and Challenges' [1999] 31 St Mary's Law Journal 49, 52.
[2] Ibid.
[3] Michael Minor and Karen J Stevens-Minor, 'China's Emerging Bankruptcy Law' [1988] 22 International Lawyer 1217, 1218.

enterprises are State Owned Enterprises (SOEs), the law was only applicable to SOEs at that time. As the market developed, private enterprises sprung up quickly. Then, lawmakers started to deal with insolvent private enterprises. The solution was to address the problem in the PRC Civil Procedure Law; the 1991 Civil Procedure Law had introduced a separate chapter applying to the bankruptcy of non-SOE companies with legal person status.[4] However, both the 1986 Bankruptcy Law and 1991 Civil Procedure Law were too brief so that they were lacking sufficient detail and had many gaps.[5] Therefore, there was a need to reform the bankruptcy law and this was initiated in 1994. Fierce debates occurred in areas concerning the scope of the law, bankruptcy administration, corporate rehabilitation, priorities in distribution and the treatment of employee's interests as well as the cross-border bankruptcy problems.[6] After much deliberation and negotiation, the new Enterprise Bankruptcy Law came into force in 2007. As its name indicates, the new law is only applicable to companies with legal person status. Non-legal persons such as partnerships and sole proprietorships and consumers are not covered by the bankruptcy system. Given this, some scholars considered the law as 'halved bankruptcy law'.[7]

1.2 Research Questions

At the time Chinese policymakers were reforming China's insolvency system, lawmakers in

[4] Charles D Booth, 'The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over' [2008] 20 Singapore Academy of Law Journal 275, 277.
[5] Ibid.
[6] Ibid.
[7] 李曙光, '中国其实只有"半部破产法"'[2007] 1 商界（中国商业评论）95 (Shuguang Li, "China Actually only Has 'Halved Bankruptcy Law' (in Chinese) [2007] 1 Business(Review) 95).

other jurisdictions were also putting the improvement of bankruptcy law on their agenda. However, reforms happening in other countries involved the introduction of personal bankruptcy law. In the late of 20th century, personal bankruptcy law experienced the first wave of expansion in the United States and Europe.[8] Furthermore, given the advent of the 2008 financial crisis, more countries have made legislative changes in their personal insolvency law.[9] However, China has not followed the two waves of the diffusion of personal bankruptcy law. At present, the Chinese insolvency system still excludes individual debtors. The exclusion of natural persons in bankruptcy law raises the question of whether China is an exception in which a personal insolvency system is not necessary or whether there are some technical obstacles for introducing a personal bankruptcy law. Therefore, this thesis aims to explore the necessity and feasibility of personal bankruptcy law in the Chinese context. If personal bankruptcy law is necessary and feasible, then, an additional question may be, 'What is an appropriate institutional design for individual bankruptcy law in China?' It is hard to find a proper answer to this question because there is no international consensus on best practices for personal bankruptcy law. However, due to the fact that some Chinese local courts have started to accept personal insolvency cases since 2019, those judicial practices in Chinese soil provide insightful information on the benefits and costs of current institutional designs and Chinese lawmakers can benefit from those valuable experiences. Therefore, instead of suggesting a specific institutional framework for personal bankruptcy law in the Chinese context, this thesis evaluates current practices and suggests future development. Accordingly,

[8] Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 2.
[9] Ibid 3.

this thesis indirectly explores a pertinent answer to the question relating to the institutional framework of Chinese personal bankruptcy law.

1.3 Research Methodology

This thesis will be a library-based study, which basically depends on a review of existing literature, legislation, case decisions and official documents. It is a comparative research project which utilizes the functional approach to consider the introduction of law as a policy response to a new social phenomenon.[10] According to the theory of functionalism, there is an assumption that, though the institutional framework of personal bankruptcy law varies, those provisions have a similar purpose or function. By conducting research on personal bankruptcy regulations in three jurisdictions, namely the United States, the United Kingdom and Germany, it is beneficial for Chinese lawmakers to identify the function or purpose of the personal bankruptcy law. In this sense, Chinese lawmakers can benefit from understanding the function of the law at two levels. First, Chinese legislators can find whether the new phenomenon addressed by personal bankruptcy law exists in Chinese society. Second, legislators can review current Chinese legal system and explore whether any institutions in this system have similar functions to personal bankruptcy law. Then, legislators can decide whether a new law should be introduced as the response to the new phenomenon. Therefore, functionalism can contribute to answering the question of necessity and feasibility of personal insolvency law in the Chinese context.

[10] Mathias Siems, *Comparative Law* (Cambridge University Press, 2014) 14.

However, prior to the beginning of the detailed analysis, one essential methodological question should be addressed. The question is, "Why does this thesis choose the United States, the United Kingdom and Germany as the basis of the study?" At first sight, from a comparative perspective, personal bankruptcy law can be classified into two groups, the 'old' system and 'new' system.[11] Old systems are primarily recognised in common law countries while new systems mainly lie in continental Europe.[12] Learning both old and new systems can help to evaluate how well the rules serve their function. In this respect, this learning process may broaden Chinese lawmakers' horizon on designing more effective provisions. However, though it is beneficial to derive lessons from both legal families, these specific countries are selected for several reasons. As far as the United States is concerned, its personal bankruptcy law often 'serves as an international model to be either emulated or avoided.'[13] In practice, lawmakers in continental countries are, more or less, influenced by the US model.[14] Therefore, taking into consideration the worldwide impact of American personal bankruptcy law, this thesis chose it as an object of study. Due to the uniqueness of American personal bankruptcy law,[15] it has already been paid much attention by scholars with the result that English insolvency law is to some degree neglected. However, English law was at the root of Anglo-American legal families and debt relief first occurred in England. Given this, English insolvency law is also used as an object of study. With regard to German debt relief law, the main reason for this choice

[11] Ramsay (n 8) 4.
[12] Ibid.
[13] Ibid 7.
[14] American consumer bankruptcy attracts European policymakers' attention because of the positive connection between a swift fresh start and entrepreneurialism. Id at 34; see also Nick Huls, 'American Influences on European Consumer Bankruptcy Law' [1992] 15 Journal of Consumer Policy 125.
[15] David Skeel described the pro-debtor US bankruptcy law was unique worldwide. David Skeel, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press 2001).

is that China has borrowed legal concepts heavily from Germany, rendering the Chinese legal system broadly a civil law jurisdiction. Furthermore, German approaches to personal bankruptcies have some innovative mechanisms, which deserve to be studied.[16] Therefore, researching German insolvency law may enable China to have a better understanding of how to design the framework on the basis of a civil law system.

1.4 Significance of the study

The thesis makes several essential contributions to knowledge. First, compared to other Chinese research on personal bankruptcy law, this thesis provides valuable information on understanding the function of personal bankruptcy law for Chinese lawmakers. Even though there is currently no personal bankruptcy law in China, a certain number of Chinese scholars have shown an interest in this given law regime. Chinese scholars have published a certain number of articles or books discussing the institutional framework for personal insolvency law in the Chinese context.[17] Those proposals have borrowed experiences from advanced and industrialised countries or regions. However, scholars have mainly focused on legal texts and overlooked how those rules function in their home countries or regions and what objectives

[16] Jason Kilborn, 'The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States' [2003] 24 Northwestern Journal of International Law & Business 257.

[17] 卜璐，消费者破产法律制度比较研究（武汉大学出版社，2013）(Lu Bu, *A Comparative Analysis of Consumer Bankruptcy Law* (Wuhan University Press, 2013) (in Chinese))；刘静，个人破产制度研究－以中国的制度构建为中心（中国检察出版社，2010）(Jing Liu, *Personal Bankruptcy Law in the Chinese Context* (China Procuratorial Press, 2010) (in Chinese))；胡玲，债务人生存权益视角下的我国个人破产立法研究（中国法制出版社，2014 ）(Ling Hu*, Research on Chinese Personal Bankruptcy Law: From the Perspective of a Debtor's Interest* (China Legal Publishing House, 2014)(in Chinese)).

the law is expected to achieve.[18] Compared with other articles or theses, this thesis not only describes the rules in various jurisdictions but also examines their history and their practical effects. Examining the history of individual bankruptcy law in different jurisdictions provides beneficial knowledge on understanding the leading debates in the legislative process. Hence, it will be helpful to grasp those issues needed to be addressed by this given law. Additionally, evaluating the practical effects of the rules is useful to find out whether the legislative purpose is achieved.

The second significant factor is that this thesis presents more comprehensive explanations on the necessity and feasibility of personal bankruptcy law in the Chinese context. Although several Chinese scholars have provided certain reasons for the establishment of individual insolvency law,[19] which include the need to comply with international standards, increasing household credit and the need to protect unincorporated business organisations,[20] few examine current Chinese treatment to personal bankruptcies. Hence, Chinese academia to some extent fails to recognise the effectiveness of present approaches to personal

[18]齐砺杰，债务危机，信用体系和中国的个人破产问题（中国政法大学出版社，2017）(Lijie Qi, Debt Crisis, Credit System and Chinese Personal Bankruptcy (China University of Politic Science and Law Press, 2017) (in Chinese)).

[19] 徐明 ,李志一, '建立《公民个人破产法》之我见' [1990] 4 法学 46 (Ming Xu and Zhiyi Li, 'Opinions on the Introduction of Personal Bankruptcy Law', [1990] 4 Law 46 (in Chinese)); 汤维建.关于建立我国个人破产制度的构想（上）[1995] 3 政法论坛 41 (Weijian Tang, 'The Establishment of Personal Bankruptcy Law in China (Part 1)', [1995] 3 Tribune of Political Science and Law 41(in Chinese)); 汤维建.关于建立我国的个人破产程序制度的构想（下）[1995] 4 政法论坛 46 (Weijian Tang, 'The Establishment of Personal Bankruptcy Law in China (Part 2)',[1995] 4 Tribune of Political Science and Law 46(in Chinese)); 李曙光.关于新《破产法》起草中的几个重要问题 [2002] 3 政法论坛 8 (Shuguang Li, 'Several Essential Issues on the Draft of New Bankruptcy Law' [2002] 3 Tribune of Political Science and Law 8(in Chinese)); Huifen Yin, 'Consumer Credit and Over-indebtedness in China.' [2018] 27 International Insolvency Review 58.

[20] Ibid.

insolvencies. It is only if existing approaches cannot address issues, that legislators may consider a new solution. This thesis observes that current approaches to personal bankruptcy fail to distribute debtors' limited assets in an orderly and fairly way. In the meantime, the absence of debt relief and the deep fear of debtor fraud lead to downplaying debtor rehabilitation. As a result, it is difficult for individuals with unpaid debt to have a dignified life. The ineffectiveness of current Chinese treatment of personal bankruptcy partly justifies the introduction of debt relief law in China. Additionally, based on the assumption that bankruptcy discharge functions as a supplement to social insurance programmes,[21] this thesis examines whether the present Chinese social safety net can provide support for those individuals with excessive debt. In this sense, this thesis observes that there are still distinctions between urban citizens and rural households in terms of entitlement and the coverage rate of social insurance programmes particularly unemployment insurance, even though the Chinese government is committed to a universal welfare system. Hence, the establishment of personal insolvency law may fill the gap between rural households and urban citizens.

The third significant point that this thesis examines is the current judicial practices and legislative experimentation in China; it evaluates the extent to which it embraces the insurance function of insolvency law. Though there is no nationwide personal bankruptcy law, some courts and government at the local level have experimented with addressing personal bankruptcies. This thesis compares those judicial experiments with personal bankruptcy

[21] Adam Feibelman, "Defining the Social Insurance Function of Consumer Bankruptcy" [2005] 13 American Bankruptcy Institute Law Review 1.

regulations in other jurisdictions including the United States, the United Kingdom and Germany. It observes that the current institutional framework reflects some features of debt relief law in the three above mentioned jurisdictions. However, there are some Chinese characteristics. The comparative analysis provides a primitive picture of how Chinese lawmakers might design the scope of a fresh start in the Chinese context. Therefore, those experimental practices contain valuable information on understanding the potential institutional framework of a nationwide debt relief law.

However, some limitations of this thesis should be noticed. In order to argue for the necessity of Chinese personal bankruptcy law, this thesis maps a trajectory of the developing problem of individual overindebtednss in China through the data on household debt. The thesis has analyzed some under-lying reasons of individual over-indebtednss. However, this thesis does not provide a detailed profile of a Chinese debtor, which may provide more insight into understanding how China-specific social-economic factors shape and contribute to the rising levels of over-indebtedness. This limitation results from the limited empirical data on portraying social-economic conditions of Chinese individual debtors. Such an issue may be addressed through further research, which is beyond the research questions of this thesis.

1.5 Chapter Summary

Chapter 2 provides a theoretical analysis of personal bankruptcy law. Traditionally, bankruptcy law is considered as a debt collection mechanism which mitigates collective action problems arising from individual enforcement. However, when debtors are natural persons, bankruptcy law not only plays a role in debt collection but also undertakes debtors' economic

rehabilitation as another policy objective. To ensure debtors' recovery, the law permits individuals to be discharged from pre-existing debt after the conclusion of insolvency proceedings. This characteristic of personal bankruptcy law is also called the fresh start policy. The essence of a fresh start is that more defaulting risks are compulsorily transferred from debtors to creditors. Hence, bankruptcy discharge can be best understood as a sort of social insurance. However, to some extent, the idea of risk reallocation conflicts with the concept of the maximization of the creditors' recovery. Therefore, there should be a justification for the risk reallocation between creditors and debtors. In this respect, this chapter aims to explain why creditors should bear more of the defaulting risks. This chapter argues that the creditor is a better controller of defaulting risk and can spread the risk more effectively. In addition, stressing the law's debt collection mechanism is challengeable in the context of personal bankruptcy because the debt contract is not as efficient as would be expected in the contemporary credit market, and thereby a debtor's rehabilitation may be the core objective. Furthermore, the individual and structural consequences of excessive household debt make risk reallocation necessary. Last but not least, the fear of moral hazard arising from bankruptcy discharge should not be overemphasized and therefore it is not a sensible reason for rejecting the idea of a fresh start.

Chapter 3 provides an examination of American personal bankruptcy law. There is a consensus that individual bankruptcy law in the United States acts as social insurance, which ensures over indebted debtors against financial difficulties. Under the Bankruptcy Code, personal debtors can file for Chapter 7 or Chapter 13 to address their debt issues. Chapter 7 is a liquidation

process whereby individuals can obtain a swift discharge after the relinquishment of non-exempt property. Comparatively, Chapter 13 is a debt adjustment plan whereby debtors need to surrender their disposable income within a certain period in exchange for debt relief. After examining the institutional framework of American personal bankruptcy law, this chapter reviews the history of the law's development. It observes that the evolution of debt relief law is fraught with conflicts. The fierce debate arises from whether the skyrocketing number of bankruptcy cases results from the debtor's abuse of the quick discharge policy. As a result of this debate, the pro-creditor ideology that debtors are opportunists has gradually come to dominate the development of American personal bankruptcy law since 1978. However, through the examination of the effects of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA 2005), this chapter finds the new act may fail to sort out those so-called abusers but may prevent needy debtors from obtaining bankruptcy protection. Hence, the failure of the BAPCPA indicates that the moral hazard is not as severe as policymakers expect. Through studying American personal bankruptcy law, policymakers in other jurisdictions can recognise that a policy debate may occur due to the inherent conflicts in the law. However, the United States experience reflects that policymakers should not overemphasise the fear of moral hazard arising from bankruptcy discharge.

Chapter 4 studies the debt relief law in England and Germany. This chapter first outlines the institutional framework in the UK and Germany. Though debt relief is possible both in the UK and Germany, the insolvency proceedings are quite different. Additionally, this chapter examines the extent to which English and German personal bankruptcy regulations embrace

the social insurance function of insolvency law at a practical level. Though policymakers generally claim that the institutional framework will strike a balance between creditors and debtors, the balance is hard to reach and, in some cases, the insurance function may be limited at the practical level. To understand the institutional differences between jurisdictions and the gap between 'law in book and law in practice', this chapter argues that interest groups and their narratives play an important role in shaping the framework of the law. Hence, when a country is interested in introducing personal insolvency law, simply transplanting models from other jurisdictions is not appropriate.

Chapter 5 describes the household credit market and over-indebtedness in China. Experiences from other jurisdictions indicate that the introduction of personal bankruptcy law is the policy response to individual over indebtedness. Therefore, this chapter studies whether household over-indebtedness is a severe issue in China. This chapter observes that household credit has experienced a skyrocketing upward trend in the last decade. Though the expansion of credit attracts attention from authorities, policymakers show more concern for the systematic financial risks arising from household credit. In this sense, the current level of household credit seems healthy and sustainable. However, this chapter argues that the likelihood of household over-indebtedness is on the rise. Firstly, due to the penetration of credit, more and more individuals have access to credit. However, a considerable number of consumers are using expensive or unaffordable credit, which may contribute to individual over indebtedness. In addition, the slowdown of the Chinese economy may decrease the debtors' future income. Credit is borrowing from tomorrow based on the debtors' presumed ability to pay from future

expected income. The potential income fluctuation may impair the repayment capability and thereby lead to over indebtedness. Furthermore, rising living costs will restrict the capability of indebted debtors to service debts and contribute to over indebtedness. Accordingly, even though the present level of consumer credit will not harm the overall financial system, this by no means indicates that over indebtedness does not apply to Chinese households. Therefore, Chinese lawmakers should consider the introduction of a personal bankruptcy system.

Chapter 5 argues that the likelihood of over indebtedness will increase in the Chinese context and thereby the establishment of personal bankruptcy law is necessary. This argument is based on the assumption that current Chinese treatment to over indebtedness is ineffective. Chapter 6 aims to demonstrate whether the assumption is valid. First, this chapter outlines the Chinese individual enforcement system. Current enforcement will not effectively deal with personal bankruptcy cases. From the creditors' perspective, the enforcement system may not distribute debtors' limited assets among multiple creditors in a fair and orderly way. From the standpoint of debtors, present institutions do not recognise the element of debtor rehabilitation. Due to the absence of debt relief and the strict punitive restrictions imposed upon debtors, individual debtors practically bear all defaulting risks. Additionally, given that bankruptcy discharges actions as substitutes for other social insurance programmes from the theoretical perspective, this chapter examines whether the current Chinese welfare system can effectively protect individuals from financial difficulties. After reviewing the structure of the Chinese welfare system and its performance, this chapter observes that the current Chinese social safety net has limitations to insure those vulnerable groups, especially rural

residents, against financial risks. Therefore, personal bankruptcy law is needed to fill the gap arising from the fragility of current social welfare policy.

Assuming that the introduction of debt relief law is necessary, Chapter 7 considers whether transplanting such a law into the Chinese legal system is possible. Beginning with the theoretical analysis of legal transplantation, this chapter argues that legal borrowing is possible. Furthermore, whether the law fits into the environment of the recipient country may determine the success or failure of legal borrowing. In the early 2000s, personal bankruptcy law was considered as a system departing from the Chinese context. The reason was that debtors may dodge a creditor in the bankruptcy procedure due to the absence of well-developed institutions such as a property registration system and credit reporting mechanism. By examining the development of the two institutions, this chapter argues that they can be competent to prevent debtors from abusing the bankruptcy system. In addition, the social context refers not only to institutions which help to enforce new legislation, but also to informal cultural factors such as traditions, social norms or values. Therefore, this chapter examines whether the introduction of personal bankruptcy law is consistent with Chinese culture. In this sense, given that traditional Confucianism still has an impact on the modern Chinese legal system, this chapter links bankruptcy discharge with Confucianism. It finds that forgiving debtors is not embodied in Confucian ethics. However, if debt relief law can address disputes between creditors and debtors and can contribute to the establishment of a harmonious society, such a system has the possibility of being accepted in the Confucian world. However, this chapter argues that swift discharge may not be acceptable to the Confucian

world where morality plays an important role.

Chapter 8 provides some insight into understanding the institutional framework of Chinese individual bankruptcy law. Though the Chinese bankruptcy system does not apply to natural persons, the voices calling for the introduction of personal bankruptcy law in China have become louder in recent years. Therefore, the first section constitutes a brief background regarding the establishment of debt relief law and outlines the objectives which policymakers wish to achieve. Then, given that courts at the local level have delivered some judgments on personal bankruptcy cases, this chapter describes the institutional designs of those regional experiments. From a comparative perspective, this chapter argues that the present framework has embodied not only characteristics of other jurisdictions including the US, the UK and Germany, but also some Chinese features. Under present judicial practices, this chapter discovers that creditors' interests are comprehensively protected but debtor recovery is limited. Finally, this last section evaluates whether the rules can achieve those goals set by the authority.

Chapter 9 is a conclusion of this thesis and a brief outline of issues for further research.

CHAPTER 2 THEORIES OF PERSONAL BANKRUPTCY LAW

2.1 Introduction

Traditionally, bankruptcy law as a debt collection mechanism plays a significant role in maximising creditor recovery through the collective and mandatory features of bankruptcy proceedings.[1] However, when defaulting borrowers are natural persons, bankruptcy law not only focuses on ensuring creditors' interests but also provides debtors with a fresh start. This chapter argues that bankruptcy discharge is a form of social insurance. By permitting borrowers to be free from pre-existing debt and allowing them to keep necessary assets out of creditors' hands, more defaulting risks are borne by creditors. Given that creditors will bear more of the risk arising from debt default, it is necessary to explain why they should accept such burdens.

The starting point in explaining the insurance function of insolvency law is to determine the superior risk bearer in the creditor-debtor relationship. The traditional view assumes that debtors have the better ability to prevent default, given they have a better knowledge of their financial circumstances.[2] However, the development of the consumer credit market enables creditors to measure consumers' creditworthiness more accurately than debtors do. Furthermore, given that creditors will deal with a vast number of debtors, they have a better ability to spread the loss of default. Therefore, creditors are the superior risk bearers.

[1] Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (BeardBooks, 2001).
[2] Theodore Eisenberg, 'Bankruptcy Law in Perspective' [1980] 28 University of California Law Review 953, 982.

Though creditors have better ability to bear the loss resulting from defaulting, the question arises as to why those risks are mandatorily imposed upon creditors. There are several reasons for shifting the burden of consumer debt default to creditors. First, when making borrowing decisions, consumers are not always rational; this will be discussed later in this chapter. By contrast, they will be subject to cognitive influences including overconfidence, availability heuristic, hyperbolic discounting and bounded willpower. In other words, consumers may have misleading conceptions of future defaulting loss. They tend to underestimate the risks and believe that they will not encounter financial difficulty. Furthermore, profit-seeking business people may take advantage of debtors' cognitive weakness. As a result of cognitive weakness, consumers may have a larger chance of borrowing too much and becoming over-indebted. Over-indebted individuals may be prone to live on social support, which imposes a heavy burden on society as a whole. Additionally, due to these intrinsic cognitive factors, consumers have less interest in purchasing credit insurance along with their debt contracts. Therefore, there is a good reason for policymakers' intervention in the creditor-debtor relationship.

Secondly, there is the challenge of overemphasising the debt collection mechanism in personal bankruptcy. Behind the debt collection mechanism, there is an assumption that pre-bankruptcy contracts are economically efficient, and thereby bankruptcy law should maintain the contractual agreements close to their former status. However, in the personal bankruptcy context, this chapter argues that the debt contracts signed by consumers depart from the economically contractual agreements in the contemporary credit market. Theoretically, a voluntary agreement between well-informed parties with equal bargaining power should

produce a financially efficient result. However, in the context of consumer debt contracts, lenders have more information about borrowers' creditworthiness and credit products than borrowers, thereby undercutting assumptions about the economic efficiency of such agreements. Additionally, due to structural factors including the government's encouragement on the growth of credit, wage stagnation, rising living expenses and the retreat of welfare payments, credit is more and more used as an important tool to maintain living standards. Thus, consumers may have to rely on loans for their existence. In this sense, individuals may 'involuntarily' enter into debt contracts. When a contract is involuntarily reached, it is problematic to regard it as economically efficient. Together, these factors suggest that pre-bankruptcy debt contracts may not be as efficient as assumed. Accordingly, the wisdom of prioritising debt collection in precarious consumer debt transactions is questionable.

Thirdly, over-indebtedness will lead to severe consequences so that reallocating default risks is necessary. From an individual perspective, debtors with excessive debt will suffer from mental and physical issues. Furthermore, the costs of over-indebtedness have spillover effects with negative consequences for society as well. The Global Recession of 2008-09 is a vivid example in explaining how high levels of household debt can destroy macro-economic stability. To address the consequences of over-indebtedness, consumer bankruptcy is viewed as an effective approach by redistributing the default risks more efficiently. Therefore, debt relief as an insurance functions as a 'macroeconomic stabiliser and safety net for distressed households'.[3]

[3] Joseph Spooner, *Bankruptcy: The Case for Relief in an Economy of Debt* (Cambridge University Press,

Furthermore, this chapter asserts that the moral hazard of embracing the insurance function of insolvency is overemphasised. 'Moral hazard' refers to the possibility that insurance coverage will reduce the insured's incentive to take steps to avoid risky activities.[4] In this view, consumers are assumed to abuse personal bankruptcy proceedings by *ex-ante* incurring excessive debt and escaping from their financial obligations through personal insolvency law. Debtors may be prone to borrowing more when they recognise they have problems with debt.

However, the concept of moral hazard should not be overstressed. On the one hand, it is hard to measure the effects of moral hazard, and there is little convincing evidence showing that a large number of borrowers are abusing bankruptcy discharge. On the other hand, bankruptcy legislation itself has mechanisms to prevent abuses, and the risk of moral hazard is controllable. Therefore, the risk of moral hazard should not be the excuse which precludes policymakers from accepting the law's insurance function.

This chapter will be structured as follows: first, section 2 will explain the two functions of personal bankruptcy law; then section 3 justifies the insurance function of insolvency law. Section 4 discuss whether the moral hazard is a big concern for the introduction of personal bankruptcy law. Finally, a brief conclusion will be provided.

2019) 81.

[4] Charles G Hallinan, The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory [1986] 21 University of Richmond Law Review 49 84,92,102.

2.2 Two Functions of Personal Bankruptcy Law

(1) Personal Bankruptcy law as a Debt Collection Device

Theoretically, insolvency law is used as an instrument to benefit creditors as a group, and it can provide positive outcomes in the situation of debtors' default.[5] According to Professor Jackson's explanation, individual creditor remedies may not provide the best outcomes for creditors when debtors do not have enough assets to cover financial obligations. In order to obtain full returns, creditors will compete with each other[6] because 'they grab rules of nonbankruptcy law and their allocation of assets on the basis of first-come, first-served'.[7]As a result of competition, the 'prisoner dilemma' and the 'common pool' problem will be raised.[8] Using bankruptcy law as a debt collection tool can effectively address the prisoner dilemma or the common pool problem. The mechanism works by making those diverse creditors act as a group through imposing a 'collective and compulsory' stay on them at the commencement of bankruptcy proceedings.[9] Collective bankruptcy proceedings may increase the aggregate value of assets used to repay creditors, which Professor Jackson refers to as 'a larger aggregate pie'.

Additionally, a collective and compulsory procedure can avoid the costs resulting from the

[5] Spooner (n.3) 78.
[6] Jackson (n.1) 10.
[7] Ibid 12.
[8] Ibid 11.
[9] Ibid 13.

pursuit of the individualised remedy approach.[10] Guided by the principle of 'first-come, first-served', individual creditors will have incentives to cancel other creditors out. To stay in the race against other creditors, an individual creditor must invest resources in the competition. However, the chance of getting a full return is still uncertain. As a result, Professor Jackson metaphorised this situation as 'running on a treadmill: you expend a lot of energy but get nowhere'.

In contrast, a collective bankruptcy procedure can save the costs resulting from individual creditor remedies through staying the enforcement efforts imposed on debtors, collecting and sharing information regarding debtors' assets and distributing debtors' assets among creditors *pro rate*.[11] The pro rate basis is viewed as a proper distribution rule because it can provide creditors with certain expectations once a bankruptcy proceeding is commenced.[12] In this way, some debt recovery is guaranteed while avoiding the costs of creditors' competition.[13] Therefore, the collective and mandatory features of bankruptcy proceedings enable creditors to receive an optimal outcome.

[10] Ibid 16.
[11] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd Edition, Cambridge University Press, 2009) 32-37.
[12] Jackson (n.1) 30-31.
[13] Jackson (n.1) 14-16.

(2) The Insurance Function of Personal Bankruptcy law

In a bankruptcy case involving either a corporate or personal debtor, the law will decide the total amount that debtors need to pay. At the same time, it will determine how to distribute the limited assets among creditors. However, when an insolvent debtor is a natural person, bankruptcy law has another function aside from the debt collection mechanism. The additional goal was embodied in the American case *Local Loan Co. v. Hunt*, indicating that bankruptcy law should give the honest but unfortunate debtor 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt'.[14] Thus, in addition to the fair collection and the distribution of a debtor's assets, the relief from excessive debt is considered as another principal purpose of personal bankruptcy law.

For years, scholars have made an effort to understand bankruptcy discharge. Some scholars explain bankruptcy discharge primarily as the ethical performance of forgiveness or mercy. In this sense, releasing debtors from financial debt can be seen as an aretaic duty.[15] The objective of aretaic duties concern 'traits of character – enduring dispositions over time that cumulatively define what sort of person a person is;'[16] ' A desire to enforce obligations when doing so would impose upon debtors significant hardship and distress manifests attributes of

[14] Local Loan Co. v Hunt 292 U.S. 234 (1934).
[15] "Aretaic duties concern dispositions that must be cultivated or suppressed in order to be thought a person of good character" See Heidi M. Hurd, 'The Virtue of Consumer Bankruptcy' in Ralph Brubaker, Robert M. Lawless and Charles J. Tabb (eds), *A Debtor's World: Interdisciplinary Perspectives on Debt* (Oxford University Press 2012) 219.
[16] Ibid.

character that rightly condemned, rather than admired. Put inversely, the virtuous person does not press his rights against someone when doing so will inflict genuine suffering and psychological despair'. [17] For a creditor, he/she may encounter a moral dilemma. Such dilemmas are named "quasi-supererogatory actions".[18]Simply, it is an action that 'if one does the action, one is a hero, and if one does not, one is a moral leper.'[19]In a quasi-supererogatory situation, avoiding the vice can be the same as embracing the virtue. In a nutshell, if creditors abandon their contractual rights when honest but unfortunate debtors are unable to pay, such an action can be demonstrating virtue. If they still claim their rights, they may be condemned for abusing their rights.[20]In this case, if creditors do not waive their claims, the avoidance of virtue could cast the creditor as a vicious actor. Avoiding a vice may offer a plausible explanation as to why society should free debtors from heavy financial obligation rather than postpone the performance of debt. The debt-postponement, in effect, makes no change between creditors and debtors. Creditors are still exercising their rights against over-indebted debtors. From the perspective of quasi-supererogatory theory, creditors are still performing a vicious action. Thus, a relief of debt is a means for creditors to manifest virtue. Meanwhile, forgiveness and generosity can be cultivated as collective aretaic obligations. Hence, members in a society ought to show their mercy to honest but unfortunate debtors, which helps the widespread cultivation of virtue.

[17] Ibid 221-222.
[18] Ibid 223.
[19] Ibid.
[20] Ibid.

Some other explanations exist as well. One theory viewed discharge as an award for debtors' cooperation in the process of liquidating and distributing an obligor's assets.[21] Debtors' active participation is assumed to maximise creditors' returns, and in exchange a bankruptcy discharge will be granted to those cooperative debtors. Additionally, another theory explains bankruptcy discharge through the 'entrepreneurial hypothesis', which views debt relief as an institution enhancing entrepreneurship in the market.[22] A further theory argues that relief from debt is not only the humane treatment of defaulting debtors but that it can also improve social utility through debtors' returning to a productive life.[23]

Though these explanations have provided valuable insights, none of them provides a coherent explanation of bankruptcy discharge. It is fair to say that the relief from debt can cultivate good virtue, encourage debtors to cooperate, promote social utility and entrepreneurship. However, those benefits are more like results of the bankruptcy discharge rather than the reason for discharge. When we delve deeper into understanding how those outcomes materialise, we can find that the risk reallocation of bankruptcy discharge plays a significant role in achieving the abovementioned benefits. Furthermore, it can be noted that such a risk allocation term is mandatorily imposed upon a debt contract. Therefore, this chapter argues that bankruptcy relief can be best understood as social insurance reallocating defaulting risks between creditors and debtors. The following paragraphs will demonstrate how the bankruptcy

[21] David G Carlson, 'Philosophy in Bankruptcy', [1987] 85 Michigan Law Review 1341, 1361-1376.
[22] John M Czarnetzky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' [2000] 32 Arizona State Law Journal 393, 399.
[23] Charles J Tabb, *The Law of Bankruptcy* (2nd edition, Thomson Reuters/ Foundation Press, 2009) 959.

discharge is similar to a form of social insurance.

The probability of future losses in daily life is a universal phenomenon. To deal with uncertain losses, one may choose to absorb those risks by oneself.[24] Instead, a person can also take actions to prevent perilous events from materialising while they may seek to reduce the possibility and severity of losses. [25] Moreover, individuals may choose to transfer risks to others. Insurance is one representative mechanism which can transfer risks among people.

In an insurance relationship, the insured and insurer are two parties. The insured will spend a certain amount of loss, the premium, for shielding against uncertain future loss. If the peril insured against occurs, the insurance provides a benefit for the policy holders because they will receive payment from the insurer.[26] The insurer will compensate some or all of the loss encountered by the insured. Furthermore, the function of insurance is not only to transfer risks from the insured to the insurer but enables insurers to fund future risks through the premium. The pooling of risks is significant from two perspectives. On the one hand, when many individuals who have a similar probability of encountering negative events transfer the premium to the insurer, the fund can be used as the source of payment once future risks occur. Pooling replaces a large loss with many small losses, which spreads risks among the insured. On the other hand, pooling can reduce the uncertainty of future losses. The insurer will deal with many individuals, which leads the insurer to anticipate loss more accurately. Thus, even

[24] Hallinan (n.4).
[25] Ibid.
[26] Richard M Hynes, 'Non-Procrustean Bankruptcy', [2004] 2 Illinois Law Review, 301, 329.

though the probability of particular loss continues to be uncertain, a statistical certainty will be achieved.

Bankruptcy discharge shares some characteristics with insurance. The apparent impact of debt relief is to provide partly or entirely, relief from pre-existing debt. Such an effect makes bankruptcy discharge a technique to reallocate risks between two parties.[27] Without bankruptcy discharge policy, except for the cost of administrating the contract, in theory, creditors have no additional costs because they can always collect from a debtor's earnings until the loan is fully recovered. However, the establishment of debt relief shifts more risks to creditors. By relinquishing the nonexempt assets or the future income to a limited period, debtors can be freed from overwhelming and pre-existing debt. Once debtors obtain debt relief, creditors cannot collect more money from discharged debtors and therefore, they should bear the risk of default. Such debt relief can be viewed as a benefit in the same way that an insurance policy provides for the insured. Additionally, in the context of insurance, benefits are not free for the insured. The premium will be paid to the insurer. In the context of the creditor-debtor relationship, the premium will be charged by creditors in the form of a higher interest rate. Accordingly, this economic analysis indicates bankruptcy discharge functions as a risk distributor between creditors and debtors.

[27] Iain Ramsay, Models of Consumer Bankruptcy: Implications for Research and Policy [1997] 20 Journal of Consumer Policy, 269, 274-278.

2.3 Justifications for the insurance function of insolvency law

As described above, personal bankruptcy is a debt collection tool for creditors and a form of insurance for individuals who file for relief from debt. Some scholars stand by the claim that a bankruptcy system should function as a debt collection mechanism which enforces the pre-bankruptcy debt contract as much as possible.[28] Accordingly, creditor wealth maximisation is viewed as the exclusive goal of bankruptcy law.[29] However, in the context of personal bankruptcy, debt relief is also one of the essential objectives. Given that debt discharge precludes creditors from touching the gains of a debtors' future labour, there is a tension between the maximisation of the creditor's returns and the debtor's relief. The more debt that can be discharged, the less creditors can collect. Policymakers often claim they have reached a balance between those conflicting ideas.[30] However, the reality seems that policymakers confuse the objectives of insolvency law in the context of personal bankruptcy cases.[31] Therefore this subsection will provide a solid justification for the insurance function of insolvency law, implying that policymakers should take debtors' rehabilitation as the core objective.

We humans can solve risks in various ways. Transferring risks to other people is just one

[28]'There the basic role of bankruptcy law is to translate relative values of nonbankruptcy entitlements into bankruptcy's collective forum with as few dislocations as possible'. Jackson (n.1) 253.
[29] Adam J. Levitin, 'Bankruptcy Politics and the Politics of Bankruptcy' [2011] 97 Cornell Law Review 1399, 1404-1405; Rizwaan Jameel Mokal, 'The Authentic Consent Model: Contractarianism, Creditor's Bargain, and Corporate Liquidation' [2001] 21 Legal Studies 400, 401-402.
[30] Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 17.
[31] Spooner (n.3) 65.

approach.[32] The other two methods are absorbing risks by ourselves and reducing the possibility of the occurrence of adverse events in the first place.[33] From this view, by saving more, debtors can absorb the loss of economic shock by themselves. However, individuals are inclined to 'saving less, spending more'.[34] Thus, only relying on debtors themselves may not be an effective way to absorb risks resulting from financial distress when the deleterious events materialise. Furthermore, reducing the likelihood of perilous events is also one of the approaches to deal with potential losses but debtors are not able to assess the probability of a risk accurately. They may be overconfident and therefore underestimate the future loss.[35] Furthermore, it is difficult to overcome individuals' cognitive shortcomings.[36] Therefore, compared with the former two approaches, transferring risks to other people may be more appropriate.

Though it is more appropriate for debtors to transfer defaulting risks to other parties in some cases, there must be a justification for imposing risks on lenders. The vital point is to determine who the superior risk bearer is in debt contracts; two factors are relevant to this determination. First, the party more able to prevent the occurrence of the perilous event should bear the risks of loss.[37] Superficially, in the creditor-debtor relationship, financial distress can be better controlled by borrowers because they can decide whether to borrow or not. This claim may

[32] Ibid 101.
[33] Ibid 100-101.
[34] See generally Jason J. Kilborn, 'Behavioural Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions', [2005] 22 Emory Bankruptcy Development Journal 13.
[35] Ibid.
[36] Ibid.
[37] Richard A. Posner, *Economic analysis of law* (Wolters Kluwer Law & Business,2014).

reflect an assumption that a debtor's financial difficulty is attributable to endogenous factors, such as overspending or living a profligate life. However, most debtors suffer from financial distress due to job loss, medical debt, and divorce.[38] Neither creditors nor debtors are more able to avoid those exogenous causes. Therefore, assuming borrowers are the better bearers is unrealistic. The second determinant of the superior risk bearer is the capability of insuring efficiently against harmful events.[39] This factor requires a deep reflection on which party has a greater knowledge of the probability of financial distress.[40] However, according to behavioural economics, individuals cannot accurately estimate future risks due to cognitive weakness. If debtors cannot predict the probability of dangerous events, they may not insure against those negative situations at the moment of borrowing money. On the contrary, by an advanced algorithm or comprehensive actuarial techniques, creditors can better estimate the financial creditworthiness of debtors.[41] Therefore, creditors can decide whether to invest in the bad-debt insurance based on the estimation of the debtors' probability of financial distress. Moreover, even though creditors are not able to assess the likelihood of debtors' financial distress, they can spread the bad-debt loss to other debtors since they deal with many consumers. For example, a CD shop permits consumers to buy CDs on credit. Unlike professional lending creditors, such a CD shop cannot assess consumers' future financial distress. The CD shop may not choose to insure against possible loss in advance. Notwithstanding, the CD shop can still transfer the loss to other consumers by increasing the

[38] See Teresa A. Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, *The Fragile Middle Class: Americans in Debt* (New Haven, Yale University Press, 2000).
[39] Posner (n.37).
[40] Ibid.
[41] Annie McClanahan, *Dead Pledges: Debt, Crisis, and Twenty-First-Century Culture* (Stanford University Press, 2017) 6.

cost of credit or the price of a CD. To compare, debtors have limited ways to spread risks if they do not have insurance against financial distress. Hence, creditors are the superior loss bearers since they are more likely to protect themselves against risks led by debtors' difficulty in making payments. However, creditors are not always better risk bearers. In tort cases, creditors are involuntarily involved in the creditor-debtor relationship. Although creditors may transfer risks to the third party (for example, by purchasing life insurance for themselves), their involuntary involvement in the transaction inhibits creditors from spreading or pooling loss to a larger group.[42] In this case, it may be questionable to consider creditors as the superior bearers of losses. However, the involuntary claim of nonbusiness is an uncommon phenomenon so that creditors can still be regarded as the superior risk bearer in the contract.[43]

Even though creditors are superior bearers for defaulting risks, the imposition of compulsory insurance on debt contracts presents a separate problem. Several explanations may provide more insight into understanding the mandatory feature of debt relief.

2.3.1 Consumer protection

In recent decades, consumer credit has skyrocketed in both developed and developing countries.[44] Theoretically, the access to credit is regarded as a debtor's rational response to

[42] Hallinan (n.4) 107.
[43] Ibid 108.
[44] Adam Feibelman, 'Consumer Bankruptcy as Development Policy' [2009] 39 Seton Hall Law Review 63.

an unpredictable fluctuation of income over time in pursuit of one's long-term preferences.[45] In this view, household borrowing has always been assumed to be economically rational. However, this argument may be problematic because households are more likely to be irrational when making borrowing decisions. When making decisions, behavioural economic literature has demonstrated that human beings will experience some intrinsic cognitive influences: overconfidence bias,[46]availability heuristic,[47]hyperbolic discounting[48]and bounded willpower.[49]As a result, consumers tend to make mistakes when gauging the degree of risk, and they generally underestimate future costs.[50] Meanwhile, it is difficult to eliminate this

[45] Aldo Barba and Massimo Pivetti, 'Rising Household Debt: Its Causes and Macroeconomic Implications- a Long-Period Analysis' [2009] 33 Cambridge Journal of Economics 113, 114; Douglas G. Baird, 'Technology, Information, and Bankruptcy' [2007] University of Illinois Law Review 305, 310-311.

[46] From the aspect of individuals' susceptibility to risk, they are inclined to be optimistic and overconfident. They believe that their risk of confronting a negative event will be lower than the average person's. The overconfidence bias may be even aggravated when individuals hold the belief that they can control possible risks successfully. See Jon D. Hanson and Douglas A. Kysar, 'Taking Behavioralism Seriously: The Problem of Market Manipulation' [1999] 74 New York University Law Review 630, 654-662, See also Russell B. Korobkin and Thomas S. Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics', [2000] 88 California Law Review 1051, 1092.

[47] Individuals may underestimate the future risk due to the availability heuristic. Three factors have an impact on the availability of an adverse event: frequency, recentness, and salience. If an event occurs frequently or recently, people tend to overestimate the probability of a similar circumstance appearing in the future. If a person witnessed a salient occurrence of a negative incident, he or she may imagine the risk of a similar event more likely to materialise. Conversely, the probability of a negative event will be underestimated if such an incident is uncommon or there's a lack of salience. Christine Joll, Cass R Sunstein and Richard Thaler, 'A Behavioural Approach to Law and Economics' [1998] 50 Stanford Law Review 1471.

[48] Hyperbolic discount is applied when individuals compare future costs with benefits. Future costs may be downplayed and individuals may take riskier actions at the present. Studies reveal that individuals prefer contemporary enjoyment to delayed gratification even though they can benefit from the latter. Thomas. H. Jackson. 'The Fresh-Start Policy in Bankruptcy law' [1985] 98 Harvard Law Review 1393, 1408.

[49] Although people accept that a particular action may lead to risks and they are reluctant to confront those risks, they still overvalue the present gratification of risky activity when costs are distant. Therefore, the related weights of costs and benefits are misrepresented, which leads individuals to abandon refraining from risky activities. See Joll, Sunstein and Thaler (n.47) 1479,1523.

[50] See generally, Jackson (n.53); See also Saul Schwartz, 'Personal Bankruptcy Law: A Behavioural Perspective' [2003] in Johanna Niemi-Kiesilainen , Iain Ramsay and William Whitford (eds.) *Consumer Bankruptcy in Global Perspective* (Hart Publishing,2003); Jason J. Kilborn, ' Behavioural Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions', [2005] 22 Emory Bankruptcy Development Journal 13.

bias from the perspective of behavioural economics.[51] Even though individuals are aware of the force of overconfidence, bounded willpower and the accurate possibility to gauge perilous events, this bias may still skew people's decisions.[52] Also, even though more information enables individuals to calculate risks more accurately, people may not benefit from more information and bias might be more dominant in spite of more information.[53] Those findings above provide insight into the fact that it is hard for individuals to overcome bias *ex ante*. As a result, debtors may be trapped in excessive debt without even recognising it. Over-indebted debtors will be prone to live on social support programmes.[54] Eventually, society will bear the burden of individual failure.

Seemingly, individual over-indebtedness is led by individual failures. However, lenders may also be responsible for debtors' heavy financial burdens.[55] Creditors such as credit card companies can gain high profits by inducing debtors too close to the margin of financial distress.[56] The absence of debt relief law leads to the debtor accepting the whole responsibility of debt defaulting. Given that lenders may be responsible for individual over-indebtedness, it is fair for policymakers to intervene in household borrowing by reallocating risks between creditors and debtors.[57]

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[51] See Hanson and Kysar (n.46) 654-658; See Korobkin and Ulen (n.46) 1071.
[52] Ibid.
[53] Ibid.
[54] Jackson (n.1) 231.
[55] Annie McClanahan, Dead Pledges: Debt, Crisis, and Twenty-First-Century Culture, (Stanford University Press, 2017) at the Introduction (The development of technology and democracy of credit led credits becoming cheaper and more available).
[56] See Ronald J. Mann, 'Bankruptcy Reform and the Sweat Box of Credit Card Debt' [2007] 75 University of Illinois Law Review, 375.
[57] "We simply must accept that back-end relief from overindebtedness is the best we can manage… If front-end restrictions on the supply side of consumer credit are judged inefficient or politically

Furthermore, debtors' cognitive weaknesses also imply that consumers may fail to insure against financial difficulty by purchasing credit insurance products. Similar to making a borrowing decision, debtors may be irrational in terms of whether to purchase credit insurance. People often, overconfidently, assume that deleterious events will not happen to them. They also, overconfidently, argue they can handle those materialised risks. Therefore, debtors are likely to waive insurance due to overconfidence. Furthermore, individuals may overestimate the current benefits but undervalue future risks when making decisions. As a result of those cognitive failures, debtors cannot obtain sufficient insurance to protect them from financial distress in the future. Given this, even though the market will provide relevant products, consumers will mistakenly consider they do not need the products.

2.3.2 Challenging the debt collection objective in personal bankruptcies

Strengthening the debt collection objective reflects the idea of regulation as a market boosting device, and the viewpoint that the outcomes of pre-bankruptcy debt contracts should involve as few dislocations as possible.[58] This perspective is based on the concept of the efficient market hypothesis, which considers that the market can produce more efficient results than centralised decision making. According to this belief, a voluntary contractual exchange can generate mutual benefits, thereby enhancing economically efficient activities.[59]

Economists define transactions generating mutual benefits between contractual parties as a

inexpedient…." Kilborn (n.34) 24.

[58] Jackson (n.1) 253.

[59] David M. Driesen, 'Contract Law's Inefficiency' [2011] 6 Virginia Law & Business Review 301,302.

"Pareto Optimal" exchange in which one party is better off without the other party being worse off.[60] Given that pre-bankruptcy contracts are outcomes of the free bargaining between parties, and both parties must anticipate the contract will make them better off, these pre-bankruptcy debt contracts are assumed to reach the Pareto-optimal equilibrium. Therefore, bankruptcy law should support this market mechanism by ensuring both parties return to their prior positions to the greatest extent possible.[61]

Notwithstanding, the question as to whether the pre-bankruptcy debt contracts can make both parties better off may be raised. Only if debt contracts are mutually beneficial, can strict enforcement be justified. However, the reality is that consumer debt contracts in the modern credit market are seemingly out of line with mutually beneficial exchange between creditors and debtors.[62] Theoretically, contractual agreements are economically efficient when they are voluntarily signed by well-informed parties who have equal bargaining power.[63] However, in the modern credit market, debtors and creditors have unequal bargaining power and asymmetric information in debt contracts. In terms of supply, the consumer lending 'revolution' has developed comprehensive practices of 'securitisation including the application of sophisticated computer technology to develop predictive credit scores and risk-based pricing'.[64] Advanced credit scoring and reporting technologies

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[60] Robert L. Birmingham, 'Breach of Contract, Damage Measures, and Economic Efficiency' [1970] 24 Rutgers Law Review 273, 278-280; see Maxwell L. Stearns and Todd Zywicki, *Public Choice Concepts and Applications in Law* (West Publishing, 2009)16.

[61] Jackson (n.1) 253.

[62] Spooner (n.3) 81.

[63] M. J. Radin, *Boilerplate: The Fine Print, Vanishing Rights, and the Rule of Law* (Princeton University Press, 2012) 3-18.

[64] Iain Ramsay and Toni Williams, The Crash that Launched a Thousand Fixes- Regulation of Consumer Credit after the Lending Revolution and the Credit Crunch < https://sas-

contribute to the expansion of credit[65] by providing information relating to borrower creditworthiness. Accordingly, creditors can target specific consumer groups for profit.[66] Furthermore, financial technologies enable lenders to transfer defaulting risks through securitisation.[67] Thus, in the modern consumer credit market, lenders are well-informed about borrowers' creditworthiness and the defaulting risks.

In contrast, borrowers are not well-informed on two levels. Firstly, debtors may have limited knowledge about credit products which they are buying. Access to accurate information regarding credit products may be expensive in the market.[68] The contemporary credit market is replete with complicated products, and the market process influences a significant number of products.[69] Given this, if borrowers want to understand the credit contracts fully, they have to invest more time or resources into the learning process.[70] On the other hand, though borrowers have obtained product-related information, empirical studies have shown that they may have trouble in accurately understanding it and may even not use the provided information.[71] Secondly, borrowers may have difficulty in fully knowing the costs and benefits

space.sas.ac.uk/3511/1/RamsayIain_and_WilliamsToni_Hart2009.pdf > accessed 28 Feb 2020.

[65] J. Lauer, *Creditworthy: A History of Consumer Surveillance and Financial Identity in American* (Columbia University Press, 2017).

[66] Ibid 209.

[67] There is an explanation on how securitisation can transfer defaulting risks. See Spooner (n.3) 50.

[68] Iain Ramsay, Consumer Law and Policy: Text and Materials on Regulating Consumer Markets (2nd edition, Hart Publishing, 2007) 65.

[69] Oren Bar-Gill and Elizabeth Warren, 'Making Credit Safer' [2008] 157 University of Pennsylvania Law Review 1.

[70] As scholars have stated, 'the standard credit card or mortgage contract has gotten longer and more difficult to read, and comparison among such contracts is challenging even for a professor. Moreover, lenders retain the right to change the contract at will, so that even a consumer who understands the initial contract may be required to invest more and more time to continue to stay abreast of multiple changes added to the contract and to compare those changes with other available credit products.' Ibid 13.

[71] Levels of Financial Capability in the UK: Results of a Baseline Survey (Financial Services Authority,

of entering debt contracts. As previously mentioned, people's decision-making processes will be influenced by cognitive weaknesses including overconfidence bias, availability heuristic, hyperbolic discounting and bounded willpower. Those factors will lead borrowers to overvalue the present benefits of entering the debt contracts and downplay future risks, including potential income shocks and life-altering accidents. As a result, the initial borrowing decision may be the result of the miscalculation of costs and benefits. Furthermore, even though borrowers are informed about future risks, they still tend to undervalue future costs. Therefore, compared with debtors, creditors are in an advantageous position in the creditor-debtor relationship.

Additionally, even though contracting parties have been fully informed, involuntarily involvement in a contract may be not economically efficient. To some extent, borrowers may not freely enter into debt contracts, and thereby those contracts may depart from economic efficiency. As a 'soft constitution' for government[72], neo-liberalism plays an important role in the policymaking process. Neoliberal economics emphasises the internationally open markets, the reduction of labour power and welfare allowance, the promotion of consumerism and entrepreneurism. Influenced by those neoliberal ideas, policymakers tend to favour policies which reduce government spending, stifle wage stagnation and increase unemployment, while permitting the value of assets to rise.[73] Against this background, consumer credit

2006) < http://www.pfrc.bris.ac.uk/publications/Reports/Fincap_baseline_results_06.pdf > accessed 29 Feb 2020; Mary J Keeney and Nuala O'Donnell, Financial Capability: New Evidence for Ireland Research Technical Papers 1/RT/09, Central Bank of Ireland.

[72] Will Davies, The New Neoliberalism [2016] 101 New Left Review 121,128.

[73] Colin Hay, 'Good Inflation, Bad Inflation: The Housing Boom, Economic Growth and the Disaggregation of Inflationary Preferences in the UK and Ireland' [2009] 11 The British Journal of

supports the context of low wage growth and the increase in asset value. Additionally, living costs continue to increase while income is stagnated. Empirical research has clearly shown the rising trend of living expenses.[74] Coexisting with the increasing living expenses, a reduction in public spending and the retreat of the welfare state shifts more risks from government to individuals.[75] As a result, a credit safety net is established, where debt substitutes for the declining social safety net.[76] Thus, from the demand-side, households have more need to borrow for their essential costs and basic living standards.[77] All these factors, that is, governments' encouragement of expanded credit, the rising living costs and a reduction in welfare entitlement, together indicate that households have little option but to enter debt contracts. In this respect, the debt contracts between lenders and borrowers might not be mutually beneficial since households may 'involuntarily' enter the credit market.

Considering the unequal positions between debtors and creditors and the formation of subsistence credit use, it is argued that contracts between lenders and households depart from mutually beneficial agreements, which undermine the justification of creditor wealth maximisation. Given this, prioritising the bankruptcy law as a debt collection tool is open to

Politics and International Relations 461.

[74] Elizabeth Warren, The Over-Consumption Myth and Other Tales of Economics, Law and Morality [2004] 82 Washington University Law Quarterly 1485, 1502; Financial Stability Report: June 2017 (Bank of England, 2017) Financial Stability Report 41 (2) < https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2017/june-2017.pdf?la=en&hash=EB9E61B5ABA0E05889E903AF041B855D79652644> accessed by 1 March 2020.

[75] Jacob S. Hacker, *The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream* (Oxford University Press, 2008).

[76] Paolo Lucchino and Salvatore Morelli, *Inequality, Debt and Growth* (Resolution Foundation 2012).

[77] Joseph Stiglitz, 'Joseph Stiglitz and Why Inequality is at the Root of the Recession' (Next Left, 9 January 2009) <http://www.nextleft.org/2009/01/joseph-stiglitz-and-why-inequality-is.html> accessed by 1 March 2020.

doubt. Conversely, we can see that the vast majority of debtors borrow to deal with everyday financial difficulty resulting from the suppressed wages and reduced social assistance. From this perspective, we can see the importance of personal bankruptcy law by acting as the safety net for distressed individuals.

2.3.3 The consequences of over-indebtedness

The consequences resulting from household over-indebtedness have three levels. Firstly, over-indebted households may suffer from both mental and physical issues. Some studies have established a link between over-indebtedness and debtors' health. In an early study, Caplovitz indicated that households with excessive debt would probably suffer from stress-related symptoms, including tension, headaches, insomnia, and loss of appetite.[78] Recent research in Europe also showed a similar scenario under which a list of psychological and impacts on well-being resulting from the onset of the debt problem was reported.[79] In addition to the effect on the borrower himself, over-indebtedness also leads to some externalities. It is challenging to capture all the costs and benefits in credit contracts and the price of products do not reflect the true costs to society as a whole.[80] Externalities resulting from over-indebtedness may be imposed on friends and families.[81] According to traditional economic theory, individuals are self-interested when making decisions.[82] Thus, when making borrowing decisions, borrowers

[78] David Caplovitz, *Consumers in Trouble: A Study of Debtors in Default* (Free Press 1974).
[79] Civic Consulting of the Consumer Policy Evaluation Consortium (CPEC), The Over-indebtedness of European Households: Updated Mapping of the Situation, Nature and Causes, Effects and Initiatives for Alleviating Its Impact 181 < https://ec.europa.eu/info/sites/info/files/final-report-on-over-indebtedness-of-european-households-synthesis-of-findings_december2013_en.pdf> accessed by 1 March 2020.
[80] Ramsay (n.68) 56.
[81] Jackson (n.48) 1419.
[82] Schwartz (n.50).

may ignore the fact that their option will influence the well-being of family members or close friends.[83] Once debtors become insolvent, the financial or psychological welfare of dependents may be in danger resulting from limited living resources or harsh creditor collection practices.

Beyond that, impacts on the debtor and his family may have spillover effects and will be imposed on society in general. Over-indebted debtors will have external effects on society in several specific aspects. One is low productivity. Over-indebted debtors may concentrate their resources on leisure activities rather than work if they are required to pay off debts via income gained from labour.[84] Through working less and enjoying idle time, debtors' productive devotion to society will be decreased.[85] Although costs may be internalised in the form of low wages of debtors, externalities will still exist because the marginal social value of a debtor's labour is underrepresented by his wages.[86] Wages do not altogether indicate career benefits because they have some nonpecuniary benefits. [87]Therefore, workers may lose less than society if they replace work with leisure. Such substitution will lead to the lower productivity of a society.

Besides, harsh collection efforts will generate a large number of impoverished individuals and cause social disturbance.[88] Those destitute persons may rely on social programmes provided

[83] Ibid.
[84] Individuals are bounded self-interest, if over-indebted debtors consider collection efforts are unfair, they may choose leisure rather than work. See Kilborn (n.50) 30.
[85] Jackson (n.48) 1422.
[86] Ibid.
[87] Ibid 1423.
[88] See Sullivan, Warren and Westbrook (n.38) 260. See also Hallinan (n.4) 117-121.

by the government and although government transfers can mitigate debtors' hardship,[89] those transfer programmes may fall into a "Samaritan's dilemma".[90] To explain, both creditors and debtors know the existence of social assistance programmes. Those programmes will offer a benefit to individuals so that destitute persons can keep a basic living standard. Creditors may be prone to lending to debtors because they can collect from the debtors' supplement, which is provided by social programmes. On the other hand, debtors will be less cautious when making borrowing decisions or purchasing adequate insurance.[91] Therefore, over-indebted debtors may place a burden on the government's finances.[92]

Furthermore, over-indebtedness has an impact on macro-economic stability. The International Monetary Fund has pointed out "newer theories and empirical evidence show that the relationship between household debt and macro-financial stability can also be negative".[93] Though an increase in household debt can promote economic growth in the short-term, it may also possibly lead to financial stability risks in the medium term.[94] Furthermore, a financial crisis triggered by a large increase in household debt will result in slower economic recovery than those arising from other events.[95] Empirical research has shown that the high level of

[89] Harold M. Hochman, James D. Rodgers, Pareto Optimal Redistribution [1969] 59 The American Economic Review 542, 543.
[90] Stephen Coate, Altruism, the Samaritan's Dilemma and Government Transfer Policy [1995] 85 American Economic Review 46.
[91] Ibid 50-51.
[92] Jackson (n.48) 1420-1424.
[93] International Monetary Fund, 'Household Debt and Financial Stability' (Washington DC, IMF, 2017) 56-57.
[94] Ibid 55.
[95] IMF World Economic Outlook (Washington DC, IMF, 2012) 91, Fabian Bornhorst and Marta Arranz, 'Growth and Importance of Sequencing Debt Reductions Across Sectors' in Martin Schindler and others (eds), *Jobs and Growth: Supporting the European Recovery* (Washington DC, IMF, 2014) Chapter2.

pre-recession debt-to-income ratio led to lower consumption and employment compared to recessions with a low level of household debt.[96] Those insights clarify the risks inherent in a debt-dependent economy. With regard to the solution to those risks, certain scholars argue that effective insolvency proceedings during a recession to address household debt problems have a beneficial macro-economic effect by rehabilitating household demand.[97] Accordingly, debt relief plays a significant role in functioning as an insurance institution for reallocating risks by 'acting as a macroeconomic stabiliser'.[98]

To alleviate the negative consequences of over-indebtedness, a bankruptcy discharge is considered as the most significant means.[99] By reallocating defaulting risks, debt relief can help make a balance between the interests of the borrowers, lenders and society.[100] From the perspective of creditors, though there is practically nothing left to collect in most cases, at least, the bankruptcy proceedings can enhance the fair distribution of payment between creditors.[101] For debtors and their families, the relief from excessive debt enables households to alleviate stress, anxiety and other negative mental and physical influences.[102] Furthermore, benefits for debtors have spillover effects on society. With regard to the solution to those risks inherent in a debt-dependent economy, some scholars argue that effective insolvency

[96] Atif Mian and Amir Sufi, *Houseof Debt: How They (and you) Caused the Great Recession, and How We Can Prevent It from Happening Again* (University of Chicago Press, 2015).
[97] Ibid.
[98] See Spooner (n.3) 81.
[99] Heikki Hiilamo, Household Debt and Economic Crises: Causes, Consequences and Remedies (Edward Elgar, 2018) 144.
[100] Ibid 145.
[101] The World Bank, 'Report on the Treatment of the Insolvency of Natural Persons' 24 <https://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf> accessed by 10 Jan 2020.
[102] Ibid 26.

proceedings during a recession to address household debt problems have a beneficial macro-economic effect by rehabilitating household demand.[103] Accordingly, debt relief plays a significant role in functioning as an insurance mechanism for reallocating risks by 'acting as a macroeconomic stabiliser'.[104] Furthermore, a World Bank Report has summarised more broad societal benefits: establishing proper account valuation; reducing wasteful collections costs and destroyed value in depressed asset sales; encouraging responsible lending and reducing negative externalities; concentrating losses on more efficient and effective loss distributors; reducing the costs of illness, crime, unemployment, and other welfare-related costs; increasing production of regular taxable income; maximising economic activity; encouraging entrepreneurship; and enhancing stability in the broader financial system.[105]

2.4 Is moral hazard a major concern?

Thus far, we have shown creditors to be the superior risk bearers in the creditor-debtor relationship. For this reason, it is appropriate for debtors to shift more defaulting risks to creditors. Furthermore, we have also demonstrated the reason why the mechanism of risk reallocation needs to be imposed on debt contracts compulsorily. However, we need to answer another question whether moral hazard is a major concern. Given that bankruptcy discharge functions as insurance, policymakers have indicated concerns about the risk of moral hazard.[106] The concept of moral hazard comes from insurance theory, in which it is explained

[103] IMF (n.95) 55.
[104] Spooner (n.3) 81.
[105] The World Bank (n.101) 27-40.
[106] The World Bank (n.101) 40.

that the availability of insurance may create undesirable incentives for insured parties to behave less prudently and carefully.[107] Specifically, the insured parties will have fewer incentives to prevent the risks while they may have more incentives to exaggerate the loss when the risky event has occurred.[108] In the context of bankruptcy, individuals may borrow more because they think the debt discharge is available to them. Meanwhile, borrowers who are already trapped in excessive debt may continue to borrow due to the protection of bankruptcy discharge.

However, it is essential not to overstate the potential risks created by the bankruptcy discharge. Firstly, an insurance contract can be designed to reduce and guard against the risk of moral hazard. Similarly, through changing the features of debt relief, it is possible to sanction abusers and encourage appropriate use.

Additionally, it is difficult to measure the effects of moral hazard.[109] The *ex ante* effects of moral hazard assume individuals will take on more debt than they can afford. However, there are many factors why debtors need to borrow. To measure the *ex ante* effect, an assumption is required that debtors have a comprehensive understanding of the bankruptcy law. However, it is very unlikely that the public is familiar with bankruptcy.[110] Beyond that, we cannot neglect the fact that creditors make the final lending decision. In other words, creditors have strong

[107] Ibid.
[108] Hallinan (n.4); Hynes (n.26).
[109] Ramsay (n.30) 23.
[110] Ibid 16.

incentives to monitor and control those reckless behaviours. In reality, current information technology has enhanced creditor's ability to monitor lending activity. The development of Big Data and algorithmic calculation has enabled more advanced market segmentation.[111] As a result, creditors are in a better position to assess borrowers' repayment capacities, and they can make the final judgement on whether to lend the money. Focusing on the *ex post* effect, an individual would be supposed to calculate the costs and benefits of the insolvency processes. This argument assumes that all costs and benefits can be measured in dollars. However, in reality, costs and benefits are not purely economic. For a defaulting debtor, costs include the loss of reputation and stigma resulting from the failure to repay.[112] Furthermore, there is no convincing empirical research to show the extent to which debtors are abusing bankruptcy discharge. Therefore, the risk of moral hazard should not be overemphasised.

2.5 Conclusion

This chapter begins by describing two functions of personal bankruptcy. The traditional viewpoint considers bankruptcy law as a debt collection tool dealing with a common pool problem. When debtors are natural persons, the other objective, debtor fresh start, is enshrined in personal bankruptcy law. The fresh start presupposes debtors can be discharged from pre-bankruptcy debt and keep some essential assets for basic living. Although certain scholars have propounded various theories to understand the fresh start, this debt discharge

[111] Lauer (n.65).

[112] Teresa A Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' [2006] 59 Stanford Law Review 213.

is considered as social insurance under which creditors bear more defaulting risks.

To interpret the law's insurance function, the starting point is the understanding that creditors are the better risk bearers in the creditor-debtor relationship. The reasons are creditors' better ability to gauge the availability of defaulting loss and to spread such risks. This chapter argues that the defaulting risks should be compulsorily imposed on creditors for several reasons. First, intrinsic human cognitive weakness leads to individual failure to gauge the possibility of debt default. Given this, individuals may borrow too much and fall into the debt trap. Cognitive factors also give rise to individuals who may not have interest in purchasing credit insurance to protect them from financial difficulty. Finally, without the bankruptcy discharge, society as a whole will bear the defaulting risks because over-indebted households tend to live on social support programmes. Secondly, there is the challenge of prioritising debt collection in personal bankruptcy cases. Since pre-bankruptcy contracts are assumed to be a mutually beneficial exchange between lenders and borrowers, the law's debt collection objective pursues the full enforcement of debt contracts. However, debt contracts in the contemporary consumer credit market detract from the ideal of voluntary contractual exchange between borrowers and lenders. On the one hand, lenders are better informed than borrowers in terms of defaulting risks and credit products. On the other hand, more and more individuals borrow for maintaining essential living standards, signaling that they may 'involuntarily' enter into debt contracts. In the light of these factors, pre-bankruptcy debt contracts may not be as efficient as assumed, thus prioritising debt collection in personal bankruptcy cases may be open to doubt. Thirdly, over-indebtedness can lead to severe consequences. For over-indebted

individuals themselves, they will suffer from psychological and physical issues. Also, impacts on the debtor may have spillover effects and will be imposed on society in general. Therefore, there is an excellent excuse to reallocate the defaulting risks more efficiently. Lastly, since there are few instances of moral hazard and the risks are controllable, policymakers should not overemphasise concerns about moral hazard when embracing the insolvency law's insurance mechanism. Therefore, all the above-mentioned factors justify the mandatory feature of the law's insurance function.

CHAPTER 3 LESSONS LEARNT FROM AMERICAN PERSONAL BANKRUPTCY LAW

3.1 Introduction

The previous chapter has explored theoretical understandings of the functions of insolvency law. Theoretically, individual bankruptcy law does not only function as a debt collection tool by collectively gathering and distributing debtors' property, but also acts as an insurance mechanism enabling individuals to exit from excessive debts. Additionally, the justifications of the law's insurance mechanism imply that ensuring debtors' rehabilitation might be more important than maximising creditors' returns in personal bankruptcies. From this view, it is fair to assume that the institutional designs of personal bankruptcy law should be to rehabilitate debtors as much as possible.

To an extent, American consumer bankruptcy law is in line with prioritising the law's insurance mechanism. Under the US system, debtors can obtain a fresh start, without the requirement for income payments as a condition of debt relief. Accordingly, bankruptcy discharge allocates the risks to creditors as superior risk-bearers and enables individuals to rehabilitate as soon as possible. Therefore, American debt relief law functions as social insurance for over-indebted debtors.[1]

[1] For scholars, the social insurance function of individual bankruptcy is recognised. Barry Adler, Ben Polak and Alan Schwartz, 'Regulating Consumer Bankruptcy: A Theoretical Inquiry.' [2000] 29 The Journal of Legal Studies 585, 587 (indicating that "consumer bankruptcy is best justified as a form of partial wage insurance"); Richard M Hynes, 'Non-Procrustean Bankruptcy', [2004] 2 Illinois Law Review 301,350-359 (considering the bankruptcy as a social insurance); Richard M. Hynes, 'Why (Consumer) Bankruptcy', [2004] 56 Alabama Law Review 121 ,153 (claiming that "the most plausible justification for bankruptcy discharge is that it provides the consumer with a form of insurance"); Iain Ramsay, Models of Consumer Bankruptcy : Implications for Research and Policy [1997] 20 Journal of Consumer

However, when exploring the history of personal bankruptcy law in the US, we can find that it is a field of conflict. Different stakeholders, including creditors, debtors and insolvency professionals, have shown various forms of interest in bankruptcy debt relief. From the perspectives of pro-debtor allies, immediate debt relief can provide debtors with a safety net, at least from an economic standpoint. On the contrary, creditor groups criticise the easy access to a quick discharge on the ground that it leads to debtors' irresponsibility. Based on the conception of moral hazard, how to prevent debtors' abuse is a highly contested issue. As a result of the lobby of financial creditors, the US system is gradually dominated by pro-creditor groups.

However, by evaluating the recently introduced 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (2005 BACPA), this chapter argues that it fails to enhance creditors' returns and sort out so-called bankruptcy opportunists who gain profit from the quick bankruptcy discharge procedure. Although legislators claim that the Act only targets potential opportunists rather than honest but unfortunate individuals, the actual effect is that it excludes or delays individuals from obtaining debt relief. The failure of the 2005 BACPA implies that the risks of moral hazard may be overemphasised. In effect, many of the studies criticising debtors' abuse are based upon economic models rather than debtors themselves. [2]

Policy, 269, 274-278 (discussing the allocation of risks can partly justify a "consumer protection" model of bankruptcy law). See also Adam Feibelman, "Defining the social insurance function of consumer bankruptcy" [2005] 13 American Bankruptcy Institute Law Review 1, 2. For creditor groups, they also share the idea of individual bankruptcy as a safety net in welfare state capitalism. See Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 49.

[2] Levi N. Pace and Jean M. Lown, 'Consumer Bankruptcy' in Jing Jian Xiao (ed), *Handbook of Consumer Finance Research* (2nd edition, Springer, 2016) 317.

Accordingly, when lawmakers are interested in introducing the personal bankruptcy law, they should be cautious about the erosion of the insurance function of insolvency law, as this may be squeezed out due to overprotected safeguarding mechanisms.

This chapter will be structured as follows: section 2 is a summarised description of the framework of American personal bankruptcy law; section 3 is a brief outline of the history of the law indicating debates in its development; section 4 analyses the failure of the 2005 BACPA and its actual effect; the last section provides a brief conclusion.

3.2 Structure of American individual bankruptcy law

a. Chapter 7

Chapter 7 in American bankruptcy law concerns the liquidation process. Under Chapter 7, debtors are not involved in any repayment plans. Instead, the bankruptcy trustee[3] will be responsible for collecting, gathering and distributing all debtors' non-exempt assets[4] in

[3] 11 U.S.C. § 701, 704.

[4] The purpose of an exemption policy is to help financially troubled individuals and their dependents to live a basic daily life after bankruptcy. Meanwhile, permitting debtors to retain specific property will encourage them to stay motivated at work. Before the enactment of the 1978 Act, the scope of exempt property was determined by the law of the state where debtors lived. The amounts of exemptions allowed by various states were different. Some states had more generous exemption laws than others. The 1978 Act established the federal exemption in bankruptcy law and allowed debtors to choose either state exemption or federal exemption. However, states are allowed to require their residents to choose only state exemption law. Generally, state exemption laws as well as federal bankruptcy law define exempt property by enumerating specific assets and allow debtors to select among these assets as exempt up to a specific value. To understand the exemption law in the US, taking homestead exemption as an example, debtors have the chance to exempt their home from distribution among creditors. But the value that can be exempted is different between state law and federal bankruptcy law. Therefore, homestead exemptions in a bankruptcy case vary greatly. See William C Whitford, 'Changing Definitions of Fresh Start in U.S. Bankruptcy Law' [1997] 20 Journal of Consumer Policy 179; See also Charles Jordan Tabb, *The Law of Bankruptcy* (2nd ed. Foundation Press 2009).

accordance with the Bankruptcy Code. Therefore, the filing of a petition under Chapter 7 will result in the loss of property. Debts existing on the filing date will be resolved in the Chapter 7 proceedings.

There are some eligibility requirements when individuals file under Chapter 7. Firstly, no individual can apply for the Chapter 7 unless, within 180 days before filing, they have received credit counselling from authorised counselling agencies.[5] If there is a debt management plan arising from the required credit counselling, it must be filed with the court. In addition, if an individual does not pass a means test, he or she cannot file under Chapter 7.[6] When the filing of a petition under Chapter 7 is dismissed for some reason, the debtor needs to wait 180 days to refile.[7]

The primary reason for filing a petition under Chapter 7 is to discharge the debtor from certain debts.[8] Literally, to 'discharge' means "to relieve of a burden" or "to set aside; dismiss;

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[5] 11 U.S.C. § 109, 111.

[6] It is a mechanical and strict calculation of net income available to pay creditors, and removes those debtors with sufficient projected future repayment ability from Chapter 7. Through means testing, a debtor's current monthly income will be calculated. Then, after subtracting various expenses, the debtor's net monthly income will be determined. Those allowable deductions include: living expenses computed according to Internal Revenue Service collection guidelines for delinquent taxpayers; projected payments for 60 months on actual secured debts; projected payments for 60 months on actual priority debts and a miscellany of special interest expenses, charitable contributions and administrative charges. To evaluate a debtor's repayment capacity, the net income will be multiplied by 60. The final result will be compared with (1) $6000 or 25% of the debtor's nonpriority unsecured claims, whichever is greater or (2) $10000. When the total available income exceeds a specific amount and the presumptive abuse is established. Once Chapter 7 debtors fail to pass the means test, cases will be dismissed and debtors have to file under Chapter 13. 11 U.S.C. § 707(b).

[7] '(1) the case was dismissed by the court for willful failure of the debtor to abide by others of the court, or to appear before the court in proper prosecution of the case; (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay' 11 U.S.C. §§ 109(g)(1)-(2).

[8] David Skeel, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press 2001) 6.

annul".[9] In the context of bankruptcy law, when a debtor obtains a discharge, debtors do not have to pay those discharged debts and creditors can no longer attempt to collect them. Assets acquired or earned after bankruptcy by debtors will be free from creditors' collection. Hence, debtors begin their life with a fresh start, at least at the economic level.[10]

However, although personal Chapter 7 cases generally end with the debtor's discharge, the right to debt relief is not absolute. Under some circumstances, an interested party may apply for a complaint objecting to the discharge. The court will determine whether the discharge should be denied based on the Bankruptcy Code.[11] In addition, though creditors cannot collect debts from discharged individuals, some types of debts are nondischargeable.[12]

b. Chapter 13

Chapter 13 is an alternative to the liquidation process, Chapter 7. Chapter 13 procedure is also

[9] Ibid.

[10] Some researchers argue that debtors' fresh start fails to achieve its aims. In a study conducted by Porter and Thorne, they found after one year post-bankruptcy, one quarter of debtors were struggling to pay routine bills and one third reported an overall financial situation similar to, or worse than, when that debtor filed for bankruptcy. Therefore, they considered the financial recovery of debtors was not successful. See Katherine Porter and Deborah Thorne, 'The Failure of Bankruptcy's Fresh Start'. [2006] 92 Cornell Law Review 67.

[11] Those grounds are: actual fraudulent transfers, unjustified failure to keep proper books and records, bankruptcy crimes, failure to explain loss of assets, refusal to testify or obey lawful court orders, commission of prohibited acts in bankruptcy of an insider, time bar on successive discharge, waiver of discharge, failure to complete personal financial discharge. 11 U.S.C. § 727.

[12] To protect the public, certain taxes and some tax penalties are not dischargeable. In order to protect innocent creditors, debts based on fraud are also nondischargeable. Attempting to protect a creditor who has not filed a claim in time, unscheduled debts are not dischargeable. The Bankruptcy Code makes an exception of discharge debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny". Debtors cannot be free from their domestic support obligations. Debts stemming from wilful and malicious injury cannot be discharged. A debt that is "for a fine, penalty, or forfeiture"; is "payable to and for the benefit of a governmental unit" and is "not compensation for actual pecuniary loss" will be nondischargeable. Unless debtors can demonstrate undue hardship, educational loans cannot be discharged. When drivers who are influenced by alcohol or drugs cause injury or death, the resulting liabilities cannot be discharged. Debts from a prior bankruptcy case where discharge was waived or denied may not be discharged in a subsequent bankruptcy case. 11 U.S.C. § 523.

called a wage earner's plan. It allows individuals with regular income to submit a debt adjustment plan to make instalments to creditors within a certain number of years.[13] During the plan, creditors are forbidden from initiating or continuing collection efforts. There are some eligibility requirements to be met before the filing of a petition under Chapter 13. Only individuals whose unsecured debts are less than $394,725 and secured debts are less than $1,184,200 can file for Chapter 13.[14] Additionally, similar to the eligibility requirements of Chapter 7, individuals need to participate in credit counselling within 180 days before filing for Chapter 13 while no prior bankruptcy petition was dismissed for specific reasons during the earlier 180 days.[15]

A Chapter 13 case begins by filing a petition with a court. When the debtor applies to the court, an unprejudiced trustee will be appointed to manage the case.[16] The role of the trustee is to evaluate the case and act as a distribution agent, gathering payments from debtors and making distributions among creditors.[17] Additionally, the Chapter 13 trustee will convene a creditor meeting where both creditors and the trustee can ask debtors questions. It is a statutory duty for the debtor to attend the meeting and answer questions regarding his financial affairs and the proposed repayment plan.[18] After the meeting, debtors, the trustee and creditors will attend a court hearing regarding the repayment plan.[19] Then, the court will

[13] The period of the repayment plan is within three to five years. In a case in which a debtor's monthly income is less than the applicable state median, the period of the plan will be for three years unless the court sanctions a longer period 'for cause'. 11 U.S.C. § 1322(d).
[14] Those amounts will be adjusted periodically to reflect inflation. 11 U.S.C. § 109(e).
[15] 11 U.S.C. § 109, 111.
[16] 11 U.S.C. § 1302.
[17] 11 U.S.C. § 1302(b).
[18] 11 U.S.C. § 343.
[19] 11 U.S.C. §§ 1324.

determine whether the repayment plan is workable and meets the standards set by the Bankruptcy Code.[20] If the court does not approve the plan, the debtor can choose to file with a modified plan[21] or convert the case to Chapter 7 liquidation.[22] Conversely, if the court confirms the plan, the debtor must make regular payments to the trustee for distributing.

With Chapter 13 discharge, debtors may obtain a discharge at the time when all payments under the plan have been completed.[23] Under certain circumstances, the debtor may apply to the court for an early discharge when he has not completed the plan. [24] Upon the grant of a discharge, individuals are released from creditors' collection efforts. However, specific debts are not dischargeable such as certain taxes, debts for alimony or child support, government-funded or guaranteed student loans or benefit overpayments, debts resulting from death or personal injuries caused by drunk driving and criminal fines.[25]

Compared to liquidation under Chapter 7, Chapter 13 provides individuals with several advantages. The most significant advantage is that debtors can keep all property in their possession during the plan.[26] Individuals have the chance to save their house from foreclosure by curing a delinquent mortgage over time, reversing an acceleration and modifying secured

[20] 11 U.S.C. §§ 1325.
[21] 11 U.S.C. § 1323.
[22] 11 U.S.C. § 1307(a).
[23] 11 U.S.C. § 1328.
[24] The discharge in available only if: (1) the debtor's failure to complete the plan results from situations beyond the debtor's control and he is not accountable for the changed circumstances; (2) creditors have obtained distributions at least as much as they would have received in the Chapter 7 liquidation; and (3) the modification of the plan is not practicable 11 U.S.C. § 1328(b).
[25] 11 U.S.C. § 1328 (a).
[26] 11 U.S.C. § 1306(b).

claims.[27] In the meantime, the court has the ability to 'cram down' security interests, signaling that debtors can only pay the value of collateral in instalments to secured creditors.[28] Additionally, debtors who pay the full amount of unsecured claims or 70% in good faith through the debtors' best efforts are not subjected to the six-year limitation to discharge in a subsequent Chapter 7 case.[29] With regards to the discharge, Chapter 13 procedure is broader than Chapter 7 liquidation.[30] Other benefits, including the avoidance of stigma resulting from straight bankruptcy and a better credit rating, can be obtained when debtors file for Chapter 13.[31]

3.3 A brief history of American bankruptcy law

Prior to 1898, Congress enacted a series of bankruptcy legislation, each of which lasted for a short time.[32] In 1898, the first permanent bankruptcy legislation was passed by Congress which expected that the 1898 Act would operate as a medium to distribute debtors' assets among creditors. In the meantime, lawmakers hoped the introduction of debt relief could encourage commercial risk-taking activities.[33] Against this background, the 1898 Act was designed for traders rather than consumers. However, the reality was that wage-earner

[27] 11 U.S.C. § 1322(b)(3) ,1322(b)(2), 1322(b)(5).
[28] 11 U.S.C. § 1325(a)(5).
[29] 11 U.S.C. § 727(a)(9).
[30] Dischargeable debts in Chapter 13, but not in Chapter 7, are liability arising from wilful and malicious injury to property, nondischargeable tax obligation and property settlements in separation procedures. 11 U.S.C. § 1328(a).
[31] Charles Jordan Tabb, *The Law of Bankruptcy* (2nd ed. Foundation Press 2009).
[32] Those three bankruptcy laws were the Bankruptcy Act 1800, 1841 and 1867. Together, the acts ruled for sixteen years. Skeel (n.8) 25.
[33] The 1898 Act underlines the protection of entrepreneurial incentives even though traders fail. Charles G Hallinan, 'The Fresh Start Policy in Consumer Bankruptcy a Historical Inventory and an Interpretive Theory' [1986] 21 University Richmond Law Review 49, 65.

debtors dominated bankruptcy applications from the late 1920s.[34] As a result, the debt-collection function of the 1898 Act did not work well due to the fact that wage-earner debtors rarely had assets for distribution, and creditors had little interest in the small dividends. Furthermore, the straight liquidation process was not suitable for the needs of the wage earner with few assets because only assets owned at the time of filing are included in the procedure. In this sense, future income were not included in the scope of bankruptcy assets when the liquidation procedure commences. However, for insolvent individuals, the most valuable asset is their human capital. Theoretically, wage earners can repay a portion of debts through future income although they have limited substantive assets when filing for bankruptcy. In this respect, the straight bankruptcy procedure may not be considered as the optimal way to address individual financial distress. Accordingly, some reforms were suggested in 1930s.

Proposals in the 1930s had several themes. Firstly, the legislation aimed to distinguish between honest and dishonest debtors. To prevent the abuse of the bankruptcy system, dishonest debtors were to be prevented from accessing debt discharge. To facilitate such a distinction, a report classified debtors into several groups and indicated various attitudes towards each group based on cases reported by referees in bankruptcy cases.[35] Secondly, the

[34] In 1912, one-fifth of bankruptcy cases were wage-earner cases. By 1930, consumer debtors constituted over half of cases and by 1940 closer to three-quarters Ibid. See also from 1920 to 1930 the wage-earner bankruptcy cases increased by 414 percent while the population increased by 16 percent. See 'Bankruptcy Reform and the Chandler Bill' [1937] 46 Yale Law Journal 1177, 1207 footnote 199, citing Department of Commerce, Cause of Bankruptcy among consumers (Domestic Commerce Series No 82 1933).

[35] United States President Herbert Hoover (1929-33), 'Strengthening of Procedure in the Judicial System: Message from the President of the United States Recommending the Strengthening of Procedure in the Judicial System: Together with the Report of the Attorney General on Bankruptcy Law

idea of a voluntary wage repayment plan was proposed. The 1898 Act had only provided one option for debtors. However, in cases where debtors with regular income could possibly meet part of their financial obligations, no alternative which could avoid bankruptcy stigma was available for wage earners.[36] To solve this problem, a voluntary payment plan procedure, which ultimately became Chapter 13, was introduced into the 1938 Chandler Act.[37] Lawmakers like Nesbit who drafted the initial Chandler Bill provisions on Chapter 13 thought this procedure would be popular with creditors and debtors.[38] However, Congressional House committees questioned its benefits and considered it as a form of wage garnishment.[39] Notwithstanding, Chapter 13 was accepted in bankruptcy law. Since then, individuals could choose between a swift relief and a voluntary payment plan according to their capacity.

The period from the 1950s to 1978 witnessed an expansion of the consumer credit economy. Several factors contributed to the growth of credit. After World War II, democracy was linked with homeownership and the ability to own a certain amount of consumer goods.[40] There was a demand for individuals to use credit to finance their purchases. By the 1960s, the emergence of credit cards and the expansion of instalment credit also facilitated the expansion

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and Practice, S Doc 65, 72d Congress 1st Session' (Washington DC, US Government Printing Office, 1932) 24-25.

[36] More details about the development of Chapter 13 in Perry v Commerce Loan Co 383 U.S 392 (1966).

[37] But the introduction of the voluntary payment plan was not due to the elite lawyers or academics but from a judicial improvisation in Alabama. Timothy Dixon and David Epstein, 'Where Did Chapter 13 Come from and Where Should It Go?' [2002] 10 American Bankruptcy Institute Law Review 741.

[38] For creditors, this programme makes collecting money easier and more certain. For debtors, it protects their employment and protects them from the stigma of bankruptcy. See Ramsay (n.1) 41.

[39] Ibid.

[40] Lizabeth Cohen, *A Consumers' Republic: The Political of Mass Consumption in Postwar America* (Vintage Books, 2003).

of consumer borrowing.[41] Furthermore, in the 1960s and 1970s, due to the pursuit of social justice, women and urban blacks finally had access to credit, which has led to the growth of credit demand.[42] In the meantime, the government offered various subsidies like tax deduction to stimulate the expansion of credit.

Accompanying the expansion of credit, bankruptcy filings also experienced an increase.[43] Individual filings rose from 25,040 in 1950 to 178,202 in 1970.[44] Correspondingly, discussions concerning consumer bankruptcy reemerged in 1950s and 1960s. During this period, one of the issues was whether to introduce a needs-based bankruptcy system. The needs-based bankruptcy law required debtors to demonstrate that they could not make an amount of repayment over a specific period.[45] Moreover, the needs-based policy may permit a referee to transfer a voluntary procedure in bankruptcy to Chapter 13 without the debtors' agreement.[46] Supporters of a needs-based approach argued it would offer greater rehabilitation and self-respect for a debtor, facilitate individual responsibility and morality, and would be economically beneficial.[47]A central argument was that those can-pay debtors could not file under a straight liquidation.[48] However, the National Bankruptcy Conference (NBC)

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41 Skeel (n.8) 190.
42 Gunnar Trumbull, *Consumer Lending in France and America: Credit and Welfare* (Cambridge University Press, 2014).
43 Vern Countryman, 'The Bankruptcy Boom" [1964] 77 Harvard Law Review 1452.
44 Skeel (n.8) 137.
45 HR 12784 88TH Congress 2d session (1964) and s 613 hr 292 89th congress 1st session (1965).
46 Ibid.
47 Those supporters include American Bar Association, American Bankers Association, credit unions, industrial bankers (finance companies), the National Federation of Independent Business, and the US Chamber of Commerce. Ramsay (n.1) 46.
48 To support this claim, empirical research found that 25-50 percent of individual bankrupts could pay their debts from future income. Robert Dolphin, *An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy* (Michigan Bureau of Business and Economic Research, Graduate School of Business Administration, Michigan State University, 1965).

and the National Association of Referees in Bankruptcy, supported a voluntary and effective Chapter 13 for wage earners rather than a mandatory one.[49] Although there were conflicts over Chapter 13, some agreements were reached. The first was that most consumer bankruptcy cases were no-asset or few-asset cases.[50] Secondly, the general goal was rehabilitating debtors.[51]

To cope with the rising number of consumer bankruptcy cases, in 1970, a new institution, the Bankruptcy Commission, was formed. Although creditor groups played an essential role in Congress's decision to establish the Commission,[52] the Commission's stated objective for personal bankruptcy law is to provide 'relief of hardship from individual enforcement, rehabilitation of debtors so that they could be more productive and a meaningful fresh start'.[53] The Commission sought to grant debtors access to a straight bankruptcy process, and favoured a reformed Chapter 13 to accommodate debtors with regular income but no assets.[54]

[49] Between 1950s and 1978, lawyers and legal academics played an important role in the development of bankruptcy law. See more details about the debates of bankruptcy law between expert representatives of creditors groups and National Association of Referees in Bankruptcy in this period in Ramsay (n.1) 42-50.

[50] For example, excluding the exemption property, 93% of Chapter 7 debtors have no assets for distribution cited in Levi N. Pace and Jean M. Lown, 'Consumer Bankruptcy' in Jing Jian Xiao (ed), *Handbook of Consumer Finance Research* (2nd edition, Springer, 2016) 316.

[51] The budget and debt counselling was also suggested to be part of bankruptcy, as well as part of preventive strategy. Maine Bankruptcy Referee Conrad Cyr in 1968 Hearings, Hearings before the Subcommittee on bankruptcy and the Committee on the Judiciary US Senate (2d Sess.) SJ Res 100 A bill to create a Commission to Study the Bankruptcy Laws of the US (1969).

[52] Creditor groups play an essential role in Congress' decision to establish the Bankruptcy Commission. Skeel (n.8) 190.

[53] Ramsay (n.1) 48.

[54] American Bar Association, Report of the Commission on the Bankruptcy Laws of the United States [1973] 29 The Business Lawyer 75, 96-97.

Finally, the Commission's proposals became the basis for the Bankruptcy Reform Act of 1978.[55] Under the 1978 Act, individuals were provided with two options to deal with their excessive debts. The first, Chapter 7, "straight bankruptcy" or "liquidation proceeding", enables insolvent debtors to be free from preexisting debt in several months at the expense of the relinquishment of all non-exempt assets. The alternative is Chapter 13, individual debt adjustment, which policymakers embraced as a preferred option for debtors. As the Commission suggested, this debt adjustment is not a mandatory repayment plan. Debtors are permitted to voluntarily choose between Chapter 7 and Chapter 13 under the 1978 Act. However, lawmakers wished the use of straight bankruptcy proceedings only as a last resort. Therefore, to encourage over-indebted debtors to enter into Chapter 13, the Act offered more incentives by giving Chapter 13 debtors more relief than Chapter 7 debtors can obtain. Furthermore, after the completion of the Chapter 13 plan, debtors may receive a "super discharge" of debts, which were nondischargeable under Chapter 7 proceedings. Moreover, the 1978 Act takes judicial approval rather than creditors' acceptance as the condition to confirm the plan.

In the era since 1978, credit continued to expand.[56] Given the deregulation of interest rates, the development of financial markets and computer technology,[57] household credit

[55] However, one major recommendation, the separation of administrative from judicial functions, was not accepted. The reason was a lack of support by the creditor industry and the opposition of judges and lawyers. Eric Posner, 'The Political Economy of the Bankruptcy Reform Act of 1978' [1997] 96 Michigan Law Review 47.

[56] One supportive piece of evidence is that the 1997 commission report indicated that "in 1978 … less than 40 percent of American families had a credit card. Today, four of every five families have at least one." National Bankruptcy Review Commission, Bankruptcy: The Next Twenty Years (1997) 1-2 < https://govinfo.library.unt.edu/nbrc/report/01title.html > accessed 10 March 2020.

[57] Richard A Brown and Susan E Burhouse, 'Implication of The Supply-Side Revolution in Consumer

continued to increase. In contrast, the income of the low-middle class in rich countries was under pressure by reason of globalisation with the result that their income may not satisfy their expenditure.[58] In the meantime, the welfare state continued retrenching after 1978, which increased household demands for credit to fill the gap between basic expenditure and income.[59] Accordingly, American families have to use credit as an ersatz welfare policy.[60] To an extent, for American individuals, credit serves as a "debt-safety-net".[61]

Correspondingly, consumer bankruptcy cases grew rapidly in the same period. In 1980 there were 314, 886 consumer bankruptcies, and the number exceeded one million in 1996.[62] Furthermore, almost two-thirds of individual insolvency cases were filed under Chapter 7 rather than Chapter 13. The increasing filing number led to debates about individual bankruptcy law, the most controversial topic being whether it is necessary to restrict consumers' access to immediate debt discharge. Interest groups such as legal experts and consumer creditor groups engaged in the debate. In terms of legal scholarships, consumer bankruptcy is a normal phenomenon for the American middle class, which is subjected to increased living pressure.[63] Moreover, most individual bankruptcy cases are attributable to

Lending' [2005] 24 Saint Louis University Public Law Review 363.

[58] Branko Milanovic, *Global Inequality: A New Approach for The Age of Globalization* (Harvard University Press 2016) 20.

[59] The period from 1978 to 2005 witnessed the unravelling of US welfare capitalism. Ramsay (n.8) 50; see Raghuram Rajan, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton University Press 2011).

[60] As Schwartz summarised "faced with stagnant wages and a falling real value of pensions, health insurance coverage, and other buffers against risks, households increasingly used credit and in particular housing-based credit as a substitute buffer. Herman Schwartz, 'Housing, the Welfare State and the Global Financial Crisis: What is the Connection' [2012] 40 Politics & Society 35.

[61] Johnna Montgomerie, 'America's Debt Safety-Net' [2013] 91 Public Administration 871.

[62] Skeel (n.8) 190.

[63] The middle class is defined in terms of homeownership, education, occupational status. Elizabeth Warren and Deborah Thorne, 'A Vulnerable Middle Class : Bankruptcy and Class Status 'in Katherine

exogenous factors such as unemployment, divorce, and medical debt.[64] Researchers concluded that due to the reduction of entitlements in the US social security and health care system, bankruptcy discharge played a vital role in providing a safety net.[65] In this view, personal bankruptcy law operates as social insurance which insures debtors against peril. Default did not occur because debtors were abusing bankruptcy protection, or because they were seeking to cancel their debt while continuing a spendthrift lifestyle.[66] However, pro-creditor groups such as the financial industry disagreed with those legal scholarships and claimed many insolvent individuals were not unfortunate but irresponsible.[67] Debtors file for the protection of the liquidation proceedings even though they can make a portion of the payment to creditors.[68] A central argument was that the stigma of bankruptcy had declined so that many debtors were filing for a swift discharge from their financial obligations.[69]Studies sponsored by creditor groups claimed that some debtors could repay a part of their debt and the cost would transfer to society.[70] One study indicated every American would pay an annual "$400 tax" for every bankruptcy filing, but there was no empirical support for this claim.[71]

Porter (eds) *Broke: How Debt Bankrupts the Middle Class* (Stanford University Press 2012).

[64] Teresa A Sullivan, *The Fragile Middle Class: American in Debt* (Yale University Press 2000).

[65] Teresa A Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (Beard books, 1989).

[66] Teresa A Sullivan, Elizabeth Warren and Jay L Westbrook, 'Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankruptcy 1981-1991' [1994] 68 American Bankruptcy Law Journal 121, 147.

[67] This was different from traditional narrative that over-indebted debtors were unfortunate and hence needed some assistance. Rafael Efrat, 'Bankruptcy Stigma: Plausible Causes for Shifting Norms' [2006] 22 Emory Bankruptcy Developments Journal 481; Rafael Efrat, 'The Evolution of Bankruptcy Stigma' [2006] 7 Theoretical Inquiries in Law 365; Rafael Efrat, 'The Moral Appeal of Personal Bankruptcy' [1998] 20 Whittier Law Review 141.

[68] Melissa B Jacoby, 'Negotiating Bankruptcy Legislation Through the News Media' [2004] 41 Houston Law Review 1091.

[69] Skeel (n.8) 203.

[70] See Ramsay (n.1)38, 56.

[71] Elizabeth Warren, "The Phantom $400" [2004] 13 Journal of Bankruptcy Law and Practice 77.

Therefore, creditor groups campaigned for the future income of debtors to be taken into consideration when determining their access to straight liquidation. If debtors owned the means to pay off part of the debt, they should file a petition under Chapter 13.

Although creditor groups encountered opposition[72], they succeeded in dominating the development of consumer bankruptcy law to satisfy their interests from 1978. The first success was the introduction of the 'substantial abuse' test in the 1984 amendments, which could be raised by judges.[73] This new test required an income and expenditure statement to be included in documents for the purpose of evaluating the need for debt relief when an individual files for Chapter 7.[74] Congress intended to use future payment capacity as a consideration.[75] If an individual bankruptcy case was dismissed by the court on the grounds of 'substantial abuse', debtors were left with other options including giving up filing for bankruptcy or filing under Chapter 13. It was the first time that access to debt relief was limited in American bankruptcy law.[76] This test was expected to exclude can-pay debtors from Chapter 7. However, due to the absence of a clear definition of 'substantial abuse', this new test did not operate well[77] and fewer cases were dismissed than expected. Therefore, in the early 1990s, the consumer credit industry continued to lobby and made efforts to introduce a

[72] Those opponents include consumer interest lawyers, law professors and the consumer bankruptcy bar. Skeel (n.8) 191.
[73] 11 U.S.C. § 707 (b). In addition to the substantive test, the 1984 reform accepted the proposal that all debtors' disposable income should be obtained by creditors for at least three years. Although the 1984 amendments took creditors' concerns into consideration, it did not seriously restrict debtors' access to a swift discharge. Ibid 196.
[74] Charles G Hallinan, 'The Fresh Start Policy in Consumer Bankruptcy a Historical Inventory and an Interpretive Theory' [1986] 21 University of Richmond Law Review 49, 95.
[75] Tabb (n.31) 180.
[76] Hallinan (n.74) 95.
[77] Tabb (n.31) 180.

'means test' as an access criterion.[78]

The creditor industry believed that a means test could kick can-pay debtors out of Chapter 7.[79] In the meantime, industry lobbyists regarded a statutory means test as an instrument to enhance personal responsibility. Whether to introduce the means test was discussed in the late 1990s. However, the 1997 National Bankruptcy Review Commission denied the proposal suggested by the credit industry.[80] Nonetheless, the financial industry continued its campaign for the introduction of a means test and as a result, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA 2005") was signed into law in 2005, representing a triumph for the creditor industry.[81] This BAPCPA added some changes into personal bankruptcy law. In addition to the most debated 'means test', other changes are 'required pre- and post-bankruptcy counselling; random audits of debtor filings; greater obligations on bankruptcy lawyers to certify the correctness of debtors' filing; a five-year requirement for a Chapter 13 repayment; limits on refilings, and repeat filings as a mechanism to stay enforcement action; and limits on cramdowns on security over automobiles.'[82] In general, it

[78] A means test has always been top of the wish list of the creditor industry. Congress had been discussing the means test seriously since the 1960s. The objective of such a test is to prohibit a consumer debtor who has sufficient income from filing for an immediate discharge. It also determines how much a debtor can pay to their creditors. Skeel (n.8) 204.

[79] Charles J Tabb, 'A Century of Regress or Progress? A Political History of Bankruptcy Legislation in 1898 and 1998' [1998] 15 Bankruptcy Developments Journal 343, 344-353.

[80] National Bankruptcy Review Commission Final Report, Bankruptcy: The Next Twenty Years [1997] 89-91. However, in late 1996, before the commission finished its report, a creditor proposed legislation was introduced into House and Senate. Unlike the proposal of the commission, creditors' recommendations would preclude debtors from using Chapter 7 if they could make part of the payments under Chapter 13. Those proposals were debated by Congress and nearly passed. Skeel (n.8) 202.

[81] BAPCPA was 'written by, bought, and paid for by the consumer credit industry, especially the credit card industry'. A. Mechele Dickerson, 'Regulating Bankruptcy: Public Choice, Ideology and Beyond' [2006] 84 Washington University Law Review 1861.

[82] Ramsay (n.1) 57.

is fair to argue that there was a perceived shift of emphasis in American individual bankruptcy law from a pro-debtor perspective to a pro-creditor one.

Although the present development of individual bankruptcy law is driven by the creditor industry, policymakers claim that current institutional design is a balance between debtors and creditors. Lawmakers believe that honest and unfortunate debtors with low income will not be prohibited from debt relief. Meanwhile, lawmakers claim that contemporary personal bankruptcy legislation will be a carefully tailored mechanism to screen out can-pays who are abusing the system.[83] However, the following section argues that the 2005 reform fails to reach its theoretical objectives. On the contrary, in practice it led to the retreat of the insurance function of insolvency law.

3.4 Evaluation of the 2005 BACPA

The 2005 reform is based on the assumption that too many debtors are taking advantage of the bankruptcy system and therefore, the rationale for the law was to introduce mechanisms for excluding opportunists before they could abuse the bankruptcy system. Policymakers consider the means test as a good watchdog mechanism to protect the law from the abuse of swift bankruptcy discharge.[84] Under the current framework, deserving poor debtors are

[83] Robert M. Lawless, Angela K Littwin, Katherine M Porter and John Pottow, 'Did Bankruptcy Reform Fail- An Empirical Study of Consumer Debtors' [2008] 82 American Bankruptcy Law Journal 349.
[84] Alan D Eisler, 'The BAPCPA'S Chilling Effect on Debtor's Counsel' [2006] 55 American University Law Review 1333.

assumed to still obtain quick debt relief, while can-pay debtors are assumed to pay creditors through Chapter 13.[85] This is because the means test sorts out those can-pay individuals from Chapter 7 cases and directs them into Chapter 13, whereby creditors can receive more returns. This is due to creditors being able to share a part of the debtors' future income via a debt payment plan. However, the following paragraphs argue that the means test has become a failure.

According to policymakers' expectations, the introduction of means testing will preclude can-pay debtors from straight bankruptcy or steer them into a repayment plan. But one question may be raised: does means testing work in practice? The answer is uncertain. When considering the decreasing number of cases filing under Chapter 7 and the increasing share of Chapter 13 in the total non-business filing, it seems the means test works well. In the table below, since 2004 it is obvious that the total number of Chapter 7 cases is declining although there are fluctuations in two time periods. [86] Additionally, the filing numbers under Chapter 13 accounted for nearly 29% in 2004 but in 2017, the share of Chapter 13 cases increased to 38%. However, compared with previous studies wherein one-third of cases filed under Chapter 13,[87] there is no significant change in the share.

[85] "The heart of [BAPCPA] consumer bankruptcy reforms [are] to help ensure that debtors who can pay creditors do pay them" Ransom v FIA Card Services, N.A., 562 U.S. 61 (2011).
[86] Compared with the filing number in 2004, there was a large increase in 2005. One possible explanation may be the 2005 Act. Debtors wished to file for bankruptcy before the new rule took effect. From 2008 to 2010, there was a growth in the filing numbers. The reason may be the financial crisis of 2008 leads to more households experienced financial trouble.
[87] Teresa A Sullivan, Elizabeth Warren, Jay Lawrence Westbrook, 'Who Uses Chapter 13' [2003] in Johanna Niemi-Kiesilainen , Iain Ramsay and William Whitford (eds.) *Consumer Bankruptcy in Global Perspective* (Hart Publishing,2003).

Table 1: Non-business filing from 2004 to 2017 in United States[88]

Year	Total non-business filings	Chapter 7	Chapter 13
2004	1,563,145	1,117,766	444,428
2005	2,039,214	1,659,017	407,322
2006	597,965	349,012	248,430
2007	822,590	500,613	321,359
2008	1,074,225	714,389	358,947
2009	1,412,838	1,008,870	402,462
2010	1,536,799	1,100,116	434,739
2011	1,362,847	958,634	402,454
2012	1,181,016	816,271	363,280
2013	1,038,720	706,499	330,899
2014	909,812	600,885	307,783
2015	819,760	519,130	299,515
2016	770,846	475,332	294,396
2017	765,863	472,190	292,581

However, the positive effects of the means test are overestimated. In the opinion of policymakers, the means test is used to kick out can-pay debtors and promote personal

[88] United State Courts, Caseload Statistics Data Tables < http://www.uscourts.gov/statistics-reports/caseload-statistics-data-tables > accessed 20TH March 2018.

responsibility so that creditors can obtain more returns. Assuming that such a test works, debtors who file under Chapter 7 after 2007 will have lower income than those who filed before 2007 because high-income debtors are precluded from Chapter 7. However, in an empirical study, scholars found that the income of 2001 filers was quite similar to the 2007 filers' income.[89] The median income of filers under Chapter 7 in 2007 was $23,136 while the figure was $23,761 in 2001.[90] On the other hand, if means testing is effective, more high-income debtors may shift to Chapter 13. Similarly, the income level has no significant difference between Chapter 13 filers in 2001 and those in 2007.[91] Furthermore, assuming that the means test works well, it is reasonable to estimate a higher success rate of repayment plan because debtors with higher future earning capacity are pushed into Chapter 13. Over the twenty-five years under the Code before the enactment of BAPCPA, the completion rate of Chapter 13 is just one-third.[92] Although some data indicates the completion rate has increased to 36%, this information was collected in the early life of the BAPCPA and this small difference may not be a reliable trend.[93] Moreover, when more debtors are directed into Chapter 13, it is fair to assume the general enhancement of creditor returns. On the contrary, for unsecured creditors, the proportion of distribution under bankruptcy procedures is low and did not significantly increase after the enactment of BAPCPA.[94] In practice, the means

[89] Robert M. Lawless, Angela K Littwin, Katherine M Porter and John Pottow, 'Did Bankruptcy Reform Fail- An Empirical Study of Consumer Debtors' [2008] 82 American Bankruptcy Law Journal 349, 358.
[90] Ibid 361.
[91] Ibid.
[92] Teresa A Sullivan, Elizabeth Warren, Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (Beard books, 1989).
[93] Jay Lawrence Westbrook, 'The Retreat of American Bankruptcy Law' [2017] 17 QUT Law Review 40, 46.
[94] Lois R Lupica, 'The Consumer Bankruptcy Fee Study: Final Report' [2012] 20 American Bankruptcy Institute Law Review 17, 67-68.

test may not be a barrier for debtors who wish to file under Chapter 7. According to one study, only 13% of lawyers interviewed claimed that means testing is a problem for their clients.[95] Moreover, according to the formula of the means test, debtors are able to make some strategic moves to avoid the sorting effects of the new law.[96] Accordingly, the test's filtering function may not function well. Congressional predictions concerning the implementation of the new means test have failed to occur.[97]

Even though the means test may fail to function according to the policymakers' expectation, we need to explore the reasons for the decline in filing numbers and the increasing share of Chapter 13. First, the requirement of debtor counselling may play a role. Possibly, after debtors receive credit counselling, they can manage their financial affairs better and they can address the financial difficulty without filing a petition under Chapter 7. But according to another study, the pre-filing counselling fails to meet its goal to help debtors to rethink their decisions about filing for bankruptcy.[98] After finishing the counselling, debtors may confirm their decisions about filing for bankruptcy and in this sense, the effect of credit counselling is to postpone debtors' filing of a petition under the Bankruptcy Code.

Other factors may provide more convincing answers. One explanation is the increased fees for

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[95] Angela Littwin, 'Adapting to BAPCPA' [2016] 90 American Bankruptcy Law Journal 183,193.

[96] First, opportunistic debtors may reduce their incomes to pass the test during the six months before filing. See Stephen G. Gilles, 'The Judgment-Proof Society' [2006] 63 Washington and Lee Law Review 603, 656; secondly, debtors may have an incentive to borrow more if their disposable income is between $100 and $167 a month. By doing that, debtors may pass the repayment test and file under Chapter 7. Thirdly, it is possible for debtors to arrange their consumption by increasing the maximum allowable consumption to avoid Chapter 13. See Michelle J White, 'Abuse or Protection- Economics of A Bankruptcy Reform Under BAPCPA' [2007] 1 University of Illinois Law Review 275, 294.

[97] See generally Littwin (n.95).

[98] Michael D Sousa, 'Just Punch my Bankruptcy Ticket: A Qualitative Study of Mandatory Debtor Financial Education' [2013] 97 Marquette Law Review 391.

filing for bankruptcy. Since the 2005 reform, the attorney fees for both Chapter 7 and Chapter 13 have increased.[99] The increased fees keep debtors outside of the immediate discharge proceeding. For those Chapter 7 filers, they must pay lawyers the total fees before filing and these increased fees partly explain why fewer debtors file for Chapter 7. Additionally, the increased share of Chapter 13 cases may also result from the rising attorney fees. Under Chapter 13, the debtors' attorney fees can be paid over the life of a plan.[100] According to one study, 'no money down' bankruptcy cases have increased since 2007.[101] In order to receive a discharge, a debtor who cannot afford Chapter 7 may enter into the repayment plan even though a swift fresh start is a more appropriate option. Moreover, lawyers may look to their own interests over their clients' so that they may encourage debtors to file under Chapter 13. Therefore, the decline of Chapter 7 cases and increased share of Chapter 13 may arise from rising attorney fees rather than the sort-out function of the means test.

Apart from the increasing fees, the decreasing trend of filing numbers may be due to the fact that the composition of consumer debts has changed.[102] Although the 2005 Act limits the dischargeability of credit card debt,[103] there is no doubt that most unsecured debt can still be discharged under the Bankruptcy Code. But educational loans survive in both Chapter 7[104]

[99] According to a fee study, the mean of attorney fees in Chapter 13 increased from $2,061 to $2,564 for discharged cases and from $1,262 to $1,491 for dismissed cases before discharge. In Chapter 7 cases, the fee has increased from $821 to $1,072 in asset cases and from $654 to $968 in no-asset cases. Lupica (n.94) 55.

[100] 11 U.S.C. § 330(a)(4)(B).

[101] Pamela Foohey, Robert M. Lawless, Katherine Porter, Deborah Thorne, 'No Money down Bankruptcy' [2017] 90 Southern California Law Review 1055.

[102] Littwin (n.95) 228.

[103]11 U.S.C. § 523(a)(2)(c).

[104] 11 U.S.C. § 523(a)(8(b).

and Chapter 13.[105] Consumers now owe more student loan debt than credit card debt. Nowadays, loans relating to education have become the "second largest form of consumer debt behind home mortgage"[106] Since 2010, educational loans have increased by 43.7% while credit card debt has fallen by 8.5%.[107] When taking the delinquencies into consideration, the number of unpaid student loans is more than 6 times that of the past decade, but delinquent credit card debt has continued to fall since 2010.[108] Such changes in the composition of consumer debts may provide insight into understanding the decline of filing numbers. Given that educational loans are nondischargeable both in Chapter 13 and Chapter 7, bankruptcy may be less attractive for financially distressed debtors. As a result, the total filing number has declined since 2005.

To sum up, the means test, as a central mechanism introduced in the 2005 BAPCPA, may not function according to policymakers' expectation on sorting out can-pay debtors. The decline in insolvency cases is not because abusers of bankruptcy discharge are kicked out. By contrast, the decrease of filing numbers is due to debtors being restricted from the help of bankruptcy law by the rising cost of attorney fees and the changed composition of individual debts.

[105] 11 U.S.C. § 1328(a)(2) & (3) other debts such as drunk driving torts, and criminal fines and restitution awards made as part of a criminal proceeding are excepted from Chapter 13 discharge.
[106] Consumer Financial Protection Bureau, Student debt swells, federal loans now top a trillion, < https://www.consumerfinance.gov/about-us/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/ > accessed by 22 March 2018.
[107] Ed Flynn, 'Why Are Filings Still Falling?' [2014] 33 American Bankruptcy Institute Journal 46,47.
[108] Ibid 80.

3.5 Conclusion

A defining feature of American consumer bankruptcy law is its debtor-friendly discharge under Chapter 7, without the requirement of an income payment plan as a condition of discharge. Under this framework, the defaulting risks are allocated to creditors as superior risk bearers and debtors obtain the economic rehabilitation. Therefore, American personal bankruptcy law is considered as a form of social insurance.

However, as the number of bankruptcy filings skyrocketed, American personal bankruptcy law has become a continuing war of ideas. The central contention is whether debtors are abusing the lenient bankruptcy regime. Based on the economic incentives assumption,[109] pro-creditor groups such as the financial industry argue that debtors will calibrate their behaviors to maximise their own financial interests. As a result, consumers may strategically evade their financial responsibilities. In contrast, with reference to convincing empirical research, pro-debtor groups argue structural factors including unemployment, illness and the reduction of the social safety net contribute to the growth of bankruptcy filing. Therefore, the bankruptcy discharge acting as an insurance mechanism supplements the retrenching social entitlement.

The result of this ideological battle is that pro-creditor groups gradually came to dominate the development of consumer bankruptcy law. As a result, the 2005 Bankruptcy Abuse and Consumer Protection Act was introduced. Policymakers considered the effect of this Act would

[109] Levi N. Pace and Jean M. Lown, 'Consumer Bankruptcy' in Jing Jian Xiao (ed), *Handbook of Consumer Finance Research* (2nd edition, Springer, 2016) 317.

be to preclude can-pay debtors from abusing bankruptcy systems. At first sight, this test seemingly operates well because the bankruptcy filing number is declining. The decreased cases may imply that the means test works well and those can-pay debtors are sorted out. However, factors including unnecessary credit counselling, increasing attorney fees and the changed composition of debts may be main reasons for the reduction of applicants. Therefore, the Act fails to target can-pay debtors, but precludes all debtors from the benefits of bankruptcy discharge.

To some extent, the development of American consumer bankruptcy law may provide some insights for countries which have an interest in establishing a personal bankruptcy system. Firstly, American experiences indicate that the risks of moral hazard should not be overemphasised. The US system offers debtors a swift discharge from excessive debtors. Moreover, there is no solid evidence indicating many debtors are abusing the bankruptcy system. Instead, there is a body of empirical research proving that bankruptcy discharge acts as an insurance mechanism, supplementing the retreat of the social safety net. Therefore, policymakers should not overreact to concerns of moral hazard since overreaction could result in the law's insurance function being limited, and individuals may not obtain the benefits of discharge. Lastly, the idea of American fresh start has an undoubted appeal, but it may be contentious; therefore, simply borrowing the fresh start idea will likely give rise to conflict in other countries.

CHAPTER 4 LESSONS LEARNT FROM ENGLISH AND GERMAN DEBT RELIEF LAW

4.1 Introduction

Since the late 20th century, the United States and other Western countries have experienced a period of dramatic increase in credit access. In the UK, since 1969, the government has noticed that consumer credit has experienced a huge expansion.[1] The debt-to-income ratio of households in the UK increased by almost 60 percent, from 99% in 1995 to 164.9% in 2009.[2] Similarly, Germany loosened consumer credit markets in the late 1970s and early 1980s.[3] As a result, although the median income in Germany rose only 12 times from 1950 to 1984, the per capita indebtedness grew more than 800 times.[4] Furthermore, total consumer debt doubled from 1984 to 1994.[5]

For many consumers, credit could function as an instrument that enables them to smooth their consumption during their lifetime and deal with emergencies that arise. However, for a minority, the growth of credit can lead to individual overindebtedness. Although there is no consensus on the definition of overindebtedness, it is described as a situation where

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[1] Great Britain, Report of the Committee on the Enforcement of Judgement Debts (Cmnd 3909) (London, HM Stationery Office, 1969) 69; In 1982, the Cork report observed that 'the increased opportunities for contracting debt have led to the emergence of the consumer debtor, a commonplace today, but virtually unknown in the Insolvency Law and Practice: Report of the Review Committee, cmd 8558 (HMSO 1982) ('Cork report') 11.

[2] European Commission, Research Note 4/2010 Over-Indebtedness: New Evidence from the EU-SILC Special Module, 7.

[3] Jason Kilborn, 'Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice' in Johanna Niemi-Kiesilainen , Iain Ramsay and William Whitford (eds) *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives* (Hart Publishing 2009) 308.

[4] Ibid.

[5] Ibid 309.

households have insufficient assets to repay their debt over a long time.[6] The adverse effects of overindebtedness make it a salient issue on the agenda of policymakers.[7] With regard to alleviating consequences of over-indebtedness, policymakers in Western countries focus on reforming their bankruptcy system. In this respect, personal bankruptcy law serves as a social insurance transferring the risk of default from debtors to their creditors through the discharge policy. However, the form and scope of debt relief vary among jurisdictions.

Through studying personal bankruptcy systems in two different jurisdictions, Germany and United Kingdom, this chapter argues that narratives of personal bankruptcies play an essential role in shaping personal bankruptcy law. Narratives can reflect the nature of issues addressed, the objective of a policy and the appropriate way to achieve the goal.[8] In the context of personal bankruptcy law, narratives reflect conflicting and contrasting ideas. On the one hand, debtors' plight in debt traps appeals to the fresh start policy or debt discharge. On the other hand, concerns about moral hazard and the erosion of payment culture prompt the restrictions on bankruptcy discharge. Critical junctures may trigger changes in narratives,[9] which may call for legislative reforms. However, given that the public is not familiar with the

[6] Johanna Niemi-Kiesiläinen and Henrikson Ann-Sofie, 'Legal Solutions to Debt Problems in Credit Societies – A Report to the Council of Europe' (Umea University, 2006) 7.

[7] "The individual costs of over-indebtedness can be substantial, including loss of the family home, depression and relationship breakdown. Debt is linked with both poverty and social exclusion. In addition, over-indebtedness imposes costs on creditors, Government and society as a whole" Department for Work and Pensions (DWP), Tackling Over-Indebtedness: Action Plan 2004 <https://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/files/file18559.pdf> accessed by 18 February 2019; see also Heikki Hiilamo, *Household Debt and Economic Crises: Causes, Consequences and Remedies* (Edward Elgar, 2018) Chapter 4.

[8] Peter A Hall, 'Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain' [1993] 25 Comparative Politics 275.

[9] Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 16.

bankruptcy process, the construction of narratives in personal bankruptcy is dominated by influential interest groups including government, the court, administration intermediaries, finance industry and pro-debtor organisations and professors. The 'storytelling power' of shareholders plays a role in shaping dominant narratives. Accordingly, influential interest groups have an impact on the development of personal bankruptcy systems. Therefore, to an extent, understanding both narratives and interest groups relevant to personal bankruptcy can help to explain the development, stability and changes in this given law.

From a practical perspective, policymakers generally claim that they will strike a balance between conflicting ideas in personal bankruptcy law. In terms of personal bankruptcy law, the balance means protecting bankruptcy processes from opportunists while offering debt relief for over-indebted debtors. However, the balance among conflicting ideas related to personal bankruptcy is hard to reach. Though the law on the book has achieved a balance, the insurance function of insolvency law is limited at the practical level. After examining the institutional framework of debt relief law in England and Germany, this chapter finds that every time they move forward one pro-debtor step, concerns about moral hazard make them retreat from insolvency law's insurance function. As a result, both countries have embraced a limited insurance function for insolvency law. Therefore, for countries interested in the introduction of personal bankruptcy law, policymakers should take a prudent attitude when claiming a balance in conflicting ideas in the personal bankruptcy context. Legislators should examine whether the law in action has a negative impact on its insurance function.

This chapter is structured as follows: Section 2 outlines the institutional framework of personal

bankruptcy law in England and Germany. Then, section 3 will evaluate the extent to which these regulations embrace its social insurance function. Section 4 provides explanations to understand stability, development and changes in personal bankruptcy law. The last section is a brief conclusion.

4.2 The structure of personal bankruptcy law in England and Germany

4.2.1 English individual bankruptcy law[10]

a. Bankruptcy

Bankruptcy is the oldest procedure that debtors can use to solve their debt problems in England. The earliest English bankruptcy law was introduced in 1542 as a debt collection approach.[11] After hundreds of years, contemporary bankruptcy procedure still functions as a process which gathers, liquidates and distributes debtors' assets on behalf of creditors. Once commenced, the bankruptcy process will be administered by a state official receiver, the first trustee in bankruptcy who is employed by the Insolvency Service.[12] In some cases, creditors

[10] In this chapter, when discussing the structure of English personal bankruptcy law, the two options called County Court Administration Orders (CCAOs) and Debt Management Arrangements (DMAs) will not be examined in detail because both of them are outside current bankruptcy system. CCAOs provide an opportunity to solve over-indebtedness outside the bankruptcy system. Initially, it was designed as an alternative to bankruptcy if debtors have small debts, regular income and a few personal assets. CCAOs may protect debtors from creditor harassment and the stigma of bankruptcy. However, in practice, this procedure did not work well. As a result, the administration order was almost extinctive by 2013. More details of the administration order are discussed by Ramsay (n.9) 77. As for Debt Management Arrangements (DMAs), they are an informal choice which is independent of the bankruptcy system. Although debtors may not surrender their assets under a DMA, the arrangement is non-binding and cannot stay creditors' collection efforts. Moreover, debts will not be frozen on commencement so that interest will continue to run. See more details about Debt Management Arrangement at Donna Mckenzie Skene and Adrian Walters, 'Consumer Bankruptcy Law Reform in Great Britain' [2006] 80 American Bankruptcy Law Journal 477,488-489.

[11] Jay Cohen, 'The History of Imprisonment for Debt and its Relation to the Development' [1982] 3 The Journal of Legal History 153,155.

[12] Insolvency Act 1986, s287, s291A.

or the Secretary of State may appoint a private-sector trustee to replace an official receiver.[13] If creditors or the Secretary of State do not make the appointment, the official receiver will act as the trustee. Subsequently, debtors will be deprived of controlling their property because their assets will become bankruptcy estate which should be vested with the official receiver immediately once he becomes the trustee.[14] After the trustee has processed proofs of debt lodged by creditors, he can distribute dividends among creditors whenever he has sufficient funds for this purpose.

In addition to the debt collection function, bankruptcy procedure in England and Wales provides debtors with a discharge from remaining unpaid debts after the liquidation process. An automatic discharge will be offered in less than one year after the commencement of the bankruptcy case.[15] From the date when the discharge comes into operation, debtors will be released from those debts which are not fully repaid through debtors' assets.

During the bankruptcy procedure, some legal consequences will follow. Initially, the official receiver will be responsible for the registration and advertisement.[16] The public has access to the record of a bankruptcy, which may make a bankrupt feel ashamed. Additionally, the official

[13] Insolvency Act 1986, s 292, s 296. In reality, a private trustee will not be appointed in every case. This only happen if debtors have assets to make the appointment or if something should be investigated. As a trustee, he must be a licensed insolvency practitioner.
[14] Insolvency Act 1986, s 306.
[15] Insolvency Act 1986, s 279 (1).
[16] When the official receiver receives a copy of a bankruptcy order, he must register relevant information to the individual insolvency register, which is maintained by the Secretary of State. Insolvency Rules 2016 r.11.16. In addition, the official receiver must cause the notice of the bankruptcy order to be gazetted (officially published in the London Gazette) and may cause the order to be advertised in newspapers if he thinks fits.

receiver will undertake an investigation against the bankrupt in terms of debtor conduct and affairs, and may make a report to the court.[17] When a person (normally the official receiver) becomes the trustee, a bankrupt must comply with the trustee's inquiry into his affairs.[18] If the bankrupt fails to comply, unless he has a reasonable excuse, he may be suitably punished. For example, the one-year discharge period will be suspended. In addition, the debtor may be subject to a restriction order (bankruptcy restriction order[19] or bankruptcy restriction undertaking[20]), which will influence the debtor's post-discharge life. Since a bankruptcy order is made against a debtor, unless the bankrupt is discharged or the bankruptcy order is annulled, the status of this debtor is regarded as an undischarged bankrupt and as an undischarged bankrupt, he will be subject to several specific disqualifications.[21] An income payment order

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[17] Insolvency Act 1986, s 289 (1).

[18] Insolvency Act 1986, s 333.

[19] "A BRO is a legal order from the court which extends the period of time for which you have to follow certain restrictions. This can be for anything from two to 15 years. The restrictions are the same as the ones you have to follow during the year before you're discharged from bankruptcy, which say you can't do any of the following: get credit of £500 or more without telling the lender that you have a BRO; act as a director or get involved with setting up, promoting or running a company without permission from the court; carry out a business in a different name from the one under which you were made bankrupt, without telling everyone you do business with the name in which you were made bankrupt; act as an insolvency practitioner. The official receiver can ask the court to make a BRO against you if it believes you've acted dishonestly or recklessly before or after you were made bankrupt. When deciding whether to make a BRO against you, the court can take any behaviour into account. It will particularly look at whether you have done any of the following: a. breaking any of the restrictions that were placed on you before your discharge from bankruptcy; b. deliberately paying off some of your creditors before others within the 2 years before bankruptcy; c. giving away or selling your belongings for less than they're worth within the 5 years before bankruptcy; failing to keep records which show how you've made losses on property or business; d. not co-operating with the official receiver or bankruptcy trustee." Citizen Advice, < https://www.citizensadvice.org.uk/debt-and-money/debt-solutions/bankruptcy-2/bankruptcy-restrictions-orders/> accessed by 21 November 2018.

[20] "A Bankruptcy Restrictions Undertaking (BRU) extends some of the restrictions placed upon you if you are bankrupt. The length of the bankruptcy itself remains the same. You are still discharged after 12 months. However, there are certain restrictions that continue. The two key ones are as follows: you must not borrow more than £500 without first informing the lender you have a BRU; You are not allowed to be a company director or manage a limited company" Bankruptcy Expert, <https://bankruptcyexpert.co.uk/what-is-bankruptcy/what-is-a-bankruptcy-bru> accessed by 2 January 2019.

[21] A summary of legal restraints and disqualifications to which an undischarged bankrupt is subject can be seen at Ian F Fletcher, *The law of insolvency* (5th edition, Sweet & Maxwell, 2017) 346-348.

may be made against a bankrupt. Under an income payment order, the bankrupt or the person from whom a bankrupt obtains his income will be required to pay a portion of that income to the trustee. Sums received by the trustee will be distributed among creditors. The income payment order will be in force for no more than three years, regardless of whether a bankrupt is discharged.

b. Individual Voluntary Arrangement ("IVA")

In addition to the liquidation process, a debt arrangement procedure, Individual Voluntary Arrangement (IVA), is established in the English personal bankruptcy system. To make a successful IVA, a debtor needs to submit a proposal with the assistance of an insolvency practitioner known as the nominee who plays a role as a trustee supervising the implementation of an arrangement. Then, using the information provided by debtors, the nominee needs to assess whether the proposal has a reasonable prospect of being approved and implemented. The decision of the nominee will be reported to the court.[22] If the report concludes that creditors should consider the proposal, the nominee must seek a decision from creditors regarding whether they approve the proposed arrangement. In principle, every secured or unsecured creditor who has been given notice about the decision process can vote in respect of that creditor's debt. However, if a creditor did not receive a formal notice but became aware of this decision procedure from other sources, he would still be eligible to attend and vote. To pass the proposed arrangement, there must be more than 75% in the

[22] Insolvency Act 1986, s 256.

value of credit owing represented by creditors who can approve the proposal. Once an arrangement is accepted, all creditors will be legally bound no matter whether they attended the creditor meeting or not.[23] During the implementation of the arrangement, the person who acts as a nominee will become the supervisor of an IVA.[24] If the plan has been fully implemented in line with its terms, the supervisor must give notice to the debtor and all creditors who are bound by this arrangement.[25] The legal consequence of completion is that a debtor's financial obligations will be released, and creditors have no right to claim the subsequently obtained assets. However, if debtors cannot comply with the obligations of an IVA, it may result in an application of a bankruptcy order made by the supervisor or a person who is bound by the arrangement.[26]

c. Debt Relief Order (DRO)

Learning from a New Zealand government paper,[27] an innovative procedure called Debt Relief Order (DRO) was introduced to the English individual bankruptcy system in the Tribunals, Courts and Enforcement Act 2007. Under the new procedure, a debtor needs to make an online application to the Insolvency Service through approved intermediaries. The debtor can access this procedure every six years, and creditors can oppose the making of the order. This

[23] Insolvency Act 1986, s 260 (2) (b).
[24] Insolvency Act 1986, s 263 (1)(2); Although the legal status of a supervisor of an IVA is not expressly defined in the Act, it becomes a subject of judicial consideration. On the one hand, the supervisor has a role as an officer of a court and is subject to its control and power to provide appropriate directions. On the other hand, he is also responsible to the Secretary of State, who may require the supervisor to offer his records for inspection, Fletcher (n.21) 66.
[25] Insolvency Act 1986, s 376.
[26] Insolvency Act 1986, s 264 (1) (c).
[27] NZ Ministry of Economic Development, No Asset Procedure Paper (Wellington, Ministry of Economic Development, 2002).

original procedure is designed for individuals who owe little debt but have no assets or income to make repayments and who cannot afford the cost of filing for a bankruptcy order.[28] Access is limited to debtors with non-exempt assets below £1,000, a vehicle valued at less than £1,000, unsecured debts less than £20,000 and no more than £50 surplus income after paying tax, national insurance, and regular household expenses. Those approved intermediaries play the role of screening agencies and will examine the eligibility of the debtor through credit reference data.[29]

The DRO procedure is a low-cost administrative procedure to deal with individual over-indebtedness. Debtors must pay £90 for the DRO with £10 allocated to intermediaries. Although a debtor may pay this fee in instalments, £90 must be paid fully before accessing the procedure. An official receiver will be nominated for this procedure, and debtors should inform him of any changed circumstances relevant to their financial affairs during a one-year period.[30] Courts only play a supervisory role in the DRO procedure. Courts may involve in a DRO according to the application of an interested party in terms of specific circumstances[31]. If debtors do not comply with obligations, the court will possibly impose a debt relief restriction order (DRRO) on them following a DRO procedure.[32] Similar to a bankruptcy restriction order, debtors who are subject to the DRROs will be prohibited from certain activities including

[28] Fletcher (n.21) 362.
[29] Approved intermediaries have free access to credit reference agencies such as Experian, Equifax and CallCredit. Iain Ramsay, 'Bankruptcy Light? The English Debt Relief Order, Bankruptcy Simplification and Legal Change' [2018] Norton Journal of Bankruptcy Law and Practice, 1, 7.
[30] Insolvency Act 1986, s 251J.
[31] Insolvency Act 1986 s251M.
[32] Fletcher (n.21) 363.

obtaining credit over the prescribed amount.

4.2.2 German Individual Insolvency Law

The overall feature of German debt relief law lies in the strict conditions on obtaining a discharge. Before filing for the insolvency proceedings, German law requires a debtor to prove he has made an unsuccessful attempt to reach an out-of-court settlement with his creditors within the last six months.[33] The terms of the agreement are unregulated and depend on the negotiation between creditors and debtors, but the debtor must be assisted by an officially approved "suitable person or agency."[34] The Länder (individual German state) is responsible for deciding whether a person or agency is appropriate. The most common suitable persons are lawyers and state-sponsored debt counsellors.[35] However, from the perspective of lawyers, individual insolvency cases will involve hard work with little remuneration. Therefore, in practice, state-sponsored debt advice centres (Schuldner-beratungsstelle) are the leading supporters of over-indebted individuals.

After the failure of informal extra-judicial credit counselling and negotiation with creditors, the procedure moves to the next phase. Before the insolvency proceeding officially commences, a new round of negotiation with creditors will begin. At this time, the court may get involved in the negotiation in the form of cramming the payment plan down, indicating that the court may force a dissenting minority of creditors to accept the payment plan.[36]

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[33] Insolvency Code (Insolvenzordnung-InsO) s305.
[34] Ibid.
[35] Jason Kilborn, *Comparative Consumer Bankruptcy* (Carolina Academic Press 2007) 40.
[36] 'if the plan for the settlement of debts has been approved by more than half the named creditors,

However, two other conditions must be met for the court to cram down a plan. One is that the plan must provide each creditor with an appropriate share and the other is that dissenting creditors cannot be placed in a more inferior position than they would if a debtor entered into the liquidation process and six-year payment period.[37]

If the second round of negotiation fails, consumer debtors will enter into a process called "simplified consumer insolvency proceedings"(vereinfachtes verbraucherinsolvenzerfahren). However, since the 2013 reform, the provisions related to the simplified insolvency proceedings have been repealed.[38] Accordingly, regardless of whether individuals have business debt or not, they now use the same regular proceedings to address their financial trouble. Once the second negotiation is unsuccessful, debtors will enter into the liquidation process.

Current liquidation procedure can be divided into two stages: first, the court will appoint an administrator who acts as the trustee to sell debtors' non-exempt property and distribute funds among creditors. Under the liquidation procedure, only a narrow range of assets is exempt from the grasp of creditors. Debtors can only keep items necessary for a modest lifestyle and domestic activity as well as those necessary for their profession.[39] Furthermore,

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and if the total of the claims of those creditors who have given approval amounts to more than half the claims of the named creditors, at the request of a creditor or of the debtor, the insolvency court shall replace the objections of a creditor to the plan for the settlement of debts with agreement' Insolvency Code (Insolvenzordnung-InsO) s309.

[37] Insolvency Code (Insolvenzordnung-InsO) s309.

[38] Susanne Braun, 'German Insolvency Act: Special Provisions of Consumer Insolvency Proceedings and the Discharge of Residual Debts' [2006] 7 German Law Journal 59, 69.

[39] Kilborn (n.35) 78.

if an exempted item is deemed to be overly luxurious, it may be seized and replaced by a less luxurious alternative.[40] If the liquidation process cannot produce enough funds to cover court fees, the insolvency application will be dismissed.[41]

In the second stage, debtors will enter into the "good behaviour period" (wohlverhalternsperiode). This period will last for six years from the commencement of insolvency proceedings. During this period, debtors should hand over their garnishable work-related income[42] and surrender half of the value of any assets obtained through inheritance.[43] Then, the administrator will be responsible for distributing the funds collected from debtors' non-exempt income to creditors *pro rata*.[44] To encourage debtors to complete this good behaviour period, in the fourth year, the trustee will return 10% of the debtor's non-exempt income assigned during the year as an incentive bonus and the proportion will rise to 15% in the fifth year.[45] In the last year, debtors can be discharged from the residual debts. During the good behaviour period, debtors must make their best efforts to find and hold a job. The Insolvency Act explicitly requires that a debtor should "engage in adequate gainful employment" or "if he is unemployed, seek such employment and not refuse any reasonable activity".[46] If debtors fail to seek and hold a job, creditors can apply for the denial of discharge.[47] After the six-year period and a court hearing, debtors can seek discharge from

[40] This mechanism is called "replacement seizure" (Austauschpfändung) Ibid.
[41] Insolvency Code (Insolvenzordnung-InsO) s26.
[42] Insolvency Code (Insolvenzordnung-InsO) s287(2).
[43] Insolvency Code (Insolvenzordnung-InsO) s295(1)(2).
[44] Insolvency Code (Insolvenzordnung-InsO) s292(1).
[45] Ibid.
[46] Insolvency Code (Insolvenzordnung-InsO) s295.
[47] Insolvency Code (Insolvenzordnung-InsO) s296.

residual debts. Unless debtors are subject to the refusal of discharge of residual debt stipulated in Section 290, they will obtain a discharge from excessive debts.[48] Since 2014, the time to discharge may be shortened if they have paid at least 35% of debts after three years.[49]

4.3 To what extent does the law embrace insolvency law's social insurance function?

At a theoretical level, the social insurance function of personal insolvency law is reflected in debt relief which enables debtors to be discharged from excessive debts and rehabilitates their economic capacity. Policymakers in England and Germany have accepted the rehabilitation function of insolvency law. In the Cork report, it was indicated that 'society is concerned to relieve and protect the individual insolvent from the harassment of his creditors, and to enable him to regain financial stability and to make a fresh start.'[50] Therefore, one of the aims of a good modern insolvency law according to the report is "to relieve and protect where necessary the insolvent, and in particular the individual insolvent, from any harassment and undue demands by his creditors, whilst taking into consideration the rights which the insolvent (and where an individual, his family) should legitimately continue to enjoy".[51] Similarly, German lawmakers considered a debt relief law as a social necessity. They announced that one of the ends of insolvency proceedings was for "the honest debtor….to free himself of his remaining

[48] Insolvency Code (Insolvenzordnung-InsO) s290.
[49] Nadja König, 'Personal insolvency dynamics in Germany and the UK: A SUR-TAR Approach.' [2016] No. 2/2016. DEP (SocioEconomics) Discussion Papers, Macroeconomics and Finance Series, 9. < https://www.wiso.uni-hamburg.de/repec/hepdoc/macppr_2_2016R.pdf> assessed 12nd January 2019.
[50] Insolvency Law and Practice: Report of the Review Committee, cmd 8558 (HMSO 1982) ('Cork report') para 192.
[51] Ibid para 54.

debts".[52] Although countries such as England and Germany recognise the social insurance function of insolvency law, whether the personal bankruptcy law in practice embraces such an objective is another matter. The following section will evaluate the extent to which English and German personal insolvency laws accept social insurance in terms of the availability and accessibility of insolvency proceedings and the possibility of second-chance discharge.

4.3.1 An evaluation of English individual insolvency law

In the 2013 World Bank report, researchers indicate that debtors should be freed from their debt and the most effective form of relief ought to be a straight discharge, which means debtors' relief from excessive debt without a payment plan.[53] The English discharge policy is close to the most effective form of relief. English institutional framework provides over-indebted debtors with three formal options (IVAs, bankruptcy, and DRO). Except for the IVA process, under bankruptcy and DRO, debtors can obtain an automatic discharge after one year without a repayment plan. But it is possible for the debtor to make payments over three years if he has surplus income in the bankruptcy process. Therefore, the UK bankruptcy law offers an example of good practice in terms of speedy discharge, flexibility and debtor recovery.[54] However, the complacent image of English personal bankruptcy law is not the whole story. The

[52] Jason Kilborn, "The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States" [2003] 24 Northwestern Journal of International Law & Business 257, 270.

[53] The World Bank, 'Report on the Treatment of the Insolvency of Natural Persons' 115 <https://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf> accessed by 10 Jan 2020.

[54] Mathew Whittaker and Katie Blacklock, 'Hangover Cure: Dealing with the Household Debt Overhang as Interest Rates Rise' (Resolution Foundation, 2014) 26-32 < https://www.resolutionfoundation.org/app/uploads/2014/07/Hangover-cure-dealing-with-the-household-debt-overhang-as-interest-rates-rise.pdf > accessed 15 March 2020; Ramsay (n.9) 102-103.

availability of debt relief is not just simply the adoption of a legal structure which permits debtors to be released from excessive debt in a relatively speedy way. That structure must be accessible to those who need relief. The accessibility of insolvency proceedings will be influenced by the degree to which policymakers limit or set conditions to, both formally and practically, a debtor's access to procedures. Some existing provisions may influence debtors' access to bankruptcy and DRO and thereby restrict them from a swift discharge. To make a bankruptcy petition in England, debtors must fully pay £680 for access to bankruptcy. However, it is likely that over-indebted debtors cannot afford the bankruptcy cost. However, given that there is no empirical research about whether the upfront fee heavily influences a debtor's decision on an application, the real impact is unclear. In the context of DRO, the cost may not be an influential factor which restricts debtors' access to this proceeding as, compared with the bankruptcy procedure, the cost of DRO is £90, a modest sum for debtors. Furthermore, the DRO fee may be paid in instalments although it must be paid fully before accessing the procedure. However, compared with bankruptcy, the access criterion for DRO is more complex. DRO is not for all types of debtors. Its objective is to provide access to debt discharge for 'those who cannot pay their debts and are unable to access current procedures of debt relief'.[55] Hence, to screen out those deserving debtors, a series of prerequisites is imposed on access to DRO. However, in the implementation of DRO, some prerequisites may lead to access problems. One condition is that only those who have unsecured debts of less than £20,000 can apply for DRO. However, when a debtor applies for DRO, the central point should be whether a debtor has limited resources to repay debts rather than whether he owes over

[55] HL Nov 29 2006, vol 687, col WA766.

£20,000. Furthermore, there is limited evidence indicating that a debtor with a high level of debt is less likely to be a NINA debtor. As a result, some qualified debtors may be excluded from DRO. In addition, a 6-year cooling period may influence debtors' access to DRO proceedings. An assumption behind the cooling period is that a debtor should learn to avoid over-indebtedness. If a debtor falls into over-indebtedness shortly after the end of DRO, he is assumed to be culpable, and he does not deserve a discharge for the second time. However, preliminary research has indicated that most users of DRO are female and many are sole parents. [56] The majority are jobless. Furthermore, the primary cause for DROs is illness/accidents.[57] After obtaining a discharge through a DRO, it is reasonable to anticipate that those individuals may fall into financial trouble again in the near future. In this respect, the cooling period appears to be a mechanism restricting vulnerable individuals from discharge protection for the second time.

Besides limiting access to bankruptcy and DRO, more and more debtors are diverted into the IVA. According to insolvency statistics, IVAs are the most common insolvency procedure used by over-indebted debtors, signaling a shift from non-consensual discharge to consensual IVAs. The preference for IVAs may be based on constructing debtors as strategic users, rationally ranking the opportunities convenient to them in order of importance and making decisions in conformity to that ranking.[58] Empirical research has led to a conception that more and more

[56] Insolvency Service, DROs Initial Evaluation Report (London, Insolvency Service, 2010).
[57] Comparison of causes of bankruptcy and DROs, Iain found that illness/accidents were considered as a main cause for DROs. Iain Ramsay, 'Bankruptcy Light? The English Debt Relief Order, Bankruptcy Simplification and Legal Change' [2018] Norton Journal of Bankruptcy Law and Practice 1, 19.
[58] Katharina Möser, 'Making Sense of the Numbers: The Shift from Non-consensual to Consensual Debt Relief and the Construction of the Consumer Debtor' [2019] 46 Journal of Law and Society

consumers fall into a debt trap because of 'living beyond ones means'.[59] Therefore, the IVAs can function as a discipline tool improving consumers' financial management ability. Additionally, 'the entry of a new model of insolvency practitioner' also contributes to the growth of IVAs.[60] Through the extensive advertisements, IVA providers offer IVAs as an alternative to bankruptcy.

On the surface, there is nothing wrong with the dominance of IVAs. After all, debtors freely choose to enter into IVAs, and they can obtain a discharge after an IVA. However, debtors' choices may be influenced by insolvency practitioners (IPs) and do not reflect actual preferences. The services of intermediaries play an important role in helping debtors to choose the appropriate procedure. In this respect, it is possible to raise the agency problem, indicating intermediaries may have conflicting interests with their clients.[61] Under the English system, IPs tend to steer debtors toward income-producing solutions such as IVA rather than bankruptcy and DROs.[62] The reason is understandable: compared with IVA, no fees can be earned from the bankruptcy.[63] Given that IPs have financial interests in IVAs, whether they can provide balanced and fair information is questionable. In practice, 'firms, particularly fee-charging firms, often fail to give fair and balanced information and advice about some

240 ,242.

[59] PricewaterhouseCoopers, Living on Tick: The 21st Century Debtor (London, PwC, 2006).

[60] Ramsay (n.9) 87.

[61] Frank McIntyre, Daniel M. Sullivan and Laura Summers, 'Lawyers Steer Clients Toward Lucrative Filings Evidence from Consumer Bankruptcies' [2015] 17 American Law and Economics Review 245.

[62]Survey of Debtors and Supervisors of Individual Voluntary Arrangements (Insolvency Service, 2008) 9-10; Review of the Impact of the IVA Protocol (Insolvency Service, 2009) 13-14.

[63] Adrian Walters, 'Individual Voluntary Arrangements: A 'Fresh Start' for Salaried Consumer Debtors in England and Wales' [2009] 18 International Insolvency Review 5, 34.

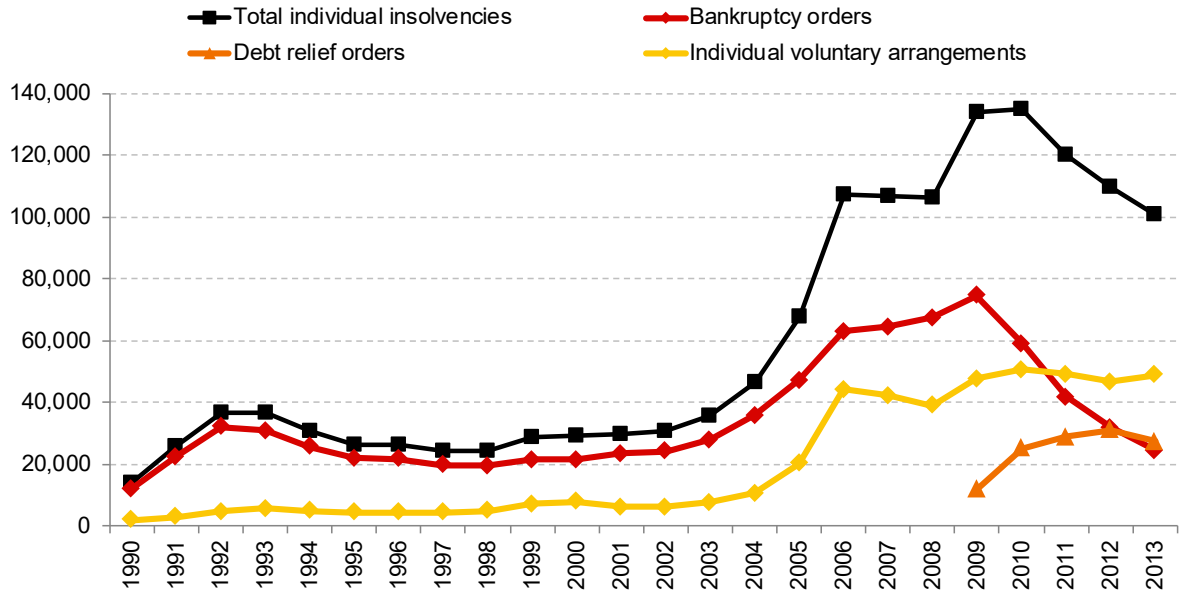
insolvency solutions such as bankruptcy and debt relief orders'.[64]

If IVAs can offer adequate debtor protection, then there is no basis to criticise IPs' influence on a debtor's procedural option. However, an IVA may provide limited protection for debtors. IVAs are contractual agreements between debtors and creditors. English courts consider IVAs as a contract-based mechanism[65] and therefore, the terms of IVAs are based on the negotiation between debtors and creditors. Unlike American Chapter 13, the English court does not need to confirm a repayment plan on behalf of debtors in the IVA. However, the bargaining power between creditors and debtors is not fair. Because creditors deal with many debtors, they may have more information about the debt restructuring market. Compared with creditors, debtors are more likely to be experiencing the IVA for the first time. As a result, there are significant information asymmetries between debtors and creditors and even though IPs may function as debtors' advisers, they have fewer incentives to fight for debtors. The reason is that IPs are repeat-actors in the restructuring market. To make more profit, IPs need to have a good business relation with creditors and therefore, they may be reluctant to fight for debtors in the negotiation process. Conversely, IPs are more likely to propose pro-creditor terms which can be accepted by creditors. Accordingly, IVAs become a pro-creditor mechanism, and it is hard for debtors to obtain protection.

[64] Financial Conduct Authority, 'Quality of Debt Management Advice' Thematic Review TR15/8 25 < https://www.fca.org.uk/publication/thematic-reviews/tr15-08.pdf > accessed by 18 March 2020.
[65] Johnson and Another v. Davies and Another [1998] EWCA Civ 483; Mond and Another v. MBNA Europe Bank Ltd [2010] BPIR 1167.

In effect, the failure rate has increased steadily among IVAs initiated in the years since 2002, and over 40 percent of IVAs commenced in 2008 have failed.[66] Additionally, a typical IVA will last for 5-6 years. Furthermore, since more debtors whom IVAs are not suitable to enter into IVA procedure, the proportion of long-term IVAs increases.[67] The long periods of IVAs, from the perspective of debtors, lead to debt relief becoming less certain. It is possible that debtors under IVAs can repay debts for a long time without obtaining debt discharge. As a result, many debtors may not get the protection from the insolvency law's insurance function through IVAs.

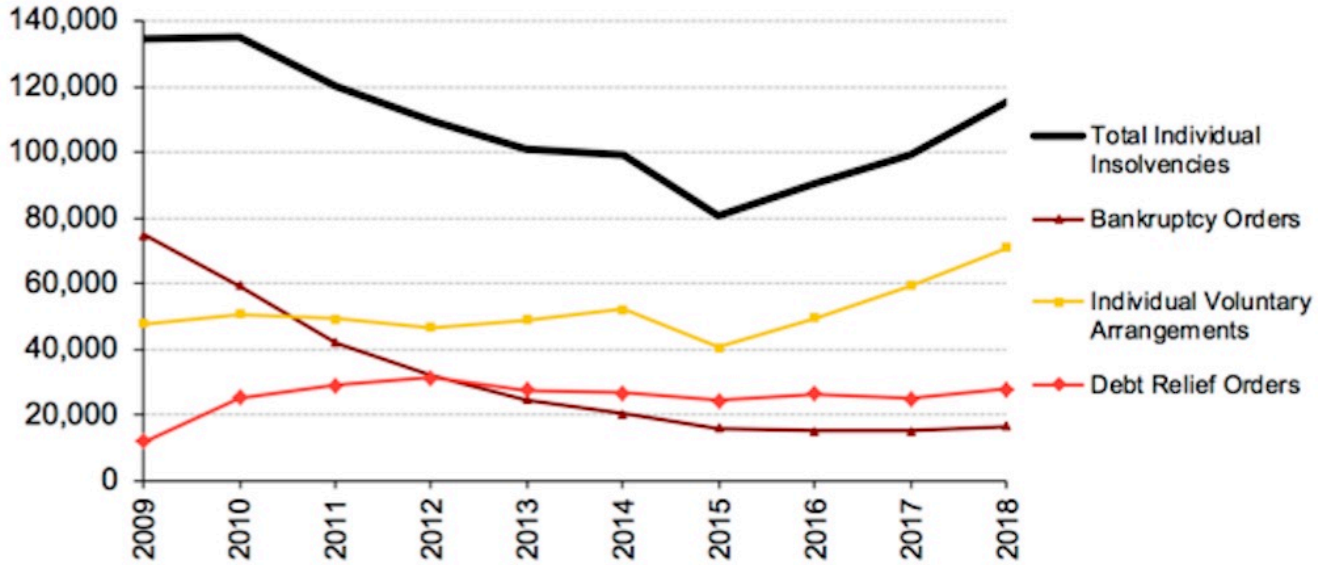
Figure 1. Individual insolvencies, 1990 to 2013, England & Wales



Source: Insolvency Service. Latest release: *Insolvency Statistics, July to September 2014*

[66] Joseph Spooner, *Bankruptcy: The Case for Relief in an Economy of Debt* (Cambridge University Press, 2019) 164.
[67] Ibid 165.

Figure 2: Individual insolvencies in England and Wales[1] (annual data)



Source: Insolvency Service. Latest release: Insolvency Statistics, October to December 2018

4.3.2 An evaluation of German personal bankruptcy law

After reviewing the structure of the German individual bankruptcy system, it seems that the acceptance of discharge in Germany reflects not only good news but also not so good news. The availability and accessibility of legal relief frees debtors from life-long liability, which is good news. However, some characteristics of German debt relief law may limit the social insurance function of the personal bankruptcy law, which is not so good news.

In German personal bankruptcy law, there is no distinction between entrepreneurs and consumers. Therefore, theoretically, both consumers and businessmen can file for insolvency proceedings to address their financial difficulty. Regarding access to insolvency procedures,

there is no minimum or maximum level of debt. Additionally, with the introduction of deferral of court fees, debtors' access to insolvency proceedings has improved significantly, which is reflected in the filing number. The number of bankruptcy filings when the new Code took effect in 1999 was only 1,634, but the estimated number of over-indebted debtors was 2.7 million.[68] Possibly this was because debtors lacked information relating to the new policy. However, it was more likely because of the procedure fee. To open the insolvency proceedings, debtors needed adequate assets to cover the administration fee and this requirement may have excluded many debtors, given that most over-indebted individuals had few assets. According to German Statistisches Bundesamt, 1,496 consumer insolvency cases were rejected for insufficiency of assets.[69] The number of rejected claims was almost equal to those of opened cases.

Since 2001 it has become possible to defer the court fee and debt relief now applies to all natural persons regardless of whether they can pay the court fee or not. Empirical research indicates that the effect of the 2001 statutory reform was obvious. The filing number excluding debtors with business debts increased from 1,634 in 1999 to 9,070 in 2001.[70] There were only 2,552 rejected cases in 2001.[71] In the subsequent years, the filing number rose but the

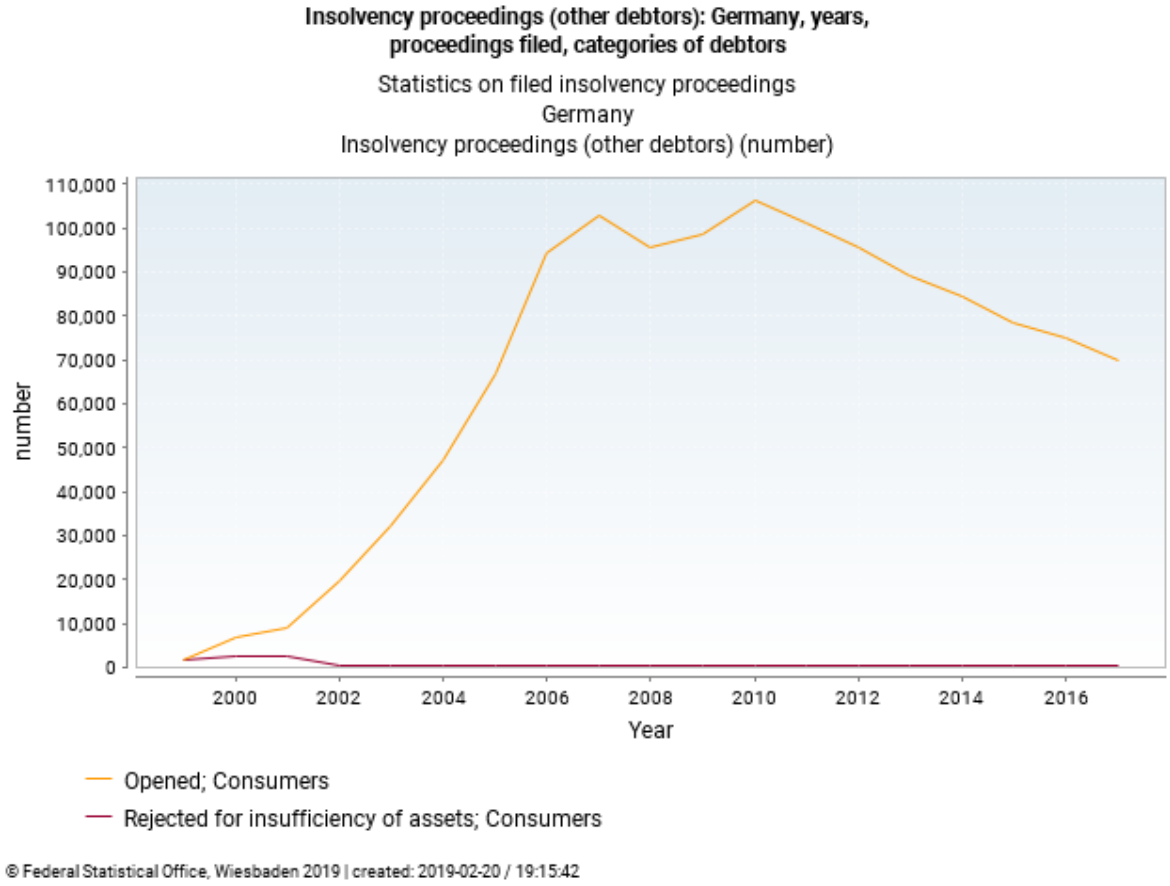
[68]Gotz Lechner, "The German Consumer Bankruptcy Process-(not) a Rational Solution for all Filers for Bankruptcy" [2009] EUI Working Papers 59.

[69] Statistisches Bundesamt,<https://www-genesis.destatis.de/genesis/online/data;sid=DE29B53D659EA6998FB6EAB3C72FE50C.GO_2_1?levelindex=2&levelid=1547914118750&downloadname=52411-0009&operation=ergebnistabelleDiagramm&option=diagramm> accessed by 14 January 2019.

[70]Statistisches Bundesamt,<https://www-genesis.destatis.de/genesis/online/data;sid=EF353B2CEF4B7E5E981342908A080B3B.GO_1_3?operation=abruftabelleBearbeiten&levelindex=1&levelid=1547914545822&auswahloperation=abruftabelleAuspraegungAuswaehlen&auswahlverzeichnis=ordnungsstruktur&auswahlziel=werteabruf&selectionname=52411-0009&auswahltext=&werteabruf=Value+retrieval> accessed by 15 January 2019.

[71] Statistisches Bundesamt, <https://www-genesis.destatis.de/genesis/online/data;sid=C3658C18ED

rejected cases declined dramatically and stayed stable. Also, the deferral of fees enables low-income debtors to file for bankruptcy proceedings. The statistical data has shown greater accessibility to the insolvency proceedings for less affluent individuals. After the introduction of debt relief, the filing number grew dramatically while the average debt sum per case has been declining from € 179,000 in 1999 to € 69,000 in 2005.[72] Hence, in respect of availability and accessibility, German individual bankruptcy law offers good news to debtors.



However, the not so good news is that the German personal bankruptcy system provides over-

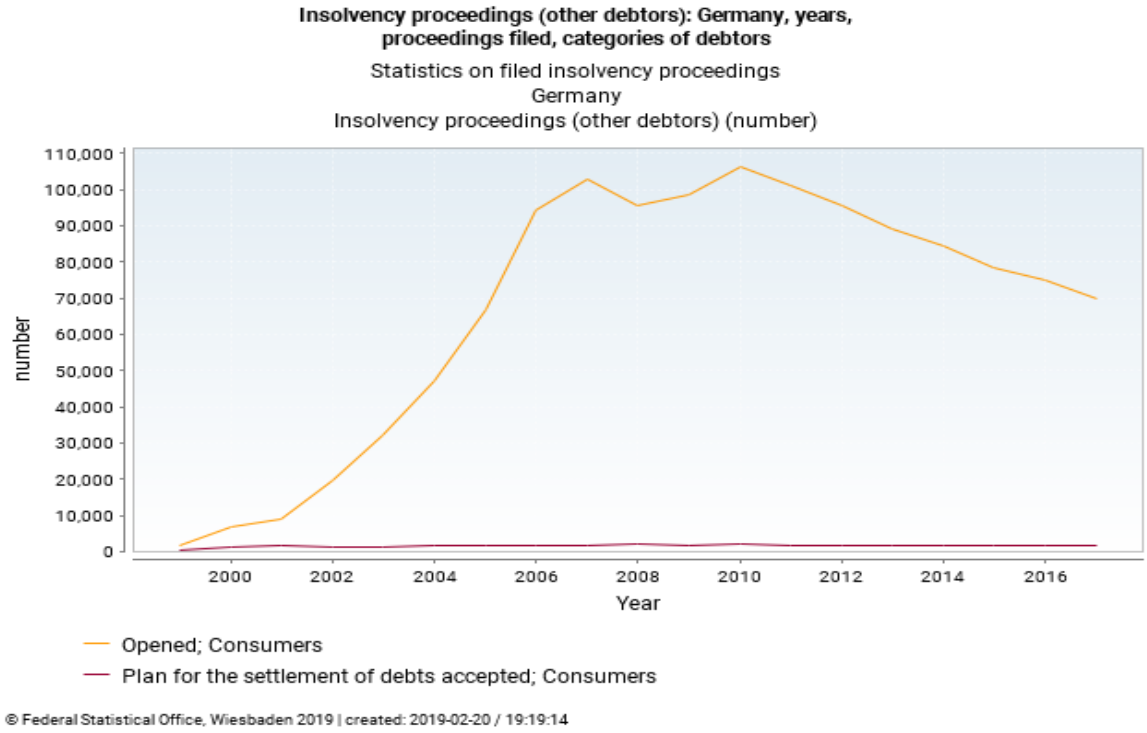
64B72C671BEF07B303AABE.GO_1_3?operation=abruftabelleBearbeiten&levelindex=1&levelid=1547914545822&auswahloperation=abruftabelleAuspraegungAuswaehlen&auswahlverzeichnis=ordnungsstruktur&auswahlziel=werteabruf&selectionname=52411-0009&auswahltext=&werteabruf=Value+retrieval> accessed by 15 January 2019.

[72] Wolfram Backert, Ditmar Brock, Götz Lechner and Katjia Maischatz, 'Bankruptcy in German: Filing Rates and the People Behind the Numbers' in Johanna Niemi-Kiesilainen, Iain Ramsay and William Whitford (eds) *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives* (Hart Publishing 2009) 274.

indebted debtors with a time-consuming road back to a debt-free life. In order to commence insolvency proceedings, a certificate of failure to negotiate with creditors is a prerequisite. Obtaining such certificate requires the assistance of a suitable person or agency. Given that personal bankruptcy cases are generally small, profit-seeking practitioners such as lawyers have less interest in this regime. But the real reason is that most debtors cannot afford attorney fee.[73] In most cases, the state-sponsored debt advice centres will be responsible for individual consultancy. With cases increasing dramatically, although there are more than 1,000 debt advice centres spread throughout Germany, debtors may wait a long time for debt advice. In 2016, the average waiting time for debt counselling was 10 weeks.[74] Furthermore, attempts to reach an agreement with creditors fail to achieve the objective of encouraging the execution of a fair arrangement between creditors and debtors.[75] It is just a waste of time for debtors to negotiate with creditors. Typically, the repayment plan will fail because debtors do not have sufficient assets to offer creditors or one main creditor under the plan. The statistics in the chart below show that only a small number of cases have been settled through a debt payment plan since the enactment of the Insolvency Code. It raises the question of whether a mandatory out-of-court negotiation is necessary. Apart from those prerequisites to entering the insolvency proceeding, debtors still need to comply with a compulsory six-year 'good behaviour' period. Although the early discharge was introduced in 2013, it is not likely that individual debtors will meet the requirements for an early discharge. Hence, a German debtor

[73] A study researching German debtors in 2005-2006 found that 80% of debtors have no repayment capacity. 50% of those who make payments pay less than 100 euros per month. Ibid.
[74] Statistisches Bundesamt,< https://www.destatis.de/EN/PressServices/Press/pr/2017/06/PE17_201_635.html > accessed by 13 January 2019.
[75] Jason Kilborn, *Comparative Consumer Bankruptcy* (Carolina Academic Press 2007) 39.

would normally spend more than six years on obtaining the debt relief.



As mentioned above, the most effective form of relief is a straight discharge which means debtors are discharged from excessive debts without a payment plan. It is evident that the German approach to personal insolvency strays away from the notion of a straight discharge. A six-year mandatory debt payment plan is a prerequisite for discharge. In comparison, in most systems where a debt payment is a pre-condition for discharge, the period usually lasts from three to five years.[76] Additionally, in an IMF report, the authors described some 'basic design features for an economically efficient personal insolvency law' from cross-country experience.[77] One feature suggests that legislation should provide a fresh start for honest but unfortunate debtors at the end of procedures (typically from 3-5 years).[78] Based on findings

[76] Ibid 115.
[77] Y Liu and C Rosenberg, Dealing with Private Debt Distress in the Wake of the European Financial Crisis, A Review of the economic and Legal Toolbox <https://www.imf.org/external/pubs/ft/wp/2013/wp1344.pdf> accessed by 16 February 2019.
[78] Ibid 15.

in World Bank and IMF reports, the six-year debt payment plan in Germany appears to be not only far from the most effective form of bankruptcy social insurance but also economically inefficient.

In practice, the German approach to personal bankruptcy reflects the view that discharge is not a privilege, and it should be earned. An earned fresh start indicates the importance of "good payment morals".[79] This earned discharge is consistent with the idea that an individual bankruptcy law can inculcate healthier and more responsible borrowing. German legislators hope that debtors can raise their morale before obtaining a discharge through a mandatory debt payment plan. However, it is not clear whether debtors' morality improves after the completion of a debt payment plan. The validity of the moral argument rests on a hidden assumption that the debtors' morality is eroded but there is no empirical research indicating this erosion. For individual insolvency cases, the default is more likely due to an unforeseeable change of personal circumstances rather than the unwillingness to repay.[80] If there is no erosion of a debtor's morality, it may be meaningless to demand that the debtor enters into a six-year repayment plan which aims at rehabilitating the eroded morality. Furthermore, even

[79] Udo Reifber, Johanna Niemi-Kiesilaine, Nik Huls and Helga Springeneer, 'Over-indebtedness in European Consumer Law: Principles from 15 European States' (Books on Demand GmbH, Norderstedt, 2010) 259.

[80] 'For nearly one out of five people (19%) who started counselling at one of the 1,400 German debt advice centers in 2015, losing the job had been the main trigger of over-indebtedness. "It is striking that, generally, unforeseeable serious changes of personal circumstances beyond the direct control of the over-indebted are named as the main trigger," said Dieter Sarreither, President of the Federal Statistical Office, at a press conference on the results of the 2015 over-indebtedness statistics in Berlin today. In 15% of the cases, health problems caused financial problems. In another 14%, debt counselling was required as a separation/divorce or the partner's death had financial consequences.' Statistisches Bundesamt,<https://www.destatis.de/EN/PressServices/Press/pr/2016/07/PE16_226_635.html> accessed by 18 January 2019.

though debtors can pass through the good behaviour period, how to measure the enhancement of morality becomes the question. The completion of a mandatory plan may be due to better financial circumstances rather than the enhancement of morality.

4.4 How to understand the stability and change of personal bankruptcy law

After reviewing the extent to which the law embraces the insurance function of insolvency law, we can find that both the English model and the German approach accept the idea of debtor's fresh start. However, the extent to which the law embraces the insurance function of insolvency law differs. Though the law in action may have different outcomes, English personal bankruptcy law provides a speedy debt discharge. On the contrary, although German debt relief law permits debtors to be discharged from excessive debt and there are no legal and practical consequences following from insolvency proceedings,[81] debtors have to endure a long waiting period. Then, we may raise the question concerning how to understand those differences. Several explanations provide insight into understanding differences in approaches to personal bankruptcy. One of the accounts refers to cultural values, which argues that debt laws are products of cultural preferences. One argument is that continental civil law jurisdictions and common law jurisdictions have distinct patterns of bankruptcy regulation. Common law and civil law legal systems reveal fundamentally divergent philosophies

[81] European Commission, Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States Relevant Provisions and Practices, 355 <https://ec.europa.eu/info/sites/info/files/insolvency_study_2016_final_en.pdf> accessed by 19 February 2019.

concerning personal bankruptcy law. Compared with common law jurisdictions which have long provided debt discharge to over-indebted individuals, civil law jurisdictions tend to insist on the sanctity of contract and hence are reluctant to accept debt relief. This philosophical difference explains the relatively lenient individual bankruptcy law under the common law legal system where debtors may obtain an automatic discharge in a shorter time, in contrast to continental jurisdictions where debtors must complete an extended repayment plan for discharge. Although we can gain some insights from this cultural value explanation, it has some flaws. In effect, the sanctity of contract can also be seen in common law legal systems. One example is how the IVA has become the main remedy proceeding in UK, overtaking quicker debt relief procedures such as bankruptcy and DRO.

Compared with the cultural value explanation, narrative analysis and interest group influence may provide more insight into understanding the development and changes in personal bankruptcy law. Taking English and German debt relief laws as examples, the following section will explain how narratives and interest groups shape their personal bankruptcy laws.

4.4.1 Narratives in personal bankruptcy law

Law is traditionally viewed as a parcel of rules and social policies. However, the law also narrates its own stories.[82] When the law attempts to react to real social problems, building and applying the rules may concern the nature of the social world.[83] A legal case tells a story

[82] 'Law, like every other cultural institution, is a place where we tell one another stories about our relationships with ourselves, one another, and authority' Clare Dalton, 'An Essay in the Deconstruction of Contract Doctrine' [1985] 94 Yale Law Journal 997.

[83] Jane B. Baron, 'The Many Promises of Storytelling in Law: An Essay Review of Narrative and the

about how someone did something somewhere at some time and the relevant results arising from his act. To an extent, those legal stories articulate the understandings of social life. In the personal bankruptcy regime, a scholar rendered a typical narrative to understand debtors' financial distress:

'Essentially, the prototypical opinion tells the story of an individual whose debts and poor financial management dictate a bankruptcy filing. Assorted legal twists and turns slow the bankruptcy, and in some cases, the courts even terminate the proceeding. More commonly, the debtor and his or her counsel maneuver through the maze. In the tale's denouement, bankruptcy discharge is achieved. Freed from the shackles of debt, the discharged bankrupt begins anew and has a veritable 'fresh start' on life.'[84]

However, there is more than one narrative in individual financial difficulty. Personal insolvency narratives are composed of conflicting and divergent ideas. Those include the notions of a fresh start, a second chance, social inclusion and the enhancement of entrepreneurialism. Counter narratives refer to the influential idea of *pacta sunt servanda*, the control of moral hazard, the importance of good payment culture and creditor wealth maximisation. Since the 2007-2008 financial crisis, it seems that pro-debtor narratives are more popular. However, there are subtle differences in those pro-debtor narratives with some narratives may focus more on entrepreneurs with excessive debt but some may pay more attention on the plight of

Legal Discourse: A Reader in Storytelling and the Law' [1991] 23 Rutgers Law Journal 79, 86.

[84] David R. Papke, 'Discharge as Denouement: Appreciating the Storytelling of Appellate Opinions' [1990] 40 Journal of Legal Education 145, 147.

over-indebted consumer debtors. Through studying the development of personal bankruptcy proceedings in England and Germany, the following paragraphs will describe how narratives shape the personal bankruptcy law and how various narratives contribute differences in the institutional framework of personal bankruptcy laws.

The narrative of creditor wealth maximisation had an influential impact on early English bankruptcy law. The introduction of bankruptcy law in England was to enhance creditor recovery. Although the discharge policy was available from 1705 in England, it was considered as a reward for debtors' cooperation with the liquidation process and the objective was still to maximise creditors' returns. In the context of Germany, compared with the notion of creditor wealth maximisation, the idea of *pacta sunt servanda* might have had a more influential impact on German pre-1999 bankruptcy law. From the perspective of debtors, they would remain liable for repayment of residual debt after the conclusion of insolvency proceedings in Germany. Meanwhile, the insolvency proceeding was not a very promising remedy for creditors either. Creditors could not touch individual debtor's future income via insolvency proceedings because those procedures coped with existing but not future assets.[85] As a result of this, insolvency proceedings before 1999 in Germany were not a useful tool to maximise creditors' recovery. Instead, it was a manifestation of *pacta sunt servanda.*

However, narratives are not unchangeable. Critical junctures may provide opportunities for

[85] Holger Sutschet, 'An Analysis of the German Legal Framework and the (Limited) Influence of EU Law' in Federico Ferretti(ed) *Comparative Perspectives of Consumer Over-Indebtedness: A View from The UK, Germany, Greece and Italy* (Eleven International Publishing 2016) 209.

reexamining existing narratives and forming new ones. The capital and credit liberalisation trend beginning in the late 20th century, and subsequent individual over-indebtedness can be seen as a critical juncture necessitating the re-examination of existing narratives in personal bankruptcy law. Since 1969, the English government had noticed the huge expansion of consumer credit.[86] In subsequent decades, derived from several factors - deregulation of consumer lending, globalisation, technological improvement, and financial innovation[87] - consumer credit grew significantly. The debt-to-income ratio of households in the UK increased by almost 60 percent from 99 percent in 1995 to 164.9 percent in 2009.[88] The expansion of consumer credit is closely associated with a rise in consumer over-indebtedness. The level of over-indebtedness in the UK is moderate but increasing.[89] This increasing household overindebtedness and related consequences prompted political concerns in the UK[90]. Furthermore, according to a report carried out by the Insolvency Service, 30% of individual debtors are NINA (No-income, No-asset) debtors, who have limited capacity to make repayment.[91]

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[86] Great Britain, Report of the Committee on the Enforcement of Judgement Debts (Cmnd 3909) (London, HM Stationery Office, 1969) 69; In 1982, the Cork report observed that 'the increased opportunities for contracting debt have led to the emergence of the consumer debtor, a commonplace today, but virtually unknown in the Nineteenth Century' Insolvency Law and Practice: Report of the Review Committee, cmd 8558 (HMSO 1982) ('Cork report') 11.

[87] Adrian Walters, 'Individual Voluntary Arrangements: A '"Fresh Start" for Salaried Consumer Debtors in England and Wales' [2009] 18 International Insolvency Review: Journal of the International Association of Insolvency Practitioners 1, 3.

[88] European Commission, Research Note 4/2010 Over-Indebtedness: New Evidence from the EU-SILC Special Module, 7.

[89] European Commission, The Over-indebtedness of European Households: Updated Mapping of the Situation, Nature and Causes, Effects and Initiatives for Alleviating Its Impact, < https://ec.europa.eu/info/sites/info/files/final-report-on-over-indebtedness-of-european-households-synthesis-of-findings_december2013_en.pdf> accessed by 20 February 2019.

[90] Department for Work and Pensions (DWP), Tackling Over-Indebtedness: Action Plan 2004 <https://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/files/file18559.pdf> accessed by 18 February 2019.

[91] Insolvency Service, NINA Consultation, para 23-26.

Given the expansion of credit and the changing nature of debtors, previous creditor wealth maximization narratives might be unsuited to a consumer-led debt crisis. As a result, the idea of fresh start gradually became one of the ends in insolvency law.[92] In the early 2000s, the UK government was concerned about the economic downturn. [93] The promotion of entrepreneurism was seen as an effective way to develop the economy. In order to boost entrepreneurism, the UK government expected to reduce the stigma of bankruptcy and help entrepreneurs to rehabilitate from failure. As a result of this, promoting entrepreneurism also becomes a strong narrative in insolvency law reforms in England in the early 2000s.

Similarly, German personal bankruptcy narratives also experienced some changes in the last several decades. A series of historical events triggered the rethinking of *pacta sunt servanda* in the debtor-creditor relationship and contributed to the formation of the idea of a fresh start in Germany. The formation of these new narratives can be divided into two phases. The first phase started in the late 20th century. Influenced by the philosophy of free-market competition, Germany loosened consumer credit markets in the late 1970s and early 1980s.[94] Due to the widespread availability of consumer credit, a massive number of consumers were eager to

[92] The Cork report has identified that a modern insolvency law should take debtor's fresh start into consideration. Report of the Review Committee, cmd 8558 (HMSO 1982) ('Cork report').

[93] During the debate on the Queen's speech, David Heathcoat-Amory said: Competitiveness and productivity are down; we are running a record trade deficit; the savings ratio has collapsed; and our enormous public expenditure commitments go far beyond any anticipated growth in the economy. That is why we shall look critically at the enterprise Bill. We shall be constructive on bits of it that we approve of, but shall look critically at it to find out whether it will strengthen the sinews of the economy to see us through any economic downturn. HC Deb 19 June 2001 col 479.

[94] Jason Kilborn, 'Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice' in Johanna Niemi-Kiesilainen , Iain Ramsay and William Whitford (eds) *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives* (Hart Publishing 2009) 308.

purchase goods through credit. As a result, household debt increased to an unprecedented degree. For instance, the median income in Germany rose only 12 times from 1950 to 1984, but the per capita indebtedness grew to more than 800 times.[95] Moreover, total consumer debt even doubled from 1984 to 1994.[96] Additionally, unemployment began to rise dramatically in the same period. The unemployment rate in West Germany rose sharply from 3.8% in 1980 to 9.3% in 1985 and decreased to around 7% in 1990.[97] After the reunification with East Germany, the unemployment rate increased by 1% per year from 1992 to 1994, reaching nearly 13% in 1997.[98] Finally, an unstable job market and rising consumer credit together resulted in a large number of heavily indebted individuals in Germany.[99] One German researcher estimated that 1.2 million households suffered from over-indebtedness in 1989.[100] In 1989 a research group established by the Ministry of Justice and the Ministry for Youth, Family, Women and Health published a report about the explosion of consumer debt and its calamitous aftereffects. It appealed for debtors to be provided with a second chance through debt relief. Thus, providing honest debtors with relief became one objective of German bankruptcy law. However, from the policymakers' perspective, they intended that German bankruptcy could achieve more objectives than just releasing debtors from excessive

[95] Ibid.
[96] Ibid 309.
[97] Jason Kilborn, 'Comparative Cause and Effect: Consumer Insolvency and the Eroding Social Safety Net' [2008] 14 Columbia Journal of European Law 563.
[98] Ibid 589.
[99] As Jason pointed out that "Borrowing when job prospects are good and employment is stable is risky. Borrowing when job prospect is not so good and employment is uncertain is a recipe for disaster" Kilborn(n.75) 7. In a comparative study, Jason stated that there was only a weak correlation between the fall of social net safety and the rise of debt relief law. He concluded that unemployment and open credit resulted in the development of personal bankruptcy legislation. Kilborn (n.97).
[100] Kilborn (n.94) 309.

debts.[101] Therefore, in addition to the notion of a second chance, raising debtor responsibility became another goal of German insolvency law.[102]

The financial crisis of 2007-2008 initiated the second phase, in which the German personal bankruptcy narrative was reexamined once more. The 2008 crisis shed light on the importance of the household debt issue. A leading book, *House of Debt*, has elaborated that the levels of expansion of credit will influence the severity of a financial crisis.[103] Providing debtors with a swift discharge improves the prospects of a recovery from a financial crisis. The resilience in the US economy was considered to be the result of a generous bankruptcy system which could enhance debtors' ability to deleverage quickly. Against this background, EU policymakers showed their interest in the personal bankruptcy system. In December 2012, the European Commission appealed for the adoption of "a new European approach to business failure and insolvency" in a communication.[104] It also claimed that 'modern insolvency law in the Member States should help sound companies to survive and encourage entrepreneurs to get a second chance'.[105] In particular, the Commission stressed the need to provide a timely discharge and a minimum of post-discharge restrictions to individual debtors.[106] The

[101] Jason Kilborn, 'The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States' [2003] 24 Northwestern Journal of International Law & Business 257.

[102] Bundestags-Drucksache 12/2443 p.3 cited in Holger Sutschet, 'An Analysis of the German Legal Framework and the (Limited) Influence of EU Law' in Federico Ferretti(ed) *Comparative Perspectives of Consumer Over-Indebtedness: A View from The UK, Germany, Greece and Italy* (Eleven International Publishing 2016) 271.

[103] Atif Mian and Amir Sufi, *House of Debt: How They (and You) Caused the Great Recession and How We Can Prevent it from Happening Again* (Chicago, University of Chicago Press, 2014).

[104] Communication from the commission to the European Parliament, the Council and the European Economic and Social Committee, at 2, Com (2012) 742 final (Dec. 12 2012).

[105] Ibid 3.

[106] Ibid 4-5.

Commission also advised that 'it is crucial that entrepreneurship does not end up as a 'life sentence' if things go wrong.'[107] It proposed that "a three-year discharge and debt settlement period should be a reasonable upper limit for an honest entrepreneur and as automatic as possible".[108] The 2012 Communication was repackaged as a Recommendation in 2014.[109] The Recommendation reiterated the need to provide a timely discharge, and that debt relief should be applicable to all natural persons (including entrepreneurs and consumers). Although the Recommendation was without legal force,[110] to an extent, it reflected policymakers' point of view relating to the personal bankruptcy system. In 2019, the EU implemented a Directive on restructuring and insolvency, which aims for providing a full discharge for honest entrepreneurs.[111] The Directive reiterates the timely discharge for entrepreneurs. The idea of promoting entrepreneurism is also reflected in German insolvency reform. For example, the Minister of Justice, Sabine Leutheusser-Schnarrenberger, argued that "the reform of insolvency law is the most important project in business law". Furthermore, she expressed that an early discharge can support "business founders, but also over-indebted consumers to bounce back after a fresh start".[112]

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[107] Ibid 6.

[108] Ibid.

[109] Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, Com (2014) 1500 final (Mar.12 2014).

[110] In 2016, themes of the 2014 Recommendation were introduced into a 2016 proposal for a directive of the European Parliament and of the Council. European Commission, Proposal fo r a Directive of the European Parliament and of the Council on Preventive Restructuring Fra meworks, Second Chances and Measures to Increase the Efficiency of Restructuring, Insolvenc y and Discharge Procedures and Amending Directive 2012/30/EU <http://ec.europa.eu/informati on_society/newsroom/image/document/2016-48/proposal_40046.pdf > accessed by 18 February 2019.

[111] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJ L 172/18.

[112] Frank M. Fossen, "Personal Bankruptcy Law, Wealth, and Entrepreneurship- Evidence from the

The paragraphs above have outlined how personal insolvency narratives are changing in England and Germany. Those changing ideas prompt the institutional development of personal bankruptcy law. For example, the acceptance of the concept of fresh start leads German policymakers to provide debt relief for natural persons. Further, to promote entrepreneurism, early discharge is available for individuals in Germany now. In the context of English personal bankruptcy law, the reduction of the automatic discharge period from three years to one year has arisen from the idea of promoting entrepreneurism. To a degree, institutional development reflects changing narratives.

Personal insolvency narratives may not only help us to understand the institutional development in a jurisdiction, it may also make us have a deeper understanding of differences existing in different personal insolvency laws. As we have mentioned above, personal insolvency law itself has some conflicting and contrasting narratives. Policymakers may have a different opinion about how to strike a balance between those values. There is no consensus on the optimal balance although policymakers may announce that their designs may achieve a balance.

Given that policymakers may have various understandings about an optimal balance, there will be differences in personal bankruptcy laws among jurisdictions. For example, as a core narrative of personal bankruptcy law, the fresh start policy is accepted both in England and

Introduction of a 'Fresh Start' Policy" [2014] 16 American Law and Economics Review 269,274.

Germany. However, the idea of fresh start itself is ambiguous. Currently, there are no clear explanations regarding the scope of a fresh start, how much of an individual's future income should be dedicated to paying debt, what assets should be exempt from a creditor's touch and which debt should be excluded. Furthermore, subtle differences in those pro-debtor narratives make the meaning of the fresh start more complex. Due to the dominance of entrepreneurship narrative, policymakers may consider that bankruptcy law's social insurance function should only protect entrepreneurs. In this context, policymakers may overlook consumer debtors who also need the bankruptcy protection. Finally, various interpretations of the idea of a fresh start may lead to significant differences in approach to personal bankruptcy.

4.4.2 Interest groups and personal bankruptcy systems

(1) Interest groups and the development of English personal bankruptcy law

In addition to personal bankruptcy narratives, an interest group analysis may provide an essential insight into understanding the stability and changes in personal bankruptcy law. Interest groups are those repeat players who can shape a specific policy through the market or politics. In the context of personal bankruptcy law, creditors, debtors, government, insolvency professionals and even political parties may be seen as repeat players. Those interest groups have an incentive to maximise their utility.[113] However, in the competition between various interest groups, not all groups can succeed in influencing policy. Compared

[113] Eric A Poser, "The Political Economy of the Bankruptcy Reform Act of 1978" [1997] 96 Michigan Law Review 47, 59-60.

with diffuse and fragmented groups, parties with united, harmonious and intense interests are most likely to influence policies.[114]

Regarding personal insolvency law, consumers may have less power in the competition between interest groups. One possible reason is that consumers may have divergent interests between probable borrowers and individuals who have already become over-indebted. Over-indebted debtors prefer a more forgiving debt relief law. In contrast, financially healthy debtors may oppose the more lenient law, which may lead to more expensive credit.[115] Comparatively, professional creditors such as banks are more likely to shape the policy because they constitute a more cohesive party. The power of other groups such as insolvency professionals, government and political parties varies among jurisdictions because of institutional differences, including the role of parliament, government administration, courts, and professional associations. To understand the influence of interest groups in personal bankruptcy laws, the following section will draw examples from England and Germany. Those examples may help countries which have an interest in the introduction of personal bankruptcy law to understand the role of interest groups in shaping the law.

The development of the IVA and DRO in England may provide two vivid examples to understand how interest groups influence policy reforms. In the early 2000s, the labour

[114] Atif Mian, Amir Sufi and Francesco Trebbi, 'Resolving Debt Overhang: Political Constraints in the Aftermath of Financial Crises' [2014] 6 American Economic Journal: Macroeconomics 1, 21.
[115] Joseph Spooner, 'Long Overdue: What the Belated Reform of Irish Personal Insolvency Law Tells us about Comparative Consumer Bankruptcy' [2012] 86 American Bankruptcy Law Journal. 243, 281-282.

government regarded the IVA as a failure because of high costs and low returns.[116] Hence, the Insolvency Service established a working group to make proposals to reform the IVA procedure. The working group was mainly formed by insolvency practitioners and creditors. Attendees reviewed the IVA mechanism and reached a consensus as to how to make IVA more accessible to consumer debtors. The Insolvency Service considered the IVA as the best instrument to tackle consumer over-indebtedness, offering benefits for debtors and creditors.[117] From the debtors' perspective, an IVA provides them with a stay on enforcement and debt relief within a finite timescale. On the other hand, compared with a quicker discharge in bankruptcy or DRO, creditors may receive more returns from debtors' future income. Furthermore, a more accessible IVA procedure can also meet the needs of courts. Since the late 20th century, the applications for bankruptcy were rising. Personal bankruptcies were petty debt cases and the Ministry of Justice, which oversees court resources, has an interest in steering those cases out of court.[118] Given that courts only play a supervisory role in an IVA, IPs are responsible for advising debtors. Therefore, courts can benefit from more approachable IVA because they can concentrate on more complex and high-value cases. Hence, a "consumerised" IVA proceeding was suggested.[119] Interest groups, including courts, the Insolvency Service, and creditors favour IVAs as the ideal tool for resolving individual overindebtedness.

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[116] Parliamentary Research Paper 02/21 Bill 115 2001-02 Enterprise Bill, 98.

[117] Insolvency Service, Improving Individual Arrangements (London, Insolvency Service, 2005) para 21.

[118] The Department of Constitutional Affairs (precursor of the Ministry of Justice) stated that the administration of long-term debt was not a 'proper role for the court… as it is not a part of the court's core functions of dispute resolution and enforcement regulation', quoted in Ramsay (n.9) 73.

[119] The simplified IVA procedure is used in low-value cases (under £75,000), reduces the majority for the approval to 50 percent and rules out creditors' modifications. See more details about the reforms related to IVA Donna Mckenzie Skene and Adrian Walters 'Consumer Bankruptcy Law Reform in Great Britain' [2006] 80 American Bankruptcy Law Journal 477.

However, before the SIVA (Simplified IVA) entered into force, the Insolvency Service decided to withdraw its proposals to introduce a reformed IVA. The withdrawal of the simplified IVA may have been the result of a bankers' campaign. The IVA market was transformed in the late 20th century and although an IVA might not fit consumer debtors, a streamlined business model, cutting costs and advertising extensively, has been developed. To attract consumers and make profit, licensed insolvency practitioners promise a significant write-off of debts. As a consequence, there was a soaring rise in IVA by the early 2000s.[120] However, with the growth of IVAs, creditors, in effect, do not obtain more returns. One possible explanation is that insolvency practitioners steer debtors into a procedure that is not the best choice for them. As a consequence, the banking industry seeks to reassert direct control over their over-indebted consumers for more returns. At a practical level, hurdle rates are imposed on the approval of an IVA. Institutional creditors do not approve an IVA that does not meet their required rate of return. This practice might contribute to the decline of IVA in 2007 by nearly 5 per cent.[121]

On the other hand, insolvency practitioners criticised the imposition of the recovery rate which aimed to dissimulate the bad loans. Furthermore, it would lead to debtors falling into debt collection or informal resolution options such as consolidation loans or debt

[120] 'Year on year, bankruptcies grew steadily while IVA growth skyrocketed culminating in more than doubling of IVA numbers in 2006 compared to 2005. Furthermore, a cursory glance shows that by 2006 IVAs had come to account for over 40 per cent of individual insolvencies under IA 1986' Adrian Walters, 'Individual Voluntary Arrangements: A "Fresh Start" for Salaried Consumer Debtors in England and Wales' [2009] 18 Journal of the International Association of Insolvency Practitioners, 1,12.

[121] Ibid.

management plans without IP intermediaries.[122] To deal with conflicts between the banking industry and insolvency practitioners, the Insolvency Service attempted to bring those two parties together. The result of the discussion was the creation of a standard form protocol designed by intermediaries and banks. In addition, the application of the protocol will be managed by an IVA standing committee whereby practitioners and lenders have a significant influence. Further, the Insolvency Service did not keep carrying out the regulation on SIVA. It argued that 'this [withdrawal] decision reflected both our developing experience of the operation of the protocol as well as concerns about (a) whether the desired policy outcome could be achieved by non-legislative means, (b) whether it removed burdens and (c) whether it was clear that it would not add new burdens.'[123]

The description of the development of IVA procedure reflects how interest groups express their opinions on the proceeding and how the institutional design of an IVA reflects their preferences. In addition to the IVA procedure, we can also find the influence of interest groups in the development of DRO. Despite the significant prepaid fee to access bankruptcy, personal bankruptcies increased dramatically during the 1990s and raised a question of debt relief for individuals with limited means. When the New Labour government reduced the automatic discharge from three years to one year, Citizens Advice[124] unsuccessfully proposed to remove the bankruptcy fee for poor debtors.[125] Furthermore, in a case where the bankruptcy fee was

[122] Dan Atkinson, 'Lenders in IVA "Rogue" Loan Abuse:' Mail on Sunday (3 June 2007) 5.
[123] Business and Enterprise Committee-Sixth Report, The Insolvency Service Session 2008-09 HC 198 (London, The Stationery Office, 2009).
[124] This is a publicly funded organisation which has now become a primary source of legal advice to individuals on limited means.
[125] Citizens Advice, Insolvency: A Second Chance: A Response by the CAB Service to the Insolvency

challenged, the court concluded that such mandatory requirement did not contravene the human right of access to the courts.[126] Notwithstanding, the Ministry of Justice proposed the introduction of a new process for individuals with limited means.[127] However, the Ministry did not have an interest in introducing such a process into the court system[128] and as a result, the Ministry handed over the responsibility for the development of a NINA procedure to the Insolvency Service. Subsequently, a working group was established by the Insolvency Service to make proposals to solve NINA issues, and a NINA Consultation document was submitted in 2005. From the aspect of the Insolvency Service, there was also a cost concern because it often acts as trustee in bankruptcies which are not profitable for the private sector. Much of its work is bankrolled by fee income on a user-pay basis. The Insolvency Service also has an interest in reducing costs associated with a NINA procedure. Hence, if the Insolvency Service was required to determine and check eligibility for such a proceeding, the cost may not be reduced. To cut down the cost for NINA procedure, the Insolvency Service proposed the assistance of debt advice agencies which play a role in processing applications. The dominance of the approved intermediary in the new process has received broad support from creditors, intermediaries and the debt advice agencies although it may give rise to the independence concern.[129] Finally, a non-judicial and self-funded procedure, Debt Relief Order (DRO), was introduced to address the gap of provisions for NINA debtors. In this respect, interest groups

Services White Paper 13/11/2001.

[126] R v. Lord Chancellor *ex parte* Lightfoot [2000] QB 597.

[127] Department of Constitutional Affairs, 'A Choice of Paths: Better Options to Manage Over-indebtedness CP23/04' para 32.

[128] Ibid para 34.

[129] Insolvency Service, 'Relief for the Indebted – an alternative to bankruptcy. Summary of Responses and Government Reply' (November 2005) 16-17.

have shaped the institutional framework of DRO in accordance with their needs.

(2) Interest groups and the development of German debt relief law

In a similar way, to understand the influence of interest groups, we can also draw some examples from the development of German debt relief law. Although policymakers became aware of individual over-indebtedness issues during 1980s, they were reluctant to become involved in the relationship between debtors and creditors. The Commission insisted that there was no way for a debtor to escape his financial obligations unless creditors agreed.[130] Legislators proposed that some restrictions should be imposed on judgment enforcement for the purpose of protecting debtors, but they contended that those protection procedures had some connection with insolvency reforms.[131] However, the Commission's view was weakened by a new elected Minister of Justice who gave backing to the introduction of the discharge following bankruptcy.[132]

However, the acceptance of discharge is not an easy task. Minority stakeholders held the view that the new provision of debt relief may infringe a creditor's constitutional right to property[133]. They argued that the debt relief policy deprived creditors of property without

[130] Jason Kilborn, "The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States" [2003] 24 Northwestern Journal of International Law & Business 257, 269.
[131] Ibid.
[132] Ibid 270.
[133] The Article 14 [Property- Inheritance-Expropriation] is as follow: '(1) Property and the right of inheritance shall be guaranteed. Their content and limits shall be defined by the laws. (2) Property entails obligations. Its use shall also serve the public good; (3) Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute concerning the

lawful justification. However, the majority of scholars and practitioners opposed that argument.[134] They acknowledged that property would be taken away from creditors through the debt relief policy, but the value of those properties was almost non-existent in most cases because most debtors could not pay.[135] Pro-debtor scholars and practitioners claimed that the legitimate interests of over-indebted debtors outweigh a creditor's interest. Supporters hold the view that debt relief encourages a debtor to comply with proceedings and to file for insolvency at an early stage. Those estimated advantages will increase creditors' probability of recovering some losses. In addition to the challenge of constitutionality, some lawyers argued that creditors recover too little from debtors in insolvency proceedings, which is against the debt collection function of insolvency.[136] As a result of the debate, a straight discharge for debtors was rejected. Instead, a partial relief through a mandatory debt repayment plan was introduced into the German legal system.

When policymakers favoured providing a partial relief for debtors, the length of a debt payment plan became a heated topic between interest groups. In the 1990s, the Kohl Administration recommended the payment plan should be seven years. However, there was no explicit explanation for the suggestion. The Bundesrat Law Committee argued that such a period was too long and it was more likely to penalize criminals.[137] Hence, the Committee

amount of compensation, recourse may be had to the ordinary courts' Deutscher Bundestag, 'Basic Law for the Federal Republic of Germany' <https://www.btg-bestellservice.de/pdf/80201000.pdf> accessed by 12 January 2019.

[134] Holger Sutschet, 'An Analysis of the German Legal Framework and the (Limited) Influence of EU Law' in Federico Ferretti(ed) *Comparative Perspectives of Consumer Over-Indebtedness: A View from The UK, Germany, Greece and Italy* (Eleven International Publishing 2016).

[135] Ibid 210.

[136] Ibid 211.

[137] Kilborn (n.130) 283.

proposed reducing the period to four years. Furthermore, the Social Democrats stated that the debt payment plan would very likely fail if it were more than four or five years.[138] Despite this, a majority of the full Bundesrat disregarded this advice and the new Insolvency Code stipulated the good-behaviour period as seven years.

The length of a payment plan was discussed once again in the early 2000s. From the perspective of the administration, it was reluctant to reduce the period radically on the grounds that the effects of this reduction on creditors and the credit market were uncertain.[139] Debtor representatives proposed reducing the period from seven to five years by comparing it with the payment period in other European nations.[140] Additionally, the Democratic Socialists participated in this debate, and they also supported the reduction of the period to five years. They stated that the time to discharge might be extended to nine or eleven years in some cases, from out-of-court negotiation to the completion of an insolvency case. As a result, a radical reduction did not emerge and instead a middle path reduced the payment plan to six years.

Since 2001, the discussions on reforming German debt relief law have continued. After the 2001 reform of personal bankruptcy law, the number of insolvency cases proliferated. Yet, stakeholders including the Länder, creditors, debtor representatives, judges, trustees, court

[138] "The practice of the debt counselling centres shows that debt arrangement plans with terms of longer than four or five years are predestined to failure" quoted at Ibid.
[139] Ibid 284.
[140] Ibid.

officials and academics criticised the additional costs and burdens generated by the complex structure of German debt relief.[141] Then, in 2002, judges and court officials demanded an easier way to discharge or an alternative form of relief outside the bankruptcy system.[142] As a result, a draft bill with two proposals was submitted: one wished to release courts by enhancing the out-of-court settlement attempts and the other one aimed to ease the financial burdens of Länder by reducing the costs of insolvency procedures.[143] However, the Länder led by the state of Bavaria campaigned for more radical reforms. A paper published by the Bavarian Ministry of Justice argued that German debt relief lacked suitable treatment for NINA debtors.[144] As a result, those NINA cases only imposed costs and burdens upon the system. The paper proposed a two-track procedure: the consumer bankruptcy and discharge were confined to 'can-pay' debtors and the vast majority of NINA debtors were directed to a 'Verjährungsmodell' (limitation period model) at which the individual debt enforcement was allowed.[145] Though the Bavarian proposal received some support from the Federal Ministry of Justice, it was heavily criticised by other interest groups.[146] Accordingly, an alternative to the 'limitation period model' was progressed by different interest groups including representatives of creditors, lawyers, debt counsellors, judges and academics. As a result of their joint efforts, an "Alternativentwurf" (Alternative Draft Bill) was submitted. This proposal suggested that the overall consumer insolvency proceedings should be kept, but the NINA

[141] See the summary of criticism in Jan-Ocko Heuer, 'Hurdles to Debt Relief for 'No Income No Assets' Debtors in Germany: A Case Study of Failed Consumer Bankruptcies Law Reform' [2020] 29 International Insolvency Review 1, 10-11.
[142] Ibid.
[143] Ibid 11.
[144] Ibid 12.
[145] Ibid.
[146] A summary of criticism is in Ibid 13.

debtors were directly transferred to the good-behaviour period.[147] In the meantime, due to the ongoing criticism of the limitation period model, the Ministry of Justice stepped back. Instead, it recommended proposals similar to the Alternative Draft to deal with NINA cases. However, instead of a separate relief procedure for NINA debtors, those proposals suggested a 'simplified debt relief procedure'. [148] Though creditors favoured the reform plan proposed by the Ministry of Justice, lawyers and debt counsellors criticised the proposal. Opponents worried that the requirement for NINA debtors to pay for insolvency proceedings may lead to the increasing rate of poverty and some constitutional concerns.[149] Ultimately, the reform plans proposed between 2006 and 2009 got stuck in the policymakers' agenda and were not enacted. In 2009, the reforms on insolvency proceedings were proposed again for enhancing entrepreneurship. The legislative process was tightened up at this time: the Ministry of Justice announced its reform plans in January 2010 and a draft bill was proposed in January 2012.[150] In the new reforms, there were no debates on the insolvency proceedings for NINA debtors. One point of agreement seemed to be that this second reform should remain the core feature of German debt relief law.[151] Therefore, the legislative process went smoothly and came into force in 2014.

Overall, experiences from England and Germany indicate that the development of a policy is

[147] Ibid 14.
[148] Ibid 15
[149] Ibid 15.
[150] Ibid 16.
[151] Ibid.

not an easy process. The process involves competition between interest groups. In the context of personal bankruptcy law, all groups such as debtors, creditors, government, court and even political parties have an interest in shaping the policy. However, not all of them have an equal ability to meet their ends. Although the law is designed for dealing with debtors' issues, debtors have little influence on policy development. The regulation of personal bankruptcy law in UK and Germany underlines the essential role of influential interest groups such as creditors, government, courts and political parties. To an extent, personal bankruptcy laws in UK and Germany represent policy equilibrium between influential interest groups. Given institutional differences including the role of parliament, government administration, courts and professional associations, it is very likely that policy equilibrium varies among jurisdictions. Hence, for a country that has an interest in introducing a personal bankruptcy law, looking for its own policy equilibrium between interest groups is more beneficial than simply transplanting the law from other jurisdictions. After all, there is little knowledge about whether policy equilibrium in other jurisdictions is optimal or not.

4.5 Conclusion

This chapter has firstly outlined the institutional designs of personal bankruptcy law in the UK and Germany. There is a possibility of debt relief in the UK and Germany. However, the regulations of personal bankruptcy law are quite different between these two countries. Furthermore, there is a gap between law in books and law in practice. As a result, those institutional and practical differences influence the extent to which the law embraces its social insurance function. To understand those differences in personal insolvency law, this chapter

has drawn attention to the role of narratives in personal bankruptcies and interest group analyses. It concludes that the development of contemporary personal insolvency law is influenced by narratives of personal bankruptcies and interest groups. Narratives embody the objectives of a policy, the character of the problem and the approach to achieve those objectives. An analysis of interest groups reflects the policy content can be seen as a competition between various groups. The result of this competition represents a policy compromise or equilibrium between interest groups. Hence, when a country is interested in evolving a personal insolvency policy, simply transplanting models from other jurisdictions is not appropriate. Instead, a country should take interest groups and domestic narratives into consideration.

CHAPTER 5 HOUSEHOLD CREDIT AND OVERINDEBTEDNESS IN CHINA

5.1 Introduction

Previous chapters have outlined theories and various institutional designs of personal bankruptcy systems. They provide insight into understanding the functions and framework of personal bankruptcy law. However, before enacting legislation, the first question which Chinese legislators have to answer is whether debt relief law is necessary for the Chinese context. The objective of this chapter is to find an appropriate answer to this fundamental question.

Learning from the experiences of other jurisdictions, personal bankruptcy law functions as a solution to individual over-indebtedness. The previous two chapters have shown that the reforms of personal bankruptcy law in the US, UK, and Germany occurred at the time when household credit was booming and individual over-indebtedness became severe. The introduction of a debt relief law for individuals in China can be justified because household over-indebtedness may become an intractable issue in near future. This chapter aims to demonstrate the severity of overindebtedness in China.

China's credit market has experienced significant development over the past decade. Following the technological transformation of China and ambitious industrial policies, the volume of credit has grown rapidly. Since there is a strong link between overindebtedness and

the expansion of consumer credit, the increase in household credit may inevitably lead to the over-indebtedness issue, at least for a small number of people.

It is hard to provide the actual image of the over-indebtedness issue in contemporary China due to limited empirical research focusing on individual over-indebtedness. Nonetheless, this chapter aims to provide a snapshot of individual over-indebtedness in the Chinese context and will evaluate the probability of over-indebtedness based on the debt-to-income ratio. It concludes that over-indebtedness is not far from Chinese households. Factors, including the expansion of credit, rising costs of credit, income fluctuation and the rising cost of living, contribute to the occurrence of individual over-indebtedness. Given this, Chinese policymakers should contemplate the solution to potential individual over-indebtedness.

The remainder of this chapter is structured as follows. Section 2 provides information about the development of the Chinese consumer credit market and the expansion of household debt. Sections 3 and 4 estimate the over-indebtedness issue in China, and section 5 concludes.

5.2 The rising household debt in China

The growth of consumer credit in China can be traced back to the beginning of the reforms to open up the economy. The progressive economic reforms and the establishment of markets have dramatically changed people's life in China. One of the significant changes occurred in terms of the attitudes towards consumption. In the context of a planned economy, everything including life necessities was distributed by the government. Due to governmental control on

supply, consuming activities were strictly restricted. China's economic reforms beginning in the late 1970s have granted consumers more autonomy. The market increasingly determines the relationship between demand and supply rather than the government. As a result of this, household consumption expanded over 12.5 times in the period 1978-95.[1] People in China could purchase goods ranging from watches to cars and since then, China has continued to grow into a consumer society.[2] The establishment of a consumer society might be a necessary condition for the growth of consumer credit. After all, the use of consumer credit relies on a precondition that goods can be freely purchased through markets and the gradual establishment of a consumer society made possible the advent of consumer credit.

However, in the period between of the 1990s and 2000s, the development of the Chinese credit market was in its infant stage. In 1987, China Construction Bank initiated the operation of residential purchase mortgage loans, marking the availability of consumer credit in China.[3] During the 1990s, China's credit markets were reluctant to lend to households. The usage of household credit was limited to traditional fields such as education, housing, and cars. The advent of the 1997 Asian Financial Crisis stimulated the development of Chinese consumer credit market and in order to mitigate the severe consequences resulting from the curtailment of exports, Chinese policymakers carried out a series of policies to encourage household consumption. Documents , including 'Management measures on personal housing loans'

[1] Zhang Xian-chu, 'Development of Consumer Credit in China and Concerns about the Underlying Legal Infrastructure' [2003] in Johanna Niemi-Kiesilainen ,Iain Ramsay and William Whitford (eds.) *Consumer Bankruptcy in Global Perspective* (Hart Publishing,2003)105.

[2] Xu Zhongwei (ed.), Dangdai Zhongguo Ruogan JIngji Wenti [Certain Issues of Contemporary Chinese Economy] (Huawen Publishing House, 1998) 248-60.

[3] Zhong Chunan, Personal Credit System (China Financial Publishing House, 2002).

(1998), 'Management measures on auto loans' (1998) and 'Opinions on consumer credit development' (1999), were published to facilitate the development of the consumer credit market.[4] Subsequently, in 1999, the People's Bank of China published its 'Guidance on the Development of Consumer Credit' and required commercial banks to start a comprehensive consumer credit business for urban individuals. However, it seemed that the consumer credit market developed slowly despite the government's supportive measures. One observation suggested that the difference between resident deposits and loans granted by banks became very large.[5] Furthermore, some studies in the early 2000s found that only 19.6 percent of urban residents had any experience of using consumer credit.[6] More than half of urban people indicated that they would not purchase goods via credit.[7] Additionally, given that official documents considered only urban residents' access to credit, the large number of the rural population was not even mentioned. All those observations together indicated the infant stage of the Chinese consumer credit at that time.

However, since 2009, the development of the consumer credit market has been speeding up. To deal with the 2008 financial crisis, the Chinese government rendered a 4 trillion yuan

[4] Bingxi Shen and Lijuan Yan, 'Development of Consumer Credit in China' [2009] in BIS Paper, Household Debt: Implications for Monetary Policy and Financial Stability < https://www.bis.org/publ/bppdf/bispap46g.pdf > accessed 15 April 2019.

[5] The gap between deposits and loans in China rose from Rmb 741.84 billion in 1996 (around GBP 84.73 billion) to Rmb 1654.36 billion (about GBP 188.96 billion) in the first quarter of 2000. Wei Lu, 'Jinru Hou Duanque Shiqi de Zhongguo JIngji' [2001] Caijing Wenti Yanjiu 11 (Wei Lu, 'China Economy in the Post-Shortage Period' [2001] Study on Financial and Economic Issues 11 (in Chinese))

[6] See Min Dong and Xing Wang , 'Zhongguo Xindai Xiaofei de Fanzhan Zhuangkuang ji Qushi Diaocha Fenxi' [2002] Zhongguo Baoxian Bao (Min Dong and Xing Wang, 'A Survey and Analysis of the Condition and Development Trend of Consumer Credit in China' [2002] Insurance Journal of China)

[7] Mei Deping, 'Zhongguo Xiaofei Xindai Shengji Cunzai de Wenti' [2000] Zhongguo Chengxiang Jingrongbao 1 (Mei Deping, 'Problems of Consumer Credit in China' [2000] Urban Finance Journal of China 1)

(around 586 billion dollars) economic stimulus plan. One of the measures was to improve and strengthen credit services with the aim of boosting economic growth.[8] The injection of stimulus fund has created favourable conditions for the development of the consumer credit market from the supply side. Furthermore, policymakers made efforts to develop the household credit market. In August 2009, China issued the 'Administrative Measures on Consumer Finance Pilot Projects'. Beijing, Shanghai, Tianjin and Chengdu were chosen as four pilot cities. In 2013, the China Banking Regulatory Commission (CBRC)[9] established more pilot cities.[10] Furthermore, the CBRC promulgated new 'the Pilot Measures for the Administration of Consumer Finance Companies', which relaxes certain requirements for establishing financial institutions in the consumer market.[11] In 2015, the consumer finance pilots were fully relaxed and expanded to areas across China.

The advancement of e-commerce and financial technology has opened more credit channels to consumers, which contributes to the development of the consumer credit market. Non-banking enterprises such as Suning, Jingdong and Alibaba provide a "buy now, pay later"

[8] Instrumentalities of the State Council, General Office of the State Council, Several Opinions of the General Office of the State Council on Providing Financial Support for Economic Development.

[9] Since 2018, China has promulgated a series of bureaucratic reforms. Then, China Banking Regulatory Commission was merged with China Insurance Regulatory Commission. Currently, the new institution is named as China Banking and Insurance Regulatory Commission (CBIRC).

[10] Those experimental cities included Shenyang, Nanjing, Hangzhou, Hefei, Quanzhou, Wuhan, Guangzhou, Chongqing, Xian and Qingdao. Instrumentalities of the State Council, General Office of the State Council, the Guiding Opinions of the General Office of the State Council on Providing Financial Support for the Adjustment, Transformation and Upgrade of the Economic Structure (No. 67 [2013] of the General Office of the State Council).

[11] For example, in the old regulation, the principal investor was required to hold 50% or more of the total equity of the consumer finance company. But the new regulation only demands a minimum of 30%. Based on the new regulation, companies can run businesses nationally rather than just in the place where the enterprise was registered. Furthermore, private capital and non-financial enterprise can establish a consumer finance company. CBRC, the Pilot Measures for the Administration of Consumer Finance Companies.

service for consumers. As a trusted online retailer, Jingdong started its consumer credit service in 2014, which is known as "Jingdong Baitiao".[12] Subsequently, as a rival of Jingdong, Alibaba also marched into the consumer financial market. In 2014, Ant Financial Service Group, which was formerly known as Alipay and is an affiliate company of the Chinese Alibaba Group, launched Huabei (Ant Check Later) acting as an online consumer loan product provided to Alipay users. By the first half of 2017, the outstanding loan balance of Huabei has reached RMB 160 billion ($25 billion).[13]

Against the background outlined above, the size of personal credit has been rising dramatically and rapidly in China. In 1999, the volume of consumer credit was just 0.0172 trillion CNY (around 0.0026 trillion in dollars).[14] However, in 2017, the total credit to households reached 6.14 trillion (USD). In other words, the size of the Chinese consumer credit market has increased more than 300 times in only 18 years. During the same period, credit to households only doubled in the United Kingdom[15] and America.[16] However, we should be cautious about comparing the Chinese consumer credit market with other developed economies only in terms of growth rate. After all, the Chinese credit market started at a low level so that it seemly increased more quickly than countries with a high level of consumer credit. Notwithstanding,

[12] Within one minute, consumers can apply for an online loan to purchase goods. The credit limit and interest rates are based on users' prior shopping history. Consumers can choose to pay the full loan back within 30 days or make monthly payments ranging from 3 to 12 months.

[13] Citi GPS: Global Perspectives & Solutions, Bank of the Future: The ABCs of Digital Disrupti on in Finance, (2018) Citi GPS, 41 < https://www.citibank.com/commercialbank/insights/assets/docs/2018/The-Bank-of-the-Future//files/assets/common/downloads/The%20Bank%20of%20the%20Future.pdf?uni=31e769f7e38adb6497e09c3cf0cb3614> accessed by 25 June 2020.

[14] Center for China in the World Economy, Research of Consumer Credit Market in China [2015] 6.

[15] According to the statistics from BIS, credit to households in England increased from 1.02 trillion (USD) in 1999 to 2.39 trillion (USD) in 2017.

[16] Consumer credit volume rose from 6.64 trillion (USD) in 1999 to 15.15 trillion (USD) in 2017.

the expansion of consumer credit is evident to all. With the rapid growth, consumer credit volume in China has surpassed English household debt levels, although it is less than half of the American level. Consumer credit in other emerging economies has also soared since 1999, although the growth in other jurisdictions has been slower, and the size in those countries was relatively small when compared with China's development. For example, the size of household debt in Brazil in 1999 was 75.19 billion USD, which was much larger than China's 2.6 billion USD. However, in 2017, credit to the household sector in Brazil reached 539.28 billion USD whilst the size of consumer credit in China rose to 6.14 trillion dollars.

Though the volume of Chinese consumer credit has experienced a significant increase, it is reasonable to assume the expansion of household credit may continue in the near future. The reason may be that China's top political leaders are keen to shift the export- and investment-driven development onto a new path led by consumption.[17] Consumer credit is expected to play a more significant role in China's future consumption-driven economy. Access to credit can supplement household income and contribute to increasing aggregate demand. As a result, the expansion of credit can boost economic growth. Given that an increase in consumer credit may boost economic growth,[18] the Chinese government has an incentive to take advantage

[17] Nicholas R. Lardy, China: Toward a Consumption-Driven Growth Path, (2006) Institute for International Economics <https://piie.com/publications/pb/pb06-6.pdf> accessed by 17 May 2019.

[18] In an empirical study, researchers indicated that there is a strong positive relationship between consumer credit and China's GDP growth. Jinzheng Ren, Baofeng Chen and Aihua Xi, Xiaofei Xindai yu Jingji Zengzhang Guanxi Yanjiu [2006] 1 Zhongguo Shangye(Jinzheng Ren, Baofeng Chen and Aihua Xi , 'The Research on the Relationship Between Consumer Credit and Economic Growth' [2006] 1 China Business); Additionally, another empirical study revealed that the role of consumer credit in economic growth has gradually increased. Yuan Liang, Xiaofei Xindai yu Jingji Zengzhang, 'Beijing he Quanguo de Bijiao Fenixi' [2012] 1 Beijing Jinrong Pinglun (Yuan Liang, Xiaofei Xindai yu Jingji Zengzhang, 'Consumer Credit and Economic Growth: A Study Comparing Beijing with the Whole Country' [2012] 1 Beijing Finance Review (in Chinese)); However, based on published statistic data, one article

of credit, and encourages the development of the consumer credit market. Therefore, it is reasonable to predict the continuing rise of Chinese consumer credit in the near future.

Table1: Total Credit to Households (2006-2017) (USD)

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
China	304.04 billion	694.78 billion	837.42 billion	1.20 trillion	1.70 trillion	2.14 trillion	2.57 trillion	3.25 trillion	3.69 trillion	4.12 trillion	4.75 trillion	6.14 trillion
United States	13.32 trillion	14.24 trillion	14.11 trillion	13.95 trillion	13.74 trillion	13.59 trillion	13.60 trillion	13.73 trillion	13.98 trillion	14.17 trillion	14.61 trillion	15.15 trillion
United Kingdom	2.56 trillion	2.85 trillion	2.15 trillion	2.39 trillion	2.29 trillion	2.30 trillion	2.43 trillion	2.52 trillion	2.44 trillion	2.40 trillion	2.09 trillion	2.39 trillion
Brazil	171.40 billion	269.72 billion	260.69 billion	411.31 billion	531.04 billion	557.32 billion	591.36 billion	591.95 billion	604.52 billion	430.47 billion	546.38 billion	539.28 billion

Source: Banks for International Settlements (BIS)[19]

5.3 The estimated risks of household credit

As the size of household credit in China rose dramatically, we may ask one essential question

considered that the growth of consumer credit can affect macroeconomic development but its impact is small. Ning Ding, 'Zhongguo Xiaofei Xindai dui Jingji Zengzhang Gongxian de Shizheng Fenxi' [2014] 3 Research on Financial and Economic Issues (Ning Ding, 'An Empirical Analysis concerning the Role of Consumer Credit in Economic Growth [2014] 3 Research on Financial and Economic Issues (in Chinese)).

[19] Bank for International Settlements, Credit to the non-financial sector < https://www.bis.org/statistics/totcredit.htm?m=6%7C380%7C669 > accessed by 16 April 2019.

as to whether increasing household credit carries risks. Generally speaking, scholars have paid special attention to China's corporate debt.[20] It is understandable why China's corporate debt always seems to be in the spotlight. In respect of volume, corporate debt has accounted for more than two-thirds of total debt at 170% of GDP. This figure is more than twice the scale of corporate debt in developed countries (85%) and over three times that of emerging economies excluding China (50%).[21] Throughout history and across countries, while credit booms seldom result in financial crisis, the rise in debt increases the probability of a crisis.[22] Some researchers are concerned that the high rising corporate debt in China may pose the risk of a crisis.[23] Comparatively, Chinese household debt has a relatively marginal status and as a result, there is limited literature discussing China's household debt issue and its consequences. However, the Great Recession has taught us that a massive increase in household debt may have a more devastating influence on the overall economy.[24] Scholars have demonstrated how the devastating impact of excessive household credit materialises. Although the use of credit enables households to smooth fluctuations in consumption, a high level of indebtedness

[20] Guonan Ma and James Laurenceson, China's Debt Challenge: Stylised Facts, Drivers and Policy Implications, Australian-China Relations Institute Working Paper < https://www.australiachinarelations.org/sites/default/files/ACRIWORKINGPAPER2016-02_Ma%20and%20Laurenceson%20160728_0.pdf > accessed by 14 May 2019; Sally Chen and Joong Shik Kang, 'Credit Booms- Is China Different?', (2018) IMF Working Paper WP/18/2.

[21] Ma and Laurenceson (n.20) 7.

[22] Giovanni Dell' Ariccia, Deniz Igan, and Luc Laeven, 'Credit Booms and Lending Standards: Evidence from the Subprime Mortgage Market' (2008) IMF Working Paper No.08/106; Stiji Claessens, Giovanni Dell'Ariccia, Deniz Igan, and Luc Laeven, 'Lessons and Policy Implications from the Global Financial Crisis' (2010) IMF Working Paper; <https://www.bcb.gov.br/Pec/Depep/Eventos/2010_Agosto_dia11_Conferencia/Arquivos/2_Lessons_and_Policy_Implications_from_the_Global_Financial_Crisis.pdf > accessed by 17 May 2019; Sally Chen and Joong Shik Kang, 'Credit Booms- Is China Different?', (2018) IMF Working Paper WP/18/2.

[23] Mali Chivakul and W. Raphael Lam, 'Assessing China's Corporate Sector Vulnerabilities' (2015) IMF Working Paper; Chen and Kang (n.22).

[24] Financial crisis arising from household debt may recover more slowly than recessions triggered by other event. IMF, World Economic Outlook (Washington DC, IMF, 2012) 91.

in private sector debt may result in the risk of rising financial instability.[25]According to the IMF, although the development of consumer credit can contribute to economic growth and lower unemployment in the short term, the effect may be weakened and even reversed in three or five years.[26] As a result, higher growth in household debt is one contributory factor to banking crises.[27] Given that China has experienced a substantial increase in consumer credit over the past decades, the question of whether the significant increase in household credit will threaten financial stability needs further exploration.

In order to understand whether the rising household credit influences Chinese financial stability, the household-debt-to-GDP ratio is a useful measurement. In the context of China, the household-debt-to-GDP was 49%, which was lower than the average level of developed countries (62.1%) but higher than the average ratio in emerging economies (39.8%).[28] Therefore, compared with data for other countries, it seems that China has a relatively low financial stability risk in the household sector, and the debt level is sustainable.[29]

However, if we interpret the debt-to-GDP growth from another aspect, the image may not be too optimistic. China's debt-to-GDP in the household sector rose from 17.9% in 2008 to 49% in 2017. By contrast, other economies have experienced a degree of deleveraging in the

[25] Jean Louis Arcand, Enrico Berkes and Ugo Panizza, 'Too Much Finance?' [2015] 20 Journal of Economic Growth 105.
[26] IMF, Financial Stability Report October 2017: Is Growth at Risk (2017) 53.
[27] Ibid.
[28] Financial Stability Analysis Group in the People's Bank of China, China Financial Stability Report 2018 (中国金融出版社, 2018).
[29] 'Given that China's household debt ratio to GDP is relatively low compared with those of developed nations, the country can manage its household debt risk as long as it takes comprehensive prevention and control measures. 'Yang Zhiyong, Household Debt Ratio not a Cause for Concern, Chinadaily <http://www.chinadaily.com.cn/a/201902/26/WS5c748446a3106c65c34eb5b2.html> accessed by 16 April 2019.

private sector during the same period. For example, while peaking at 95.70% in 2009, English household-debt-to-GDP decreased from 93.30% in 2008 to 86% in 2017.[30] The ratio in the United States also reflected a decreasing tendency, which was from 93.3% in 2008 to 86% in 2017.[31] Therefore, although the current debt-to-GDP ratio is relatively low when compared with other developed countries, the rapid rate of increase raises some concerns.

When solely focusing on Chinese household-debt-to-GDP figures, it seems to be that the level of household credit is sustainable and healthy.[32] However, those abovementioned numbers may not provide a full picture of the risks of increasing household debt. The index only evaluates the potential risks of credit from a macro perspective; hence it only portrays a general impression of the Chinese household balance sheet, providing policymakers with some insights on how rising household debt influences financial vulnerability at a general level. The macro concerns, however, provide limited information on understanding particular micro issues such as individual over-indebtedness. Therefore, the debt-to-GDP ratio is not an appropriate indicator when measuring the micro-level debt burden and it may hide some important aspects of household debt problems. In other words, though the overall level of household debt is sustainable, it provides limited information on individual debt burdens.

Some indicators highlighting the degree of individual indebtedness reflect that household debt

[30] Bank for International Settlements, Credit to the non-financial sector < https://www.bis.org/statistics/totcredit.htm?m=6%7C380%7C669 > accessed by 16 April 2019.
[31] Bank for International Settlements, Credit to the non-financial sector < https://www.bis.org/statistics/totcredit.htm?m=6%7C380%7C669 > accessed by 16 April 2019.
[32] Financial Stability Analysis Group in the People's Bank of China (n.28) 37.

burdens have been increasing sharply even though household debt, in general, may not pose abnormal risks to China's financial stability. According to the 2018 China Financial Stability Report, the debt-to-income ratio[33] increased from 43.2% in 2008 to 112.2% in 2017.[34] Such a rapid increase in debt-to-income ratio reflects a higher probability of default because households are bearing more of a burden. In addition to the debt-to-income ratio, we can also use the debt-to-asset ratio to estimate Chinese household debt burdens at a micro perspective. The debt-to-asset ratio reflects how total outstanding debt is divided by a household's total assets composed of financial assets and real assets. According to the released 'Chinese family wealth survey', debt-to-asset in China was 13.6% in 2015. However, the residents' debt-to-asset ratio was only 6.13% by the end of 2012, thus the ratio had almost doubled in China in three years. This rising debt-to-asset ratio suggests that Chinese households may become less resilient to economic shocks in the near term. In particular, given that most households concentrate their assets on real estate, if house prices decline significantly, the debt-to-asset ratio is more likely to be influenced, and the figures may increase.

Furthermore, the abovementioned measurements of household financial burden may even be underestimated. Therefore, the severity of individual debt burdens may be underestimated. According to a study, the participation rate in the credit market for Chinese residents was 39.6% in 2017.[35] This means that a significant number of households are not borrowing money from

[33] Debt-to-income ratio reflects how much of a borrower's monthly income is used to repay debt.
[34] Financial Stability Analysis Group in the People's Bank of China (n.28) 39.
[35] Survey and Research Center for China Household Finance, Zhongguo Gongxin Jieceng Xindai Fazhan Baogao (The Report of the Development of Consumer Credit Market in Working Class) (2017) 28.

the formal credit market. In the Chinese context, informal lending may be a common approach to raise money for households when they have the demand. For example, a report published by the World Bank in 2018 observed that only 22.7% of Chinese consumers over the age of 15 would borrow from a financial institution or use a credit card.[36] Comparatively, they 'borrowed from family or friends' and an 'any money' account at 28.3% and 44.7%, respectively.[37] In 2014, a report has investigated the size of private lending. The report estimated that the size of informal borrowing in 2013 was 5.28 trillion CNY, which accounted for 26.6% of the balance sheet of deposit-based financial institutions.[38] Given that the calculation of leverage measures does not include credit in informal consumer market, those data may be underestimated. We can reasonably assume that the household debt burden may be more substantial than actually reported.

Even though those figures are underestimated, the ratio of debt-to-income and debt-to-asset can still provide insight into understanding the level of individual indebtedness. A paper published in 2018 offered more detail to understand household financial vulnerability in China.[39] Based on the data provided in three published waves of the China Household Finance Survey (2011, 2013, 2015), they measured certain leverage indicators including the debt-to-asset (DA), debt-to-income (DI) and debt-servicing-to-disposable-income (DSI). Those indicators reflected the ability of a household to repay debt. In the paper, financially vulnerable

[36] The World Bank, The Little Data Book on Financial Inclusion (2018) 45.
[37] Ibid.
[38] Survey and Research Center for China Household Finance, Zhongguo Minjian Jinrong Fazhan Baoga (The Report of Chinese Informal Finance Market) (2014).
[39] Michael Funke, Rongrong Sun and Linxu Zhu, 'The Credit Risk of Chinese Households- A Micro-Level Assessment' [2018] CFDS Discussion Paper Series.

households were defined as those whose financial burden exceeds the thresholds DA>1, DI>4 and DSI>0.4. The results indicated that the proportions of Chinese debtors outstripping the authors' three thresholds are rather high and rising.[40] In other words, more and more households may have a heavy financial burden in China. However, the fact that consumers have a heavier debt burden does not necessarily mean that they face financial problems as such. Highly indebted households are likely to have relatively high income and wealth so that even though some debtors have a large amount of debt, they are able to cover their liability. Therefore, increasing leverage measures are not necessarily a signal of inability to meet obligations and we cannot conclude that individuals whose debt-to-income figures are rising are over-indebted. Debt becomes a problem only if debtors cannot meet their commitments. However, that is not to say that those leverage measures are meaningless. At least those indicators reflect that Chinese households are more vulnerable than before.

Against the backdrop of a rising debt burden in the household sector, we can assume that households have a higher probability of inability to meet their commitments. To an extent, it is more likely for individuals to turn from being indebted into over-indebted. Since there is scarce published research on Chinese household over-indebtedness, the general impression of over-indebtedness in China appears to be equivocal.[41]Findings in 2018 China Financial Stability Report appeared to indicate an optimistic image of individual over-indebtedness in

[40] Ibid 8.

[41] Currently, there is no consensus about the definition of over-indebtedness. However, one critical element of over-indebtedness concerns the inability to pay. Heikki Hiilamo, *Household Debt and Economic Crises: Causes, Consequences and Remedies* (Edward Elgar, 2018) 14.

the Chinese context. The report revealed that the non-performing-loan ratio (NPL ratio) in the household sector was 1.5% in 2017.[42] This number was 0.35% lower than the overall NPL ratio.[43] Furthermore, the NPL ratio in individual housing loans, credit card loans and automobile loans were, respectively, 0.3%, 1.6%, 0.7% in 2017, while they were lower than previous year's figure by 0.1%, 0.3% and 0.1%.[44] This data indicates that the risk of household over-indebtedness in China is low even though the expansion of credit is continuing. However, given that Chinese central bank, the People's Bank of China, has not regularly published relevant data about the NPL ratio, we cannot make a longitudinal comparison to understand the stability of the figure. Therefore, there is little knowledge about whether the over-indebtedness issue is aggravated or alleviated in contemporary China. Additionally, the calculation of the NPL ratio does not take informal lending into consideration and hence the data is not an accurate mirror of the over-indebtedness issue in China. Consequently, it is hard to know precisely how serious individual over-indebtedness is in China.

Although we do not have a comprehensive understanding of household over-indebtedness in China, it is believed that borrowing is a risky activity. Therefore, it is reasonable to assume that at least a small number of debtors may fall into a debt crisis. Researchers have indicated that Chinese households in the lowest income quintile face a higher probability of insolvency, and struggle in complying with their financial obligations.[45] In recent years, public media has also

[42] Financial Stability Analysis Group in the People's Bank of China (n.28) 40.
[43] Ibid.
[44] Ibid.
[45] Michael Funke, Rongrong Sun and Linxu Zhu, 'The Credit Risk of Chinese Households- A Micro-Level Assessment' [2018] CFDS Discussion Paper Series.

reported more and more news about how debt default influences householders' daily lives. For example, some online lenders ask female borrowers to take selfies in which their ID cards have to be shown. If they fail to meet their commitments, those photos will be sent to their friends, relatives and even colleagues.[46] There is occasional news about a debtor's suicide because of the inability to pay.[47] In addition to published news items, credit card dispute cases are increasing rapidly, which may provide some insight into the image of debt default. The number of cases concerning credit card disputes climbed from 95,150 in 2014[48] to 169,045 in 2015.[49] A report revealed that from January to October in 2017, the number of credit card dispute cases ranks at 6th in relation to the total number of accepted first-instance civil and commercial cases.[50] However, the report does not have a detailed description of the reasons for credit card dispute cases. Therefore, we cannot precisely know whether those cases are caused by severe overdraft or deferred repayment or other factors. Nevertheless, we may presume that disputes led by the inability to pay also increased due to the sharp climb in the total caseload. Therefore, even though no solid evidence indicates that household over-indebtedness has become an inevitable phenomenon in contemporary China, we cannot deny that some debtors have already fallen into a debt crisis.

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[46] Lucy Hornby, Chinese Borrowers Told to Post Nude Photos as Collateral. Financial Times < https://www.ft.com/content/cce6d400-32c6-11e6-ad39-3fee5ffe5b5b> accessed by 20 April 2019.
[47] Pinghui Zhuang, Chinese Family of Three Attempt Suicide over Loan Shark Debts. South China Morning Post< https://www.scmp.com/news/china/society/article/2147215/chinese-family-three-attempt-suicide-over-loan-shark-debts >accessed by 20 April 2019.
[48] The Supreme People's Court of China, Annual Report of the People's Court (2014), http://www.court.gov.cn/fabu-xiangqing-13848.html accessed by 10 April 2019.
[49] The Supreme People's Court of China, 2015 Trial Implementation in the People's Court, http://www.court.gov.cn/fabu-xiangqing-18362.html accessed by 10 April 2019.
[50] China Justice Big Data Service Platform, Justice Big Data Report: Civil and Commercial Cases, http://data.court.gov.cn/pages/research.html accessed by 11 April 2019.

5.4 The rising probability of household over-indebtedness

Due to the lack of information, we cannot accurately study the degree of over-indebtedness in China. However, we can estimate the probability of over-indebtedness based on the change of the debt-to-income ratio. According to Caplovitz's study, the debt/income ratio can be used as a measurement of over-indebtedness.[51] Factors which can influence the numerator and denominator will reflect the household debt burdens: the larger the number is, the more likely a debtor is to be over-indebted. Section 2 has shown that household credit has significantly risen, and thereby, the numerator becomes larger, which may lead to a higher probability of over-indebtedness. In addition to the increased volume of debt, the increasing costs of debt, decreasing income, and fluctuating cost of living can also influence the value of debt-to-income, which affects the probability of household over-indebtedness. Through exploring three factors -the costs of debt, the fluctuation of incomes and the cost of living- in the context of China, the following section makes the case that over-indebtedness is almost inevitable for Chinese households, and it may be more severe than anticipated.

5.4.1 The costs of debt

The interest payment on borrowed capital determines the costs of debt. Hiilamo explains some structural and individual factors that influence the costs of debt, including the economic fluctuation, finance industry practices, financial illiteracy, unsuccessful investments, reckless spending and bad luck.[52] The next section finds that a considerable number of consumers are

[51] David Caplovitz, *Consumers in Trouble: A Study of Debtors in Default* (Free Press, 1974)105-115
[52] Hiilamo (n.41) 69.

using expensive or unaffordable credit. Therefore, the risk of over-indebtedness may become a significant issue in Chinese society, at least for those who use costly credit.

For all groups of borrowers, more attention should be paid to low-income individuals in the Chinese context. Low-income individuals account for around 60% of the population[53] and when they have a demand for credit, they are more likely to rely on costly sources of credit.[54] Whether the interest rate is high or low impacts the probability of debt default. As a result, low-income individuals may fall into a vicious circle: the poorer they are, the more expensive the cost of credit is, and the more likely they are to fail to repay. Even though low-income consumers have a higher possibility of default, creditors are still willing to offer credit; such a business practice reflects a traditional economic theory that higher risk means higher expected yield.

In effect, lenders are increasingly targeting low-income individuals for higher profits in China. One representative example is the development of the campus loan market in China. Concerned about college students' ability to comply with their financial obligations, the China Banking Regulatory Commission in 2009 published a Notice explicitly pointing out that banking financial institutions could not issue credit cards to college students who had no regular income.[55] Since then, credit card business focusing on university students has slowed.

[53] China Power Team, How Well-off is China's Middle Class? China Power < https://chinapower.csis.org/china-middle-class/# > accessed by 14 June 2020.
[54] Julie Birkenmaier and Sabrina W Tyuse, Affordable Financial Services and Credit for the Poor, [2005] 13 Journal of Community Practice 69, 70.
[55] CBRC, Notice of the China Banking Regulatory Commission on Further Regulating the Credit Card Business,< http://www.lawinfochina.com/display.aspx?lib=law&id=7579&CGid=> accessed by 12 April

However, lending to college students sprang up after 2015 in a new form. In late 2015, China released Recommendations for the 13th Five-Year Plan for Economic and Social Development to guide future progress. For the first time, improving Internet finance was included in a national development plan, considered as one component of advancing inclusive finance. Against this background, internet lending has become popular in China. Apart from the traditional e-commerce giants, including JD and Alibaba, more and more lending platforms marched into the consumer credit market. However, due to insufficient regulation, some lending platforms were established by loan sharks to prey on university students. Credit provided by those loan sharks is costly; not only is the interest rate much higher than the prescribed rate[56] but it is also a widespread practice that lenders will deduct a certain percentage of borrowed principal as a deposit, service fee or service charge while still calculating interest based on the whole amount.

It is not hard to imagine that a college student without a regular income may fail to repay such costly capital. In effect, public media have reported more and more news relating to how creditors harass defaulting students. For example, a debtor's nude photos may be posted online when they cannot make payments.[57] In order to keep the society stable, regulators published a series of documents to deal with rampant campus loans. In April 2016, CBRC and

2019.

[56] According to the Supreme People's Courts regulation on dealing with private loan cases, the highest annual interest rate allowed by Chinese legislation is 24 per cent. Furthermore, the total amount of loan using compound interest should not surpass the principal plus 24 percent annual interest. But the interest rate of many campus loans exceeds the prescribed level, up to 76%.

[57] Lucy Hornby, Chinese Borrowers Told to Post Nude Photos as Collateral. Financial Times < https://www.ft.com/content/cce6d400-32c6-11e6-ad39-3fee5ffe5b5b> accessed by 20 April 2019.

Ministry of Education jointly issued a paper stressing education relating to borrowing behaviours and the need for prevention of illegal campus loans.[58] Four months later, CBRC enacted Interim Measures for the Administration of the Business Activity of Online Lending Information Intermediary Institutions, which strengthened the supervision of these activities. The authority banned a large number of online lenders from extending credit to college students in June 2017, only permitting certain authorised banks to issue loans.[59] But the story is far from ending. Despite strict regulations, predatory lending is still prevailing on campuses.[60] Currently, some lenders are preying on students through posting ads inside campuses not through the Internet.[61]

The growth of campus loans mirrors the fact that previously excluded consumers may have access to credit due to the development of the financial industry. One characteristic of the low-income segment of the market are the high-interest rates. Researchers have found that expensive credit is a major cause of over-indebtedness.[62] Therefore, since the financial

[58]中华人民共和国教育部，关于加强校园不良网络借贷风险防范和教育引导工作的通知 (2016) (Ministry of Education of the People's Republic of China, Notice on Educating and Preventing Risks of Campus Online Lending (2016))<http://www.moe.gov.cn/srcsite/A12/s7060/201605/t20160504_241921.html>accessed by 13 April 2019.

[59] 中国银监会，教育部，人力资源社会保障部，关于进一步加强校园贷规范管理工作的通知 (2017)(China Banking Regulatory Commission, Ministry of Education and Ministry of Human Resources and Social Security, Notice on Further Regulating Campus Loans (2017)) < http://www.gov.cn/xinwen/2017-06/29/content_5206540.htm > accessed by 13 April 2019.

[60] Kristin Huang, Loan Sharks Continue to Prey on Chinese University Students by Going Offline to Bypass Crackdown, South China Morning Post < https://www.scmp.com/news/china/society/article/2126435/loan-sharks-continue-prey-chinese-university-students-going> accessed by 20th April 2019.

[61] Ibid.

[62] CPEC, *The Overindebtedness of European Households: Updated Mapping of the Situation, Nature and Causes, Effects and Initiatives for Alleviating Its Impact*. Final Report, Part 1. Berlin: Civic Consulting of the Consumer Policy Evaluation Consortium 150 < https://ec.europa.eu/info/sites/info/files/final-report-on-over-indebtedness-of-european-households-synthesis-of-findings_december2013_en.pdf> accessed by 15 April 2019.

industry is now marching into the bottom end of the market, the probability of over-indebtedness becomes higher for those low-income borrowers. As a result, it is reasonable to predict that the issue of over-indebtedness will become more urgent as the development of inclusive finance in China unfolds.

5.4.2 Income fluctuation

One obvious feature of credit is borrowing from tomorrow. In other words, a debtor's ability to pay depends on future expected income. Any interruption of that income will influence whether debtors can meet their financial commitments. Credit payments which were previously unproblematic can become unmanageable because of a decline in income. In effect, a reduction of income is a reliable forecast of over-indebtedness [63] and we can assume that if a considerable number of households experience a decrease in income, they will probably become over-indebted.

In the context of China, overall household income has increased sharply, rising from 68.243 USD in December 1957 to 10263.710 USD in December 2019.[64] But the past tendency may have nothing to do when predicting the future trend. Hence, one essential question is whether the increase in household income will continue in the future. The People's Bank of China has conducted quarterly questionnaires to report household expectation of future income since 1999. The most up-to-date report revealed that 89.7% of households believed their income

[63] CPEC revealed that the lower the income is, the higher probability debtors become over-indebted. Ibid 7.
[64] CEIC, China GDP per Capital < https://www.ceicdata.com/en/indicator/china/gdp-per-capita> accessed by 20 April 2019.

would increase or stay the same.[65]Only a small share of the population deems their income may decline. It seems that most Chinese households feel confident in their income growth. To an extent, data released by the National Bureau of Statistics (NBS) echoes household confidence in income expectation. In the first quarter of 2019, household disposable income was 8,493 CNY (around 977 GBP), which was an increase of 6.8% since the same period the previous year.[66]

However, the economic slowdown in China may have some impact on optimistic expectations about future income growth. Over the last three decades, Chinese economic development experienced a dramatic increase, resulting in China's rise to the second-largest economy in the world. However, the economic expansion is slowing down and the past ten years witnessed the GDP growth decrease from 14.23% in 2007 to 6.6% in 2018.[67] The slower growth rate may impose pressure on the job market because there are fewer vacancies. Borrowing when employment prospects are poor may be disastrous. The current pressure of unemployment has been reflected in government reports. Prime Minister Li Keqiang reported that the unemployment rate was around 4.5%[68] in 2017 but 5% in 2018.[69] Meanwhile, Li stressed the

[65] Financial Survey and Statistics Department, Urban Depositor Survey Report (Q1 2019)< http://www.pbc.gov.cn/en/3688247/3688981/3709408/3793669/index.html > accessed by 20 April 2019.

[66] National Bureau of Statistics, 2019 年一季度居民收入和消费支出情况（Household Income and Consumption in the first quarter of 2019）<http://www.stats.gov.cn/tjsj/zxfb/201904/t20190417_1659987.html>accessed by 20 April 2019

[67] The World Bank, Data of China, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2017&locations=CN&start=2007> accessed by 21 April 2019.

[68] Keqiang Li, Annual Government Work Report in 2017 <http://www.gov.cn/zhuanti/2017lh/live/0305.htm> accessed by 22 April 2019.

[69] Keqiang Li, Annual Government Work Report in 2018 < http://www.xinhuanet.com/fortune/2019-03/16/c_1124242390.htm> accessed by 21 April 2019.

need to control the unemployment rate at under 5.5% in 2019.[70] Furthermore, the lower growth rate may last for a while[71], and therefore, it is likely that the unemployment rate may rise and the probability of over-indebtedness may be higher than before.

5.4.3 The cost of living

The loss of income may result in over-indebtedness, while increased expenditure may also lead to debtors' financial distress. Rising living costs will restrict the capability of indebted debtors to service debts and thereby give rise to over-indebtedness. Caplovitz has described a situation where consumers might experience the need for unforeseen expenditure such as medical bills, the death of a relative and car repairs giving rise to a heavy debt burden.[72] However, those suddenly increasing financial burdens are individual factors, which may not be representative of the population at large. Indeed, changes in personal circumstances may lead to an increase in the cost of living but the influence of individual factors is confined to households that encounter unexpected misfortune.[73] By contrast, general hikes in utility bills, housing costs, food or transport have a broader impact on all indebted debtors.[74] If the cost of basic living expenses rises, it is more likely for indebted debtors to fail to service their debts. Therefore, the following paragraphs will explore whether the cost of living in China is increasing and whether such an increase will result in the rise of the debt burden.

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[70] Ibid.
[71] The World Bank estimated the growth of Chinese economy will continue slowing in near future. The World Bank Group, Global Economic Prospects: Darkening Skies (2019).
[72] David Caplovitz, *Consumers in Trouble: A Study of Debtors in Default* (Free Press, 1974)
[73] Hiilamo (n.41) 91.
[74] Ibid.

In the context of China, the government calculates the consumer price index (CPI) to measure the cost of living for average households. Table 2 below shows the change in CPI in various countries or regions during the period 2010-2018. Comparatively, excluding the figures for the past two years, the annual growth rate of CPI in China is relatively high. In other words, living expenses rose quickly in China. In addition to the CPI, there are several reports focusing on households' subjective experiences of the cost of living in China. Before 2017, the People's Bank of China used to publish findings, reporting on how households felt about the cost of living, whether it was affordable (Table 3). As indicated in the table, almost half of interviewees considered the living cost was too high to afford.

However, both the CPI and the published reports may provide limited information when we estimate over-indebtedness influenced by the increasing living costs. The CPI figures are a rough measure and cannot fully indicate the changes in indebted consumers' ability to meet their commitments. One study notes that the main concerns for causing over-indebtedness refer to utility bills, which were subsequently followed by housing costs and other costs such as transport and food.[75] Other areas of expenditures like child-related costs, health care bills, education and insurance were less important contributors to over-indebtedness.[76] Given that various areas of expenditure weigh differently, when calculating the CPI figure, we do not know whether the area which may result in over-indebtedness is increasing. Additionally,

[75] CPEC, *The Overindebtedness of European Households: Updated Mapping of the Situation, Nature and Causes, Effects and Initiatives for Alleviating Its Impact*. Final Report, Part 1. Berlin: Civic Consulting of the Consumer Policy Evaluation Consortium. < https://ec.europa.eu/info/sites/info/files/final-report-on-over-indebtedness-of-european-households-synthesis-of-findings_december2013_en.pdf> accessed by 15 April 2019.
[76] Ibid.

those reports conducted by the central bank only reflected households' subjective attitude and expectation of living costs; they did not show whether specific areas of expenditure, such as utility bills or housing costs, have been rising. Therefore, what we can conclude from the CPI and Central Bank's reports is that living costs in China rose relatively quickly over the last decade. However, from the perspective of CPI and questionnaires, we cannot know whether the increasing areas of expenditure are those viewed as more significant causes of over-indebtedness.

The current housing boom may provide complementary information to understand whether the rising living costs in China have an impact on the probability of over-indebtedness. In the past decade, housing prices have experienced significant growth. Based on data from 35 major Chinese cities, housing prices have increased at an annual rate of 17 percent in the past ten years in real terms.[77] However, the growth of people's disposable income has not caught up with the rising housing prices in the same period. The growth of income has risen only half as much as housing prices.[78] However, in one study, the authors found the price-to-income ratios in their samples were between 6 and 10, which is high but not unusual.[79] Furthermore, they indicated that the growth in house prices was not faster than the growth in income. Nevertheless, given that their data stopped in 2012 and is based on individuals who may have had a high income, their conclusion about the relationship between income and housing price

[77] Kaiji Chen and Yi Wen, 'The Great Housing Boom of China' [2017] 9 American Economic Journal: Macroeconomics 73.
[78] Ibid.
[79] Hanming Fang, Quanlin Gu, Wei Xiong and Li-An Zhou, 'Demystifying the Chinese Housing Boom'[2015] 30 NBER Macroeconomics Annual < https://www.journals.uchicago.edu/doi/full/10.1086/685953> accessed by 15 July 2019.

may be inaccurate. The reality seems to be that the gap between housing prices and income has become wider than before. For example, the price of a 90-square-meter apartment in Beijing or Shanghai is more than 25 times what it was in 2016.[80] Regardless of whether income grows faster than the housing price, compared with OECD countries, the real housing prices in China have increased rapidly (Table 4).[81]

Furthermore, housing prices may continue to rise partly because of the Chinese tax system. Under the current tax system, the local government has a limited stream of on-going fiscal revenues. Land sales revenue[82] is deemed to be core fiscal income. Therefore, the government may be reluctant to reduce the price of land, which may lead to the rise of housing prices. More fundamentally, even though real estate is becoming much more expensive than previously, households in China are still keen to own a house. From the demand side, investing in real estate is deemed to be effective and safe in China.[83] Traditional Chinese culture may also fuel the investment in housing.[84] As mentioned before, the housing cost is an influential contributory factor to over-indebtedness. Therefore, with the rise of housing prices and the need to purchase a house or apartment, households may bear more onerous debt burdens, resulting in a higher probability of over-indebtedness.

[80] Edward Glaeser, Wei Huang, Yueran Ma and Andrei Shleifer, 'A Real Estate Boom with Chinese Characteristics' [2017] 31 Journal of Economic Perspectives 93.
[81] OECD Data <https://data.oecd.org/price/inflation-cpi.htm> accessed by 14 July 2019.
[82] This revenue is collected by local government when government transfers the state-owned land interest to developers.
[83] Edward Glaeser, Wei Huang, Yueran Ma and Andrei Shleifer, 'A Real Estate Boom with Chinese Characteristics' [2017] 31 Journal of Economic Perspectives 105.
[84] Ibid.

Table 2 Annual Consumer Price Index (CPI) (%) (2010-2018)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
CHN	3.3	5.4	2.6	2.6	2.0	1.4	2.0	1.6	2.1
USA	1.64	3.16	2.07	1.46	1.62	0.12	1.26	2.13	2.44
GBR	2.50	3.80	2.60	2.30	1.50	0.4	1.0	2.6	2.3
DEU	1.1	2.08	2.01	1.50	0.91	0.51	0.49	1.51	1.73
OECD(Total)	1.79	2.84	2.23	1.59	1.72	0.63	1.12	2.25	2.59

Source: OECD data[85]

Table 3 Price Sentiment Index[86]

	Living Cost is high and unaffordable
2017 Q4	No data
2017 Q3	No data
2017 Q2	No data
2017 Q1	44.1%
2016 Q4	44.4%
2016 Q3	50%
2016 Q2	53.4%
2016 Q1	52.7%
2015 Q4	51.1%

[85] OECD Data <https://data.oecd.org/price/inflation-cpi.htm> accessed by 25 April 2019.
[86] Financial Survey and Statistics Department, Urban Depositor Survey Report < http://www.pbc.gov.cn/en/3688247/3688981/3709408/index.html > accessed by 26 April 2019.

2015 Q3	48%
2015 Q2	47.4%
2015 Q1	48.8%
2014 Q4	52.9%
2014 Q3	54%
2014 Q2	56.5%
2014 Q1	55.8%
2013 Q4	61.6%
2013 Q3	59.7%
2013 Q2	59.1%
2013 Q1	62.1%

Table 4 Housing Prices (2015=100, 2011-2018)

	2011	2012	2013	2014	2015	2016	2017	2018
China	99	95.7	100	102.7	100	109.9	122.5	127.1
OECD(total)	93.8	92.9	94.4	96.3	100	104.2	107.9	110.9

5.5 Conclusion

Overall, three points emerge from this chapter. First, consumer credit has experienced significant growth over the last decade in China, and the expansion of credit will continue; the high-growth tendency will not change in the short term. From the supply side, given the advantage of consumer credit and the transition from an investment-driven economy to

consumption-driven model, the Chinese government may encourage the growth of consumer loans with the purpose of increasing the aggregate demand. Therefore, it is reasonable to assume the volume of consumer credit may continue to increase.

Secondly, the current level of household credit does not pose a threat to Chinese overall financial stability. Despite the rapid increase when solely focusing on household-debt-to-GDP, the household debt burden is sustainable and healthy. With regards to individual over-indebtedness, given that few empirical studies are focusing on this topic, we have little knowledge of this regime. Despite this, the expansion of credit means that Chinese households bear more debt burden than before.

Thirdly, this chapter argues that the possibility of individual over-indebtedness is increasing in China and thereby individual over-indebtedness will inevitably occur. Currently, it is much easier for consumers to have access to credit through various channels such as banks, retail shops and online lending platforms. Despite the advantages of consumer credit, predatory and illegal creditors may have an opportunity to target vulnerable consumers for higher profits. When vulnerable consumers meet with predatory lending practices, a possible result is that consumers cannot meet their commitments because of the expensive cost of credit. As a result, households will fall into over-indebtedness and in addition to costly credit, the decrease in income may cause over-indebtedness. If income is interrupted, households may struggle to comply with their financial obligations because borrowing is based on the expected future income. Household disposable income in China still maintains a relatively high growth rate but

lower economic growth may lead to an unstable labour market. As a result, the probability of a decline in household income becomes higher and therefore the economic slowdown makes borrowing riskier.

Additionally, the increase in the cost of living can also contribute to over-indebtedness by restricting debtors' resources to service debts. In the context of China, there is an increasing tendency in the cost of living when we look at the released CPI figures and questionnaires. However, CPI and results of questionnaires do not accurately tell us whether specific living expenses - which can be viewed as important causes of over-indebtedness - are rising or not. Nonetheless, due to the increase in housing prices, we can estimate at least, that housing costs are growing fast and given that the rise of housing costs is a leading contributor to over-indebtedness, the probability of over-indebtedness will become higher.

CHAPTER 6 CURRENT TREATMENT TO INDIVIDUAL OVERINDEBTEDNESS IN CHINA

6.1 Introduction

The previous chapter outlined the development of consumer finance in China. It showed that consumer credit has experienced significant growth over the past decade. Furthermore, the expansion of credit may continue to increase, given that Chinese economic growth is transitioning from investing- and exporting-driven models to a consumption-driven one. From a comparative perspective, using household credit as a development policy is gradually becoming a prominent feature of various jurisdictions.[1] China seems to be one of the countries which favour the usage of credit.[2] Researchers have discovered that access to credit plays a role in promoting household consumption and boosting the economy.[3] The growth of household credit can contribute to higher consumption, lower unemployment and better economic growth.[4] However, as household credit expands, credit-associated risks such as systematic financial instability and household over-indebtedness, will possibly occur. The previous chapter has shown that the current level of consumer debt burdens does not pose a systematic threat to the Chinese financial system. However, due to the expansion of credit, the rising living cost, the increasing costs of credit, and the potential for income disruption, the occurrence of over-indebtedness is inevitable. Given this, the last chapter argued that policymakers should anticipate solutions to the currently underestimated issue of household

[1] Adam Feibelman, 'Consumer Bankruptcy as Development Policy' [2009] 39 Seton Hall Law Review 63.
[2] Ibid.
[3] IMF, Financial Stability Report October 2017: Is Growth at Risk (2017).
[4] Ibid 53.

over-indebtedness.

Theoretically, to deal with household over-indebtedness, a personal bankruptcy system is deemed as the most effective approach.[5] However, under the current legal framework, Chinese bankruptcy law does not apply to individuals. In this sense, to deal with potential individual over-indebtedness, the reform of the law may be necessary. Nonetheless, before appealing to reform the bankruptcy system, we should contemplate whether certain existing institutions have similar functions as personal bankruptcy law. The mechanism of a personal bankruptcy system is the orderly distribution of debtors' limited assets among creditors as well as insuring over-indebted consumers against debt default through a grant of discharge. Therefore, this chapter will examine the current Chinese legal treatment of household debt. Specifically, it will explore whether certain institutions currently undertake the insurance function of the law and act as a debt collection mechanism in the way a personal bankruptcy law should operate.

Additionally, since personal bankruptcy law can be a substitute for other social programmes.[6] Therefore, a society can determine to insure individuals against financial risk through the bankruptcy procedure or through other programmes, or both. This chapter assumes that if other social insurance programmes cannot provide comprehensive protection, there is a need

[5] The World Bank, 'Report on the Treatment of the Insolvency of Natural Persons' 115 <https://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf> accessed by 10 Jan 2020 ; Heikki Hiilamo, *Household Debt and Economic Crises: Causes, Consequences and Remedies* (Edward Elgar, 2018) 144.

[6] Adam Feibelman, 'Defining the Social Insurance Function of Consumer Bankruptcy' [2005] 13 American Bankruptcy Institute Law Review 129, 132.

to introduce personal bankruptcy law as a supplement. Therefore, it will also review the Chinese social insurance system and discuss whether the current system can provide sufficient protection for Chinese households.

After reviewing the legal treatment of debt default and the development of the Chinese social insurance system, several themes occur. Under the individual enforcement procedure, the creditors' interests are preeminent while debtors' protection is downplayed. Furthermore, the current enforcement procedure does not deal with creditors' cooperation problems appropriately. For example, it does not distribute a debtor's assets in a fair and orderly manner in cases where there is more than one creditor. Regarding to Chinese welfare system, policymakers are keen to cover more and more individuals via universal social security. However, the unequal benefit distribution fails to effectively protect vulnerable individuals such as rural residents and urban workers outside the formal sector. Hence, there is a need to introduce a personal bankruptcy law to fill the gap in insuring vulnerable groups against potential risks.

This chapter is structured in three parts. The first part will describe the treatment of Chinese debtors under enforcement procedures; the second part will explain the structure and performance of the contemporary Chinese social welfare system; the final part will make a brief conclusion that the introduction of a personal bankruptcy system is necessary in the Chinese context.

6.2 Defaulting debtors and Chinese enforcement procedure

6.2.1 Procedures without the involvement of the court

When consumers cannot meet their commitments, creditors may not choose to directly sue those defaulting debtors. Instead, creditors can first try to collect debts either by themselves or through a third party, out-of-court.

For banking institutions running a credit card business, they may have a comprehensive debt collection process.[7] According to banking business practices, bank staff will send debtors a letter demanding overdue payment. The letter fully discloses information including the name of cardholder; the subject of collection and collection-related legislation; rights and duties of cardholders; procedures for viewing the card balance, making payments, submitting challenges and relevant evidence; contact details of the card issuer; the official seal and other information subject to a supervisor's legislation.[8] If cardholders object to the statement, commercial banks should investigate whether the objection is valid or not. China Banking Regulatory Commission's (CBRC) rule stipulates that banks can only process collection on the contracting party and his guarantors rather than through other third-parties such as relatives.[9] Furthermore, commercial banks should not employ improper and illegal methods involving

[7] In 2011, China Banking Regulatory Commission issued a rule to regulate the credit card business of commercial banks. The regulation stated that commercial banks should build a management system of debt collection for credit card arrears and standardise the collection procedures. China Banking Regulatory Commission, Measures for the Supervision and Administration of the Credit Card Business of Commercial Bank, Article 66.

[8] China Banking Regulatory Commission, Measures for the Supervision and Administration of the Credit Card Business of Commercial Bank, Article 69.

[9] Ibid Article 68.

violence, coercive measures, threat or abuse, and the procedure of debt collection should be recorded.[10] Meanwhile, all records are kept for at least two years.[11] In special circumstances, if debtors are unable to comply with their financial obligations but are willing to make payments, they can negotiate with banks and settle debts through a written or oral repayment plan. [12] However, the departmental rule does not explain the meaning of special circumstances. Consequently, it leaves banks with a degree of discretionary power. According to the rule, a settlement plan cannot last longer than five years.[13] The terms of the contractual composition with creditors involves debtors bargaining with creditors. However, CBRC legislation requires the inclusion of some specific terms in the plan.[14]Once both creditors and debtors agree on the plan and sign the document, debt collection will be suspended unless the debtor breaks the terms of the repayment plan. If the individualised agreement cannot be reached or the debtor fails to comply with the plan, then banks can sue the debtor in court.

Although CBRC provides banking institutions with some guidance on debt collection, the regulation does not compulsorily apply to non-banking creditors such as online lending platforms. As a result of this, non-banking creditors do not need to follow the requirement of establishing management rules for the debt collection procedure. Given the associated costs

[10] Ibid.
[11] Ibid.
[12] Ibid Article 70.
[13] Ibid.
[14] Those terms include: 1. the balance, structure and currency of debt; 2. the repayment period, method, currency, date and repayment amount of each period; 3. if there is any annual fee, instead of other fees charged during the repayment period; 4. a commitment made by the cardholder that he shall not apply to any other bank for a credit card before the relevant amounts in the individualised agreement on installment repayment are all settled; 5. the rights, obligations and liabilities of both sides for breach of contract and 6. other matters relevant to repayment. Ibid Article 70.

including employing staff, training employees or renting an office, non-banking lenders may have no incentive to establish their own debt collection system. Instead, they routinely commission debt collectors when the debt remains unpaid.[15] Most debt collectors are employed by debt-collection agencies, while some work independently and some are attorneys. Similar to the process of debt collection in commercial banks, in most cases debt collectors will first send a letter to debtors to demand payment. If they fail to make payments after a stipulated time, debt collectors will take further steps to collect the debts. Normally, they will contact delinquent debtors by phone to try to convince them to pay. However, because there is no nationally applicable fair debt collection legislation in China, debtor collectors may use some inexpedient methods. It is easy to understand the use of some improper methods because of the remuneration structure: the more debt collectors recover, the more they earn. As a result, debt collectors will call debtors at any time of the day, tell their employers, relatives and even neighbours about the problems. In some extreme instances like Yu Huan's case,[16] collectors will exercise physical violence. However, debtors are not always the victims of debt collection as they themselves sometimes threaten or abuse

[15] However, no rules forbid banking institutions to entrust third parties to collect debts. In effect, banks may prefer commissioning debt collectors as the middlemen. A research study investigated debt collection practice in China and in the sample of 110 banking institutions, 83 banks authorise third party debt collectors. '我国第三方债务催收市场调查报告 (The market report of the third-party debt collectors in China)' <http://www.financialnews.com.cn/ll/xs/201512/t20151207_88412.html> accessed by 25 April 2019.

[16] The case of Yu Huan happened in 2016 and stirred heated debate in China. The fact was that Yu Huan stabbed a violent debt collector who died later because of the injury. The debate centred on whether Yu Huan's behavior was in justifiable defense of his mother whom the collector was harassing. In addition to the controversial legal issue, this case reflected the ugly side of debt collection practice in China. Anthony Kuhn, 'A Debt Collector is Killed in China, Triggering Debates Over Right to Self-Defense' (NPR, 30 March 2017) < https://www.npr.org/sections/parallels/2017/03/30/521901404/a-debt-collector-is-killed-in-china-triggering-debate-over-right-to-self-defense?t=1599901808637 > accessed by 25 April 2019.

those collectors who are carrying out their work.[17] It is also possible for debtors to reach a contractual agreement with creditors via debt collectors. However, due to limited empirical research on the debt collection regime, we cannot know how many settlements are achieved; whether the negotiation mechanism works effectively; and what terms are included in the agreement.

6.2.2 Procedures with the involvement of the court

In addition to extrajudicial means of debt collection, creditors may hope to recover the undisputed debt by invoking the power of the courts. Usually, creditors will initiate the proceedings in a basic-level court in the area where the defendant is domiciled or is their habitual residence.[18] Once the court accepts the case, it is very likely that the court will first attempt to mediate the case between plaintiffs and defendants. Due to the pursuit of a harmonious resolution to the dispute, mediation is viewed as a preferred approach.[19] Furthermore, during the 2012 reform, a new provision was inserted into Chinese Civil

[17] In a research study, 47.8% debt collectors reported that they were thwarted by debtors in terms of violence or abuse. 我国第三方债务催收市场调查报告 (The market report of the third-party debt collectors in China) <http://www.financialnews.com.cn/ll/xs/201512/t20151207_88412.html> accessed by 25 April 2019.

[18] According to Chinese civil procedure law, jurisdiction of courts on cases is separated into two categories, namely territorial jurisdiction and grade jurisdiction. According to the civil procedure law, the general rule is that defendant's domicile or habitual residence regulates the territorial jurisdiction. In cases where more than one court at the same level claims its jurisdiction, the court that first accepted will hear the case. As for the grade jurisdiction, it is governed on the basis of cases. In most cases, the amount of disputed money is a crucial factor. Whether the case leads to sensitive social influence is also a significant consideration. Higher-level courts will be responsible for hearing cases either concerning a large amount of money, e.g. at least one million of RMB, or involving critical social impact. Chuan Feng, Leyton P. Nelson and Thomas W. Simon, *China's Changing Legal System: Lawyers & Judges on Civil & Criminal Law* (palgrave macmillan, 2016).

[19] Peter C.H. Chan, *Mediation in Contemporary Chinese Civil Justice: A Proceduralist Diachronic Perspective* (Brill/Nijhoff, 2017) 20.

Procedure Law, providing that 'when parties bring a lawsuit to a People's Court, and the dispute is appropriate for mediation, mediation shall first be attempted unless the parties refuse mediation'.[20] Under this new article, the court has broad discretionary powers to determine whether a case is suitable for mediation or not. Generally speaking, purely civil cases like matrimonial disputes or disputes between neighbours and other less complicated civil and commercial cases are deemed suitable for mediation.[21] In this respect, given most consumer debt cases are relatively low value, less complex and even undisputed, the courts may tend to mediate personal insolvency cases through the medication process.

If pre-trial mediation fails, the court will hear the case. Through the trial, the court will ascertain the facts and make a judgement. Pursuant to the judgment, the losing parties should take action to execute their obligations. However, the story between the creditors and individual debtors is far from over as not all debtors voluntarily carry out the requirements of the effective judgement. According to a report of the Supreme People's Court, the automatic performance rate of judgement instruments was 51% in 2016 and 57% in 2017 respectively.[22] When debtors fail to comply with their obligations for no matter what reasons, creditors can apply for compulsory enforcement in the court where they bring the lawsuit.[23] Then, the

[20] Civil Procedure Law of the People's Republic of China, Article 122.
[21] Office for Civil Law of the Legislative Affairs Commission of the National People's Congress Standing Committee (ed), The Civil Procedure Law of the People's Republic of China: Annotated Provisions, Legislative Reasoning and Related Regulations (2012 revised edition)(Peking University Press, 2012) (全国人大常委会法制工作委员会民法室编《中华人民共和国民事诉讼法条纹说明， 立法理由及相关规定 （2012） 修订版》（2012）北京大学出版社).
[22] The Supreme People's Court, Report of the Supreme People's Court on the Work of the People's Courts in Solving the 'Difficulties in Enforcement' (Law Press, 2018) 79.
[23] In addition to an effective judgment, the basis for enforcement includes arbitration awards, notarized claim rights and a mediation agreement confirmed by the court through judicial confirmation procedure.

court will exercise its power to collect the debt for the creditors. An enforcement tribunal or enforcement bureau in a court is responsible for the enforcement of a judgment. The main measures can be summarised as: '1. inquiry, seizure, and freezing of the assets of the debtor; 2. transfer the deposit of the debtor, detaining and distilling the income of the debtor; 3. sealing, seizure, freezing, auction, and sale of the property of the debtor; 4. searching for the concealed property of the debtor in their living space or other possible places; 5. compulsory liquidation of real estate.'[24]

Under some circumstances, the court may suspend or terminate an enforcement case. Cases suspended are those where non-substantial enforcement obstacles occur.[25] By contrast, terminated cases are those circumstances where debtors have no ability to fulfil an obligation or the legal judgement is revoked.[26] Regarding pecuniary defaulting cases, according to the civil procedure law, the compulsory enforcement against debtors who lack the ability to repay

[24] Qing-Yun Jiang, *Court Delay and Law Enforcement in China: Civil Process and Economic Perspective* (Gabler Edition Wissenschaft, 2006) 199; See also Civil Procedure of the People's Republic of China, Article 243 - 244.

[25] 'under any of the following circumstances, the people's court shall issue a ruling to suspend enforcement: (1) the applicant indicates the enforcement may be deferred. (2) a person which is not a party to the case raises any justified objection to the subject matter of enforcement. (3) a citizen as one of the parties dies and it is necessary to wait for his or her successors to succeed to his or her rights or obligations; (4) a legal persona or any other organization as one of the parties is terminated, and the successors to its rights and obligations have not been determined (5) other circumstances under which the people's court deems that enforcement shall be suspended. Enforcement shall be resumed after the circumstances causing suspension have disappeared' Civil Procedure of the People's Republic of China, Article 256.

[26] 'under any of the following circumstances, the people's court shall issue a ruling to terminate enforcement: (1) the applicant withdraws the application for enforcement. (2) the legal instrument on which enforcement is based has been revoked; (3) the citizens as the party against whom enforcement is sought dies, without any estate for enforcement, and no one succeeds to his or her obligations; (4) the person entitled to recover support for elderly parents, support for other adult dependents or child support dies; (5) the citizen as the party against whom enforcement is sought is unable to repay his or her borrowing for living in hardship, has no source of income, and has lost his or her ability to work. (6) other circumstances under which the people's court deems that enforcement shall be terminated.' Civil Procedure of the People's Republic of China, Article 257.

can be permanently terminated only in an extreme situation.[27] In cases where there is no property available to be collected, the present solution is to temporarily terminate the enforcement process.[28] However, the temporary termination of the enforcement does not amount to a discharge of debt. Creditors can still resort to extrajudicial remedies after the termination of the compulsory enforcement proceedings. Furthermore, temporarily terminated cases may possibly be resumed. If creditors find some clues indicating that judgment debtors have obtained any property, they can apply to resume compulsory enforcement.[29] Additionally, courts can sometimes restart the enforcement process *ex officio*.[30]

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[27] The special circumstance is stipulated in Article 257 (5) stating that "the citizen as the party against whom enforcement is sought is unable to repay his or her borrowing for living in hardship, has no source of income, and has lost his or her ability to work., Civil Procedure of the People's Republic of China, Article 257 (5).

[28] 'Under any of the following circumstances, a case may be concluded by means of "termination of the enforcement process": "(1) The party subject to enforcement has no property for enforcement, and the enforcement applicant provides written consent for the termination of the enforcement process by the people's court. (2) The enforcement has been suspended for two years because the party subject to enforcement has no property for enforcement and it is verified that the party subject to enforcement indeed has no property for enforcement. (3) The enforcement applicant expressly indicates that it or he is unable to locate the property of the party subject to enforcement or provide any clue as to where it might be located and confirms in writing the determination made by the people's court after exhausting all possible property investigation measures that the party subject to enforcement has no property for enforcement. (4) The property of the party subject to enforcement cannot be auctioned or sold, the movable property still cannot be sold after two auctions or the immovable property or any other property right still cannot be sold after three auctions, and the enforcement applicant refuses to accept such property to offset debts or the property cannot be delivered to offset debts in accordance with the law, and the people's court finds that the party subject to enforcement has no other property for enforcement after exhausting all possible property investigation measures. (5) The people's court finds that the party subject to enforcement has no property for enforcement or has property which is inappropriate for enforcement after exhausting all possible property investigation measures, and the parties reach a reconciliation agreement on performance in installments, and the performance of the agreement has yet been completed. (6) The party subject to enforcement has no property for enforcement, the enforcement applicant falls within a poverty-stricken group, and the enforcement court has granted proper relief money to the enforcement applicant….' Notice of the Supreme People's Court on Issuing the Opinions on Several Issues concerning the Filing and Conclusion of Enforcement Cases, Article 16.

[29] Notice of the Supreme People's Court on Issuing the Provisions on Strictly Regulating the Termination of the Enforcement Procedure (for Trial Implementation), Article 9.

[30]"…. Within five years after the termination of the enforcement procedure, the enforcement court shall inquire about the property of the judgment debtor through the system for network enforcement inquiry and control every six months and inform the enforcement applicant of the inquiry results. If

For debtors who fail to fulfil their obligations, the courts may restrict their high consumption activities. The legislative objective of a high consumption restriction order is to protect the 'lawful rights and interests of the enforcement applicants and persons subject to enforcement'.[31] It is considered as a safeguarding mechanism deterring culpable debtors from escaping their financial obligations. However, it appears to be that this safeguarding mechanism is overusing in enforcement procedure. Generally speaking, before the imposition of the consumption restriction, the court will consider whether debtors have ever failed to comply with obligations, evaded the fulfilment of their obligation or refused to perform, and also assess their capability to observe their responsibilities.[32] Therefore, theoretically, an honest debtor will not be subject to a high consumption restriction order just because of the inability to pay. In this sense, the court will exercise discretionary power to decide the honesty of defaulting individuals case by case.[33] However, if debtors are included on the list of persons judged to be dishonest,[34] the court must impose the high consumption limit orders on

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the conditions for resuming the enforcement are met, the enforcement court shall resume the enforcement in a timely manner." Ibid.

[31] Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Preamble.

[32] Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Article 2.

[33] Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Article 1.

[34] The list of dishonest debtors was introduced in 2013 for the purpose of promoting the voluntary performance of obligations determined in effective legal instruments and boosting the development of the social credit system. Debtors who fall into specific circumstances will be included on the list and will be considered to be culpable and dishonest. Those situations are: '(1) Having the capability of performing obligations but refusing to perform the obligations determined in the effective legal instrument. (2) Obstructing or resisting enforcement by forged evidence, violence, threat or any other method. (3) Evading enforcement by fraudulent litigation or false arbitration, concealment or transfer of property or any other method. (4) Violating the property reporting system. (5) Violating the Order on Restriction of Consumption. (6) Refusing to perform the enforcement reconciliation agreement without any good reason' Several Provisions of the Supreme People's Court on Issuing the Information on the List of Dishonest Judgement Debtors, Article 1.

them.[35] The definition of dishonesty is so broad. In practice, when debtors cannot comply with pecuniary obligations, they will be seen as dishonest individuals. As a result, they will be included on the list of persons judged to be dishonest and the high consumption restrictions will practically and compulsorily be imposed on all defaulting debtors, no matter whether they are culpable or not. Under the consumption restriction orders, debtors will be prohibited from high consumption or other consumption not necessary for life or work.[36] Those consumption restrictions can be lifted once debtors fulfil their obligations. Additionally, during the restriction period, if the person subject to enforcement provides a reliable and valid guarantee or obtains the consent of the enforcement applicant, the court shall lift the limit order.[37]

During the enforcement process, creditors and debtors may reach a compromise. The compromise will suspend enforcement cases under some circumstances.[38] Both parties can voluntarily negotiate the content of the compromise, which embodies the free will of both parties with the court playing a role in confirming the negotiated agreement. If debtors cannot

[35] Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Article 1.

[36] The legislation has listed some prohibited consumption behaviors: (1) To take an airplane, take the soft berth of a train, or take the second-class berth or above of a steamship as the means of transportation. (2) To have high consumption activities at star hotels, night clubs, golf courses, or other places. (3) To purchase real estate, or build, expand, or luxuriously furnish houses. (4) To rent high-end office buildings, hotels, apartments, or other places for conducting businesses. (5) To purchase vehicles not necessary for business operations. (6) To travel or take a vacation. (7) To send his or her children to high-cost private schools. (8) To purchase insurance and financial products by paying high premium. (9) To take any seat in G-category high speed train, or take a seat of the business class or a higher class in any other high speed train, or to have any other consumption not necessary for life or work.' Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Article 3.

[37] Several Provisions of the Supreme People's Court on Restricting High Consumption and Relevant Consumption of Persons Subject to Enforcement, Article 9.

[38] Provisions of the Supreme People's Court on Several Issues concerning Enforcement Compromise, Article 2.

fulfil the obligations included in the compromise, the creditor can apply for continuing the suspended enforcement procedure or bring a lawsuit to the enforcement court concerning the performance of the compromise.[39] But if the debtor completes the settlement, the enforcement case will be terminated.

In cases where more than one creditor applies for compulsory enforcement procedure, a participation-in-distribution mechanism may operate. The objective of such a mechanism is to deal with the distribution of debtors' insufficient assets among multiple creditors. When a debtor has already been subject to an enforcement process, other creditors who have the enforcement grounds can apply for participating in the distribution of assets.[40] Under this procedure, the court is responsible for proposing a property distribution plan and circulating it between creditors.[41] If no creditors object to the plan, debtors' assets will be distributed in accordance with the plan. After enforcement expenses and priority debts are paid off, unsecured debts will be paid according to their proportion of the total debts.[42] Because Chinese bankruptcy law does not apply to individuals, some scholars consider the participation-in-distribution procedure as a supplement of personal insolvency law, which fairly distributes debtors' assets.[43]

[39] Ibid Article 9.
[40]Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China, Article 508.
[41] Ibid Article 511.
[42] Ibid Article 510.
[43] 冀宗儒，民事诉讼法案例评析 (对外经济贸易大学出版社, 2004) 301 [Zongru JI, Case Analysis in Civil Procedure Law, (University of International Business and Economics Press, 2004) 301].

6.2.3 The drawbacks of current solutions to personal bankruptcy in China

After reviewing approaches to individual insolvencies in China, it seems that the current framework cannot fully replace the functions which personal bankruptcy law has. First, the participation-in-distribution process cannot take the place of personal bankruptcy law acting as a debt collection mechanism in cases where there are multiple creditors. To participate in the distribution, the creditor should obtain an effective judgment. However, for creditors whose claims are not due, they may not receive a judgment. As a result, even though those creditors know the debtor is insolvent, the absence of a court judgment will preclude them from participating in the distribution. In this sense, the principle of the participation-in-distribution mechanism is still 'first come, first served', which is distinct the collective debt collection approach in bankruptcy law. By contrast, the commencement of a bankruptcy proceeding has the effect of accelerating the process, meaning that the entire debt will become immediately due and payable. Additionally, the effect of the automatic stay in bankruptcy law inhibits creditors from recovering from the debtor or his property. In this sense, all creditors' claims will be addressed collectively but participating in distribution will not prevent both judicial and non-judicial debt collection. Therefore, it cannot address collective action problems. Also, the filing of a bankruptcy petition will create the bankruptcy estate, which will cover most debtor's property. However, in the participation-in-distribution process, what creditors can get results only from assets which have been seized and frozen by the court. Therefore, from a comparative perspective, the scope of assets is much narrower than the range of bankruptcy estate. Furthermore, no rules are regulating the avoidance power in

participation-in-distribution. However, bankruptcy law has made provisions relating to the avoidance of preferences, the avoidance of certain set-off rights and the avoidance of fraudulent transfers. In this respect, the participation-in-distribution procedure is a drawback in protecting creditors from debtors' abusive activities.

Last but not least, the participation-in-distribution mechanism does not keep strictly to the *pro rata* principle which is viewed as the golden rule in insolvency law. Under the participation-in-distribution mechanism, since debtors who first initiate the enforcement procedure devote their energy and time to investigating debtors' financial situations and preventing the depreciation of debtors' assets, later participants as free riders may benefit from those investigations and preservation efforts. Accordingly, some courts may not strictly obey the *pro rata* principle during the distribution and they may assign more as a reward to those diligent and dedicated creditors.[44] Therefore, even though both the participation-in-distribution rules and the personal bankruptcy law operate as debt collection mechanisms, the former may not be considered as a replacement of the latter.

Additionally, the current solution to individual overindebtedness reflects that creditors are in the advantageous position in the creditor-debtor relationship in and out of court. Before taking cases to the court, due to the absence of fair debt collection regulations, debtors may be at risk of improper debt collection methods. Only in extreme cases where debt collectors

[44]浙江省高级人民法院执行局关于印发《关于多个债权人对同一被执行人申请执行异议处理若干疑难问题的解答》的通知 （浙高法执［2012］ 5 号；重庆市高级人民法院关于执行工作适用法律若干问题的解答（一） （渝高法［2016］ 63 号）.

commit a serious crime such as false imprisonment, will the authority become involved. To an extent, it appears to be acquiescence of improper collection practices. Such acquiescence, more or less reflects legislators' tendency to neglect the probable harm resulting from improper collection practices and to prioritise creditors' interests. Though the court is involved in enforcement procedure, it appears to play the role of maximising returns. On the one hand, the court will carry out various measures such as sealing up, garnishing wages and freezing properties, to collect debt for creditors but on the other hand, the lack of discharge signifies the enforcement proceedings may be suspended though not terminated unless debtors meet their commitments.[45] Therefore, no matter whether in extrajudicial or in-court remedies, maximising creditor returns appears to be the most important concern.

Compared to the pursuit of maximising creditor returns, debtor recovery is to some degree downplayed. Civil Procedure Law stipulates the general principle that the people's court shall ensure that debtors can keep necessities of life for them and their dependent family members.[46]According to Provisions of the Supreme People's Court for the People's Courts to Seal up, Distrain and Freeze Properties in Civil Enforcement, some specific properties which are necessary for the life of the debtor and his dependent family members are immune from enforcement measures.[47] However, pecuniary debt cannot be discharged under the current

[45] As we have discussed in the last section, in some cases, the enforcement case will be terminated temporarily and will possibly be resumed later.

[46] Civil Procedure Law of the People's Republic of China, Article 244.

[47] 'The people's court shall not seal up, distrain or freeze the following properties of a the enforcee: (1) clothes, furniture, kitchenware, tableware and other necessities for family life, which are necessary for the life of the enforcee and his dependent family members; (2) living expenses necessary for the enforcee and his dependent family members. If there is a lowest local rate for security of living, the necessary living expenses shall be determined according to such rate; (3) articles necessary for the enforcee and his dependent family members to complete compulsory education; (4) unpublicized

Chinese legal framework. In other words, a debtor is still liable for his obligations. Despite legislation protecting some necessary properties during the compulsory enforcement procedure, no law prevents debtors from creditors' out-of-court collection methods. Therefore, creditors may pursue the self-help remedy to recover their loss and debtors have to get used to creditors' collection for the rest of their life. Furthermore, the establishment of the dishonest list system and the high consumption restriction order, has a negative impact on an individual debtor's daily life. Both institutions are designed for deterring culpable debtors. However, in practice, the inability to make payment can be a sufficient reason for being put on the record by the dishonest list system and the imposition of the high-consumption restriction order.[48] For individuals captured on the dishonest list, the consequences are serious. Those individuals may have difficulty in regard to their employment. In one instance, an employee was laid off because he was recorded on the dishonest list and could not purchase a plane ticket for a business trip.[49] Additionally, restricting defaulting debtors may have spill-over

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inventions or unpublished works; (5) auxiliary devices and medical articles necessary for the physical handicap of the enforcee and his dependent family members; (6) medals of the enforcee, and his other articles of honor and commendation; (7) properties immune from being sealed up, distrained or frozen, as prescribed in a treaty, agreement, or other document having the nature of a treaty or agreement, which is concluded in the name of the People's Republic of China, the Government of the People's Republic of China or a governmental department of the People's Republic of China with a foreign country or international organization in accordance with the Law of the People's Republic of China on the Procedures for Conclusion of Treaties ; (8) other properties prescribed in laws or judicial interpretations which shall not be sealed up, distrained or frozen." Provisions of the Supreme People's Court for the People's Courts to Seal up, Distrain and Freeze Properties in Civil Enforcement, Article 5.

[48] The High Court of Hainan has published five typical enforcement failure cases. Except for one case where the debtor is in prison, other debtors have all had restriction orders imposed on them. However, the high consumption restriction orders are imposed not because they escaped debts in bad faith but just because of their inability to pay. 邢东伟，翟小功，'海南高院发布五起执行不能典型案例'(法制日报－法制网，28th September 2018) (Dongwei Xing and Xiaogong Zhai, 'Five Representative Unenforceable Cases' (Legaldaily, 28th September 2018))< http://www.legaldaily.com.cn/index/content/2018-09/26/content_7655066.htm?node=20908 > accessed by 25 May 2020.

[49] 周再奔，'全国首例因失信被执行人身份遭公司辞退 江西公布 5 起典型案例'(中国江西网，21st February, 2017) (Zaiben Zhou, 'First Case Where an Employee is Fired Because of Defaulting Court Orders and Five Representative Unenforceable Cases in Jiangxi Province' (China Jiangxi, 21st February

effects on their families. For children, either of whose parents is subject to the dishonest list, it means they cannot attend a private school. What's worse, it has been reported in the news that a student cannot register in university because one of his parents is included in the dishonest list.[50] Some scholars justify this by stating that as children and their parents are in the same economic community, they are all economically responsible for the debt.[51] Moreover, to demonstrate the economic community, the spouse joint debt is used as an analogy.[52] It is not difficult to see that defaulting debtors take on an inferior status, whether they are culpable or honest but unfortunate. In this sense, debtor rehabilitation is hard to achieve.

6.3 Chinese social welfare system

6.3.1 The structure of social welfare in China

In the past decades, China has made significant efforts to build its social protection network. The current social welfare system is composed of two types of social programmes. One is the contributory social insurance including pension schemes, medical care system or unemployment insurance. The other is a non-contributory social assistance programme such

2017))<http://jx.ifeng.com/a/20170221/5403231_0.shtml> accessed by 25 May 2020.

[50] 中钢网，'国家宣布：一人失信，牵连全家！请立即结清欠款' (搜狐, 13th January 2019) (Zhonggang, 'One Default, All Influenced! Do Pay Off Debts' (Sohu, 13th January 2019))<https://www.sohu.com/a/288674790_141885> accessed by 25 May 2019.

[51] 徐国栋，*民法哲学* (中国法制出版社，2015) 202 (Guodong Xu, Philosophy of Civil Law (China Legal Publishing House, 2015) 202).

[52] 彭益鸿,论失信被执行人失权 [2017] 1 中山大学法律评论 24, 50 (Yijun Peng, Study on the Restriction on Rights of Dishonest Persons subject to Enforcement, [2017] 1 Sun Yatsen University Law Review, 24, 50).

as the Minimum Living Standard Guarantee System (dibao). The following section will outline China's social protection in detail and provide a brief assessment of how it performs in Chinese society.

a. Old-age pension system

The current old-age pension system comprises two parts. The first part is the Employee Old-Age Pension System (EOAPS), which applies to employees in enterprises, governmental organisations and public institutions, as well as migrant workers. The other is the Basic Pension Insurance for Urban and Rural Residents, which is a unification of the Urban Residents Pension Programme (URPP) and the New Rural Pension Programme (NRPP).

The Employee Old-Age Pension System (EOAPS) was established to support the SOE restructuring in the 1990s. Prior to the economic reform, urban workers attached to their work units could enjoy comprehensive protection.[53] When the SOE reform was initiated, the urban workers' iron bowl was shattered, which meant that the lifelong connections between workers and the work unit no longer existed. Against this background, China began to construct its social safety net and as a result of this, the EOAPS was established in 1997.

The State Council has stipulated in the Decisions on Construction on Workers Basic Pension Schemes that both individuals and enterprises should contribute to this pension programme.

[53] Fang Cai and Yang Du, The Social Protection System in Aging China, [2015] 10 Asian Economic Policy Review 250.

With some adjustments,[54] the current rule requires that employees contribute 8% and employers contribute 20% of the total wage to the pension fund. The contribution from employers enters the social pooling account, while the fund from employees is separately managed in an individual account. The objective of this tactic is to prevent the social pooling from acquiring funds from individual accounts.

The Urban Residents Pension Programme (URPP) was initiated in several pilot cities including Beijing, Chongqing, Xi'an and Kunming in 2009 and was adopted nationwide in 2012. As a voluntary programme, the initial objective of URPP was to cover urban residents who are outside the formal workplace.[55] According to the 2011 Guidelines for Establishing Urban ROAPS, urban residents who are over 16 and currently not in education can voluntarily participate in the system in their place of residence.[56] Even though the Guidelines became ineffective after 2015, urban residents aged 16 or above not currently in education are still eligible to engage in the URPP.[57]

Presently, funds for the URPP are from individual contributions and subsidies from the government. Unlike EOAPS, funds from government and individuals are managed in an individual account including basic pensions and individual pensions. The annual individual

[54] See more about the program's modification in Joe C. B. Leung and Yuebin Xu, *China's Social Welfare: The Third Turning Poin,* (2015, Cambridge: Polity).
[55] Ibid.
[56] 国务院 (The State Council), 关于开展城镇居民社会养老保险试点的指导意见(现已失效) [Guideline Opinions of the State Council on Developing Pilots of Social Pension Scheme in Urban Area (ineffective)].
[57] The State Council, Opinions of the State Council on Establishing a Unified Basic Pension Insurance System for Urban and Rural Residents.

contribution is set at 12 levels, ranging from RMB 100 to RMB 2000.[58] Participants can voluntarily opt for one level to make contributions. The governmental subsidies forming the basic pensions come from both central and local government. The central government will subsidise residents[59] who are eligible to withdraw pensions since the programme began. The central government will cover all expenditure on basic pensions for the central and western areas but only 50% for eastern regions. Beyond that, the local government in eastern regions is responsible for contributing to the basic pensions.

In 2007, a new type of rural pension scheme funded by government was piloted in several cities and provinces. During the 17th CPC Congress, all local governments were encouraged to introduce a pension programme for rural residents. This new type of rural pension programme is similar to the URPP in terms of the targeted group, institutional design and management, which aims to promote rural-urban mobility.[60] As a result, the New Rural Pension Programme was launched and expanded nationwide; in 2014, it was formally combined with the URPP under the Opinions on Establishing a Unified Urban and Rural Pension System. Since then, those two pension programmes have been merged as the Basic Pension Insurance for Urban and Rural Residents (BPIURR).

Rural dwellers aged over 16 can voluntarily participate in the programme. Individuals, the collective community and government are responsible for financing this pension scheme.

[58] Ibid.
[59] Those eligible residents are those elderly aged 60 or older.
[60] Leung and Xu (n.54) 103.

Rural residents can make contributions to the scheme at five levels, RMB 100, 200, 300, 400 and 500, respectively. Participants can freely select the level of contribution but the higher the contributions are; the more benefits residents will obtain when they come to withdraw their pensions. Contributions made by the collective will be determined by the rural autonomous organisation (village committees). Both central and local government will finance this programme. The central government will fully subsidise the capital of the basic tier in western and central regions but only 50% in the eastern regions. Local governments are required to finance at least RMB 30 for each enrollee.

Participants who attain the age of 60 and have made contributions for 15 years can receive pension benefits. Those who had already reached 60 when the scheme started are permitted to withdraw the basic pensions even though they did not make contributions. However, their children should register in the scheme and make contributions for their parents. The NRPP benefits consist of two parts: a basic pension and an individual account pension. A basic pension is set by the central government at the level of RMB 55 per month. Meanwhile, participants will receive the monthly payment equal to the total savings divided by 139 from the individual account.

b. Unemployment Insurance

In China, the term "unemployment" was not used officially until China's economic reforms.[61] But as the reforms of SOEs were introduced in the late twentieth century, the unemployment

[61] Instead, unemployed individuals were called surplus employees. Ibid 145.

rate began to increase. SOEs were encouraged to relocate their labour resources through methods including "optimising and regrouping and assignment of posts through merit".[62] Without the government guaranteed place to work, many workers became unemployed due to the bankruptcy or dismissal of SOEs.

Accordingly, to cushion the unemployment resulting from economic reforms, China launched its first unemployment insurance programme in 1986.[63] Following decades have witnessed the development of the unemployment insurance.[64] Currently unemployment insurance is regulated by the State Council's Regulation on Unemployment Insurance and the Social Insurance Law. At present, all employees excluding civil servants must participate in the unemployment insurance programme.[65] Enterprises need to contribute 2% based on their total amount of salaries [66] and employees are made to contribute 1% of their wages.[67] To receive benefits from the unemployment insurance programme, workers should meet several requirements.[68] In addition, the maximum period for receiving unemployment insurance benefits is 24 months if employees have contributed for over 10 years, 18 months if they have covered services for five to ten years and 12 months if they have paid the premiums for a cumulative period ranging from one year to five years.[69] If a re-employed worker loses his job

[62] Ibid 146.
[63] Ibid 78.
[64] See more about the development of Chinese unemployment insurance in Ibid 145-150.
[65] Social Insurance Law, Article 44.
[66] The State Council, Regulations on Unemployment Insurance, Article 6.
[67] Ibid.
[68] Those three requirements are: a. before he/she becomes unemployed, his/her employer and he/she have paid the unemployment insurance premiums for one year or more; b. his/her employment is discontinued against his/her will; c. he/she has performed unemployment registration and filed a job application. Social Insurance Law, Article 45.
[69] Social Insurance Law, Article 46.

again, the period of premium payment will be recalculated, however, the maximum period for receiving benefits will include previous years of entitlement.[70] The benefit rates will not be determined by the central government. Instead, the local government will be responsible to regulate benefit rates. Furthermore, the benefits of unemployment insurance have no links with previous income levels. In practice, the unemployment benefits should be below the local minimum wage but above the minimum living safeguard for urban residents.[71]

c. Medical Insurance System

The current medical insurance system for urban residents consists of two schemes: Urban Employee Basic Medical Insurance and Urban Resident Basic Medical Insurance. The Urban Employee Basic Medical Insurance Scheme (UEBMIS) was launched in the late 1990s. The funding of the programme is based on social pooling and individual accounts. All types of urban employees are required to participate in this scheme by contributing 2% of their wages while employers are required to pay 6%. Individual contributions will enter individual accounts. 30% of employers' contributions will go into individual accounts while the rest will be put into social pooling.

Regarding the benefits of UEBMIS, 10 percent of the local average wage was set as a standard above which urban residents can claim for reimbursement, no more than a ceiling of 4 times the average wage in earlier years. If the medical costs are below the floor of 10 per cent, they can be paid through the personal account or by residents themselves. The rates for eligibility

[70] Ibid.

[71] Social Insurance Law, Article 47; The State Council, Regulations on Unemployment Insurance Article 18.

standard, the ceiling and the reimbursement are adjustable because city human resources and social security bureaus can determine the exact rates in terms of rebalancing revenues with expenditure.

First piloted in several cities in 2007, the Urban Resident Basic Medical Insurance was adopted nationwide in 2010. This programme aims to cover residents who are not included in the UEBMIS. Children, students, unemployed and other informally employed residents can voluntarily participate in this scheme but at the household level. This programme is funded by contributions from households and government subsidies. Given that local governments have a certain degree of discretion in designing their schemes, the exact rates of premiums and subsidies, as well as the benefit packages differ nationwide.

In the rural regions, the previous Rural Cooperative Medical System (RCMS) had played a significant role in providing health care for rural residents before economic reforms.[72] As the Household Responsibility System was proposed in China, the RCMS ceased to operate. In order to fill the gap in rural health insurance, the New Cooperative Medical System (NCMS) was started in the early 2000s.

Under the NCMS, catastrophic illness and in-patient care are covered. Rural residents can freely participate in the scheme. Stakeholders who make contributions to the system include individuals, local and central government. At first, the central and local government subsidised

[72] Leung and Xu (n.54) 208.

each participant to the sum of RMB 20 and these increased periodically; between 2003 and 2014, subsidies from government rose from RMB 20 to RMB 320 per person per year.[73] During the same period, individual contributions grew from RMB 10 to RMB 70.[74] At present, government aid has increased to RMB 520 and individual contributions have reached RMB 250.[75]

d. Social Assistance

The emergence of social assistance protection was in response to dealing with urban poverty resulting from laid-off workers in SOEs in the 1990s. Over the decades, social assistance programmes have developed. Currently, various schemes, including the Minimum Living Standard Guarantee System (dibao), medical assistance, education assistance, employment assistance, housing assistance and temporary assistance, have formed a comprehensive social assistance system. In addition, both rural and urban residents are covered in all those social aid schemes. Among these programmes, the dibao system is the major player since other schemes are mainly made available to dibao beneficiaries. In other words, dibao functions as the qualifying requirement for residents to be covered by other programmes.

The Minimum Living Standard Guarantee System (dibao) is an institutional means-tested programme and provides cash assistance to households whose average income is below the threshold set by local governments. It plays a role in helping poverty-stricken households to

[73] Ibid 121
[74] Ibid
[75] 国家医疗保障局 (National Healthcare Security Administration)、财政部（Ministry of Finance），"关于做好 2019 年城乡居民基本医疗保障工作的通知"(The Notification on Guaranteeing the Work of Urban and Rural Medical Insurance in 2019) 医保发［2019］30 号.

live at a subsistence level. Beneficiaries can receive an allowance up to the minimum living line. The assistance line is determined by the minimum costs of necessities such as food, electricity, water, etcetera. Furthermore, the local government will also consider its financial capacity when determining the assistance line.[76] As a result, the minimum living line varies across the country. For instance, the urban average standard line in 2013 was 373 Yuan (about 41 GBP) per head per month, which is only 16.6% of the average disposable income. However, the urban standards differ from 277 Yuan (around 32 GBP) in Ningxia to 640 Yuan (around 74 GBP) in Shanghai.[77]

6.3.2 The performance of China's social welfare

In theory, the debt relief mechanism functions as a form of social insurance. Bankruptcy protection and some social programmes may overlap in function and are substitutes for each other.[78] Therefore, this section will explore how China's social insurance programmes perform in practice and whether there is a need to introduce personal bankruptcy law.

The performance of China's social welfare has reflected several themes. Given the lack of a unified system across China, contemporary social protection policies are devised segmentally between rural and urban areas. The early development of the social security system was

[76] Haomiao Zhang, 'The Social Assistance Policy in Urban China: A Critical Review' [2015] 35 International Journal of Sociology and Social Policy 403.
[77] Ministry of Civil Affairs, 2012 Annual Statistical Report on Social Service Development.
[78] Adam Feibelman, 'Defining the Social Insurance Function of Consumer Bankruptcy' [2005] 13 American Bankruptcy Institute Law Review 129.

mainly driven by reducing the financial burden of SOEs and promoting their restructuring to improve competitiveness. In other words, social protection programmes in rural regions lag behind their counterparts in cities. For instance, the pension system was first introduced in the 1990s for urban residents in the formal sector, and subsequently expanded to rural residents almost two decades later.[79]One issue resulting from the institutional disparities is the substantial gap in benefits between urban and rural residents. Taking the pension schemes as an example, in 2011, the average monthly entitlement for urban retirees ranged from RMB 1528 to RMB 2241.[80] Comparatively, the benefits provided in a rural pension programme may be limited. For instance, the minimum monthly sum in NRPP may be RMB 55, which is much less than the benefits of urban residents. The disparities not only exist in the pension schemes; they also occur in other social insurance programmes. According to the data from the National Health Statistics in 2013, the *per-capita* fund under NCMC, URBMI and UEBMI are $61.2, $66.2 and $424.7 respectively. Furthermore, researchers have shown that the rural medical scheme, NCMC, offers less generous benefits packages than the urban employed-based medical insurance, particularly for out-patient services.[81] Thus, due to the imbalanced development of social protection programmes between rural and urban regions, the disparities seem to be inevitable.

[79] Leung and Xu (n.54) 75

[80] Retirees from enterprises receive RMB 1528. Benefits for those from public institutions and government organizations are RMB 2105 and RMB 2241, respectively. National Bureau of Statistics and Ministry of Human Resources and Social Security, China Labor Statistical Yearbook 2012 (Beijing: China Statistics, 2012).

[81] Qingyue Meng, Hai Fang, Xiaoyun Liu, Beibei Yuan and Jinxu Ba, Consolidating the Social Health Insurance Schemes in China: Towards an Equitable and Efficient Health System, [2015] 386(10002) The Lancet, 1484.

Although there are disparities between urban and rural areas, China's social insurance system has made a significant achievement in terms of the coverage rate except for unemployment insurance. The table below indicates how the coverage of China's major social security programmes changed between 2009 and 2017. The data has shown that China's efforts to make a comprehensive social protection system for its large population are on track. The coverage rate of the Basic Pension Insurance for Urban and Rural Residents was over 85% in 2017.[82] In addition to the pension schemes, the medical insurance system has also made remarkable progress on covering Chinese residents. As we can see from the table, medical insurance expanded rapidly between 2009 and 2017. In effect, the coverage rate of China's medical insurance exceeded 95% in 2016.[83] However, compared with other major social insurance programmes, unemployment insurance seems to be underdeveloped. Although the unemployment insurance is a compulsory programme, it is only applicable to urban employees. In other words, there is no unemployment insurance for rural workers. As a result, unemployment insurance covers only 23% of China's total workforce.[84] According to Bösch, the low unemployment insurance coverage rate exists for several reasons; first, because many companies can escape from paying-out benefits, also that individuals outside the formal sector have limited access to unemployment insurance, and further, that local authorities may

[82] 中华人民共和国人力资源和社会保障部（Ministry of Human Resources and Social Security of the People's Republic of China），'城乡居民养老保险跨入新时代'(The Basic Pension Insurance for Urban and Rural Residents Reached a New Stage) < http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/buneiyaowen/201804/t20180402_291432.html > accessed by 25 August 2019.

[83] The State Council Information Office of the People's Republic of China, 'Development of China's Public Health as an Essential Element of Human Rights'< http://www.scio.gov.cn/zfbps/ndhf/36088/Document/1565111/1565111.htm > accessed by 25th August 2019.

[84] Hande Gencer, *How to Classify the Chinese Welfare State* (Master thesis, University of Bremen, 2017) 52

misuse those contribution payments.[85]

Table 1: The Coverage of Major Social Insurance Programmes in China between 2009-2017 (10000 persons)[86]

	2017	2016	2015	2014	2013	2012	2011	2010	2009
EOAPS	40293.3	37929.7	35361.2	34124.4	32218.4	30426.8	28391.3	25707.3	23549.9
BPIURR[87]	No data	No data	50472.2	50107.5	49750.1	48369.5	No data	No data	No data
UI[88]	18784.2	18088.8	17326.0	17042.6	16416.8	15224.7	14317.1	13375.6	12715.5
UBMI[89]	117681.4	74391.6	66581.6	59746.9	57072.6	53641.3	47343.2	No data	40147.0

There is no doubt that the social insurance programme has expanded dramatically in China. However, regardless of the existence of gaps between rural and urban regions, the overall benefit levels in China's social protection programme are low. Taking pension schemes as an example, according to China Social Security System Development Report estimates, the average pension replacement rate[90] in China is less than 50%.[91] Estimated by the Chinese

[85] Ibid

[86] National Bureau of Statistics of China, National Data <http://data.stats.gov.cn/english/easyquery.htm?cn=C01> accessed by 24 August 2019.

[87] BPIURR means the Basic Pension Insurance for Urban and Rural Residents.

[88] UI means Unemployment Insurance,

[89] UBMI means Urban Basic Medical Insurance. Since 2007, the number of participants in Urban Basic Medical Insurance refers to the number of enrollees both in Urban Employee Basic Medical Insurance and Urban Resident Basic Medical Insurance.

[90] According to OECD, the replacement rate is defined as 'gross pension entitlement divided by gross pre-retirement earnings. It is a measure of how effectively a pension system provides income during retirement to replace earnings, the main source of income prior to retirement' OECD Data, 'Gross Pension Replacement Rates'< https://data.oecd.org/pension/gross-pension-replacement-rates.htm#indicator-chart > accessed by 25 August 2019.

[91] 王延中，社会保障绿皮书：中国社会保障发展报告 No.10（社会科学文献出版社，2019）

Academy of Social Sciences (CASS) in 2012, China's pension replacement rate declined from 72.9% in 2002 to 57.7% in 2005 and reached around 50% in 2011.[92] Furthermore, a gap exists in the pension entitlement. The CASS data[93] has indicated that the amount of entitlement received by a retiree in August 2011 ranges from RMB 200 to RMB 10,000. Meanwhile, more than 75% of retirees receive below RMB 2,000 and 77.3% were less than the average RMB 2,615.[94] Until 2017, the average pension entitlement was RMB 125 per person per month.[95]However, social insurance programmes such as pension schemes, medical insurance and unemployment insurance are contributory programmes. The guiding principle is "the more you contribute, the more you will receive". Given that the various programmes did not start at the same time, the fund pooling of later programmes is reasonably less than previously established programmes.

In effect, to understand the low benefit levels of China's social protection programmes, the performance of the non-contributory social assistance system may be a better example. As we have outlined above, China's contemporary social assistance scheme consists of a major Minimum Living Standard Guarantee System (dibao) and other ancillary social aids such as

(Yanzhong Wang, Green Book of China Social Security System: China Social Security System Development Report No.10 (Social Science Academic Press, 2019)).

92 中国财经，'我国养老金替代率跌破国际警戒线''(China's Pension Replacement Rate Fell Below the International Warning Line')< http://finance.china.com.cn/roll/20130919/1825334.shtml > accessed by 26 August 2019.

93 Cited in Leung and Xu (n.54) 76.

94 Ibid.

95 中华人民共和国人力资源和社会保障部（Ministry of Human Resources and Social Security of the People's Republic of China）,'城乡居民养老保险跨入新时代'(The Basic Pension Insurance for Urban and Rural Residents Reached a New Stage) < http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/buneiyaowen/201804/t20180402_291432.html > accessed by 25th August 2019.

education assistance, medical assistance and employment assistance. Researchers have already pointed out that the cash support from dibao is insufficient. The principle of dibao is to keep recipients' living standard at the subsistence level. The data below shows the variation of dibao standards between 2008 and 2017.[96] Indeed, the dibao allowance is increasing both in urban and rural areas. However, in practice, the fact is that it is too low to keep an average living standard.[97] The dibao allowance only accounted for a small proportion of the average disposable income. For example, the urban dibao allowance in 2013 only accounted for 16.6% of the average disposable income. In most cases, the dibao standard cannot help residents to maintain even a very basic living.[98] Furthermore, it seems that dibao benefit levels increase relatively slower than inflation. Although there is no accurate data, interviewees in a study expressed that the increase in dibao allowances cannot help them to catch up with their living expenses.[99] As for other ancillary social aid schemes, it seems that their effects are limited. A study based on Chengdu's social assistance system indicates that those special assistance programmes cannot provide much help for those vulnerable residents.[100] However, given the absence of systematic literature relating to other special programmes at a national level, we

[96] Ministry of Civil Affairs, China Civil Affairs' Statistical Yearbook 2018 (2018).
[97] Qin Gao, 'Public assistance and poverty reduction: the case of Shanghai' [2013] 13(2) Global Social Policy 193.
[98] Dorothy J. Solinger, 'A Question of Confidence: State Legitimacy and the New Urban Poor' in Peter Gries and Stanley Rosen (Eds), *Chinese Politics: State, Society, and the Market* (Routledge, 2010).
[99] In a study researching the social assistance program in Chengdu, one of interviewees states that "Now everything's price is increasing. My Dibao allowance only increased a little during the last two years. I could not make ends meet although we seldom eat meat, fish or milk. I'm fine with the diet but really worried about my son. He is shorter and thinner than his classmates, and gets sick easily." Another interviewee explains that "I have liver disease and need to buy medicine every month. Although I choose the cheapest medicine, it is still a heavy burden on my family. We always eat cheap vegetables with staple food, such as rice and wheat. But the expenditure outweighs the income every month. We have to borrow money from my cousins. I hope the benefit of urban Dibao could be increased, 80-100 RMB would help a lot. " Haomiao Zhang, 'The Social Assistance Policy in Urban China: A Critical Review' [2015] 35 International Journal of Sociology and Social Policy 403, 409.
[100] Ibid 410

should draw a cautious conclusion about their real effects.

Average Dibao Standards between 2008-2017 (RMB/Per person/Per month)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Urban	205	228	251	288	330	373	411	451	495	541
Rural	82	101	117	143	172	203	231	265	312	358

Source: Ministry of Civil Affairs, China Civil Affairs' Statistical Yearbook 2018

6.3.3 Chinese Social Welfare System and Personal Bankruptcy Law

At a comparative level, the institutional designs of the Chinese welfare system seem to include elements of three welfare models.[101] The Chinese welfare system is closely similar to a conservative-corporatist model in which social benefits are based on past contributions and employment records. However, there are several differences between the conservative-corporatist model and the Chinese welfare system. On the one hand, current Chinese social insurance systems are not divided along vocational lines; by contrast, the divergence in Chinese social insurance is between the urban-employed workers and the rest of the population including rural individuals, unemployed residents, and within the urban labour

[101] Esping-Andersen's research has established a convincing typology of the modern welfare state: a social-democratic model, a conservative-corporatist model and a liberal welfare-state model. In a liberal welfare-state regime, public welfare provision and regulation are at the minimum level and individuals are supposed to care for themselves. Hence, the liberal states tend to provide means-tested social assistance with social stigma, limited social insurance, and private market solutions such as company-based welfare. In the conservative-corporatist model, benefits rely on employment records and past contributions. The institutional design of the conservative-corporatist model reflects occupationally divided social insurance schemes supplemented by NGO-based social service provision. Under the social-democratic model, the state functions as the dominant welfare provider. Institutionally, this model pursues the universal social security and welfare programs. Gøsta Esping-Anderse, The Three Worlds of Welfare Capitalism (Cambridge: Polity, 1990).

force, between the formal sector and other groups of employees, for example, the self-employed, part-time workers and migrant workers. On the other hand, in the conservative-corporatist model, social rights for unemployed individuals typically come from the previous status of employment. Due to the establishment of the residence–based schemes for unemployed urban residents and the whole rural population, the Chinese welfare regime is more universal than the conservative-corporatist model, expressing a policy inclination to universal social insurance. However, we should notice that urban residents have more comprehensive risk coverage than the rural population. In this respect, rural households only have access to pension and health insurance and they are excluded from unemployment insurance. In this sense, the Chinese welfare system is different from the social-democratic model in which the state is the dominant welfare provider. The absence of comprehensive risk coverage for the rural population leads the market and the family to assume a strong role in welfare provision. Therefore, to some extent, at least for rural residents, the Chinese welfare system may share some commonalities with the liberal welfare regime in terms of the dependence on private welfare provision. This welfare mix expresses 'a considerable policy commitment to universal social insurance, albeit with gaps in the social security system which reinforce the role of the family outside the urban formal employment sector, especially for rural residents'[102].

The abovementioned characteristics of the Chinese welfare system may justify the

[102] Hande Gencer, 'How to Classify the Chinese Welfare State' (Master thesis, University of Bremen, 2017) 53.

introduction of personal bankruptcy law. Theoretically, the discharge policy in bankruptcy law functions as social insurance, insuring individuals against the risks of income disruption, medical-related debts, disability and financial consequences of relationship breakdown.[103] Existing research has strongly indicated that bankruptcy and other social insurance programmes have overlapping functions.[104] To an extent, bankruptcy law can be theoretically assumed as a potential substitute for other social insurance programmes.[105] Given this, when a welfare state is reluctant to or fails to devote public resources to establishing a comprehensive social insurance system, to a certain extent the personal bankruptcy law can fill such a gap. In the Chinese context, policymakers are inclined to establish universal social insurance. However, in the Chinese social security system, there are significant differences between urban residents and the rural population and between employees in the formal sector and other types of workers. As a result, the benefit distribution is unequal. Furthermore, individuals including rural residents or workers outside the formal sector have fewer social benefits. Ironically, those vulnerable individuals may be the most inferior risk bearers and need more help from the state. However, the absence of a universal social insurance system makes vulnerable groups depend more on the market such as credit and their families. Some families may fall over the financial edge resulting from serious illness or wage interruption. Given this, the establishment of personal bankruptcy law can, more or less, function as a 'universal social

[103] Feibelman (n.78) 132.

[104] 'The dynamic of capitalism, combined with a thin social safety net, guarantees that some families will always fail. Without universal health insurance to protect every family from the financial ravages of illness and without higher levels of unemployment compensation to cushion the effects of a layoff , each day, in good times and in bad, some families will fall over the financial edge' Teresa A Sullivan, *The Fragile Middle Class: American in Debt* (Yale University Press 2000) 3.

[105] Feibelman (n.78) 132.

insurance' insuring vulnerable individuals against financial risk.

6.4 Conclusion

The first part of this chapter lays out the institutional designs of Chinese enforcement procedure. It argues that the existing enforcement process fails to function as a collective debt collection device and cannot provide sufficient debtor rehabilitation. In relation to the debt collection function, the participation-in-distribution is different from the function of personal bankruptcy law in some significant aspects. First, not all creditors can gain access to the participation-in-distribution system and only creditors who receive a court judgement can participate in the process. 'First come, first serve' is still the principle. Additionally, compared with bankruptcy law, there is no automatic stay and the scope of assets is narrower than the concept of the bankruptcy estate in participation-in-distribution. In the meantime, the participation-in-distribution mechanism does not establish the claw-back power which is significant in bankruptcy law. All factors together appear to indicate that the participation-in-distribution system cannot provide fair and orderly distribution where there are multiple creditors.

With regards to debtor rehabilitation, it is limited because of the absence of discharge and strict restrictions imposed on defaulting debtors. To prevent debtor fraud, several institutions such as the list of dishonest judgment debtors and high consumption restriction orders have been introduced. However, in practice, the inability to pay is a sufficient reason for the imposition of high consumption restrictions and inclusion on the dishonest list. It seems that

current system does not establish clear distinction between culpable and honest debtors. The consequences of being a dishonest individual are serious. Not only will the debtor himself be restricted in daily life, his children might be negatively influenced. Therefore, China's current treatment of personal bankruptcy does not offer debtor rehabilitation, but seemingly aggravates the consequences of overindebtedness.

The second part of this chapter discusses the Chinese welfare system. Given that the personal bankruptcy law and other social insurance programmes have overlapping functions and substitute at the theoretical perspective, this chapter assumes that a nation with a comprehensive social insurance system has fewer incentives to introduce a personal bankruptcy system. After reviewing the structure of the Chinese welfare system and its performance, this chapter argues that there is a need to introduce a personal bankruptcy law, the reason being that the current Chinese welfare system has limitations to insure vulnerable groups such as rural residents against financial risks, though policymakers have an inclination to a universal social insurance system. Given this, the bankruptcy law can fill this gap and provide insurance for those vulnerable individuals.

CHAPTER 7 OBSTACLES OF INTRODUCING PERSONAL BANKRUPTCY LAW IN CHINA

7.1 Introduction

As consumer credit continues its increasing trend in China, it is inevitable that policymakers consider the solution to related consequences such as individual over-indebtedness especially since the current legal and social security systems in China are not competent to deal with over-indebtedness effectively. Placing excessive emphasis on creditor wealth maximisation in current legal framework may fail to resolve those direct and indirect costs resulting from over-indebtedness. Additionally, although the Chinese social insurance system has improved a lot in the past three decades, it has shortcomings. One of these is the distinction in risk coverage between urban residents and the rural population; another, its limited benefit generosity. Currently, the social security system can only provide modest help for over-indebted individuals. Furthermore, the absence of debt discharge enables creditors to collect benefits from welfare provision, which may make those entitlements meaningless. Therefore, how to tackle potential over-indebtedness issues should be high on the policymakers' agenda.

Experiences from other jurisdictions indicate that personal bankruptcy law is commonly regarded as an effective solution to individual over-indebtedness. To some extent, the law's insurance function can insure individuals against financial risks and supplement other social insurance programmes. That is why more and more countries have enacted their individual

bankruptcy legislation since the 1990s when the over-indebtedness issue became serious.[1] Given that, covering individuals in current Chinese bankruptcy legislation may be an appropriate response to over-indebtedness in the Chinese context.

When legislators in a country have no relevant prior knowledge in a specific area of law, it is reasonable to borrow legal rules from other jurisdictions.[2] The process of borrowing is regarded as legal transplantation. Although views on the possibility of legal transplantation are conflicting at the theoretical level,[3] in reality, the legal transplantation process is commonplace around the world. Furthermore, with regards to the Chinese legal system, its development can be seen as a story of legal transplantation and Chinese legal history indicates that Chinese lawmakers are not resistant to the process of legal transplantation. In effect, from the perspective of Chinese scholars, legal transplantation is a low-cost approach to investigating problems, researching and verifying models and drafting bills.[4] In this sense, borrowing legal rules relating to personal bankruptcy law from other jurisdictions is theoretically acceptable from the perspective of Chinese legislators.

However, beyond the ability to use legal transplantation, one should also examine whether the transplanted legislation can be well-received. Although it is difficult to precisely measure

[1] Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 3-4.
[2] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edition, Athens: University of Georgia Press, 1993).
[3] See more discussion in section 7.2.
[4] Chenguang Wang, 'Butong guojia falv jian de xianghu jiejian yu xishou' (in Chinese) [1992] 4 China Legal Science 39.

the success or failure of legal transplantation, scholars have at least pointed out some determinants to evaluate how far a foreign rule is accepted in a recipient country.[5] The general principle is that 'the more foreign rules can fit into the environment of a society, the better those rules are received'.[6] The environment of a society refers not only to informal cultural factors such as traditions, social norms or values but also institutions which help to enforce the new legislation.

Given this, this chapter will examine the extent to which personal bankruptcy law can fit Chinese conditions. When the reform of bankruptcy law was carried out in the early 2000s, natural persons were excluded because of the absence of well-developed institutions such as a property registration system and credit report mechanism. Policymakers viewed those institutions as necessary elements to enforce personal bankruptcy law. However, this chapter argues that both the property registration system and credit score mechanism have experienced significant development in the last decade. Those developments imply that they can be competent to support the enforcement of a personal bankruptcy system. Therefore, previous opposition focusing on institutional issues has become outdated. In addition to the institutional concerns, this chapter also reviews how the ideas of personal bankruptcy law can fit into Chinese culture. Therefore, we interpret bankruptcy discharge in the context of traditional Confucianism. The reason to establish such a connection is that Confucianism continues to influence many aspects of Chinese society including legal thinking and practice.

[5] There is a brief summary in Mathisa Siems, *Comparative Law* (Cambridge University Press, 2014) 198.
[6] Ibid.

Therefore, we wish to find out whether the fresh start concept can fit into a Confucian world. This chapter argues that forgiving an insolvent debtor is not reflected in Confucian ethics. However, if a personal bankruptcy system can solve disputes between creditors and debtors and can contribute to the establishment of a harmonious society, such a system is possibly accepted in the Confucian world. Therefore, we conclude that cultural obstacles deriving from Confucianism may not be a significant concern.

This chapter is structured as follows: the second section will theoretically discuss the legal transplant. It will explain whether legal borrowing is possible and discuss factors influencing how far foreign rules can be received by a nation. Then, the third section will outline those opposite views on introducing personal bankruptcy law in China. Meanwhile, it will argue that those former opinions are outdated and have become untenable. Then, the chapter will demonstrate how the fresh start idea in personal bankruptcy law can fit into Confucian thinking. In the end, this chapter will conclude briefly that the introduction of personal bankruptcy law is generally consistent with Chinese conditions.

7.2 Discussion on Legal Transplantation

The last chapter explored the existing individual enforcement system in China and its welfare system. However, both institutions have limitations on debtor recovery. Therefore, we argue that Chinese policymakers should pave the way for the introduction of a personal bankruptcy system. However, in the context of China, personal bankruptcy legislation is a relatively

unfamiliar area for legislators. In Chinese history, the first bankruptcy law was introduced by the Qing dynasty in 1905. The bankruptcy law in the Qing dynasty stipulated that both merchants (natural person traders) and non-trader individuals could file for bankruptcy.[7] Even though there was a distinction between consumers and merchants, at least the law applied to individuals. However, following debates about some of the provisions, this first Chinese bankruptcy law was abolished after operating for only a short period of time.[8] When Kuomingtang became the ruler of China, a new bankruptcy law was passed on July 17, 1935. The 1935 bankruptcy law did not distinguish between traders and consumers. Moreover, it extended the law to companies, partnerships, and deceased debtors.[9] Since the foundation of the new Republic in 1949, all legislation enacted by the Kuomingtang government has been abolished and the 1935 bankruptcy law did not survive in mainland China. The Communist government drafted an insolvency law in the 1980s and in 2007 a reformed bankruptcy law came into force. However, both the 1986 and 2007 bankruptcy laws can only apply to companies and they exclude individuals. Therefore, the timeline of the development of bankruptcy law implies that Communist legislators have limited domestic experience with regard to personal bankruptcy law.

Against this background, legal borrowing or legal transplantation may play an important part in the legislative process of Chinese personal bankruptcy law. When legislators in a country

[7] Nieh-Yun Chang, Translation of the Chinese Bankruptcy Code of 1905 (Forgotten Books, 2018).
[8] 许德风，破产法论：解释与功能比较的视野（北京大学出版社，2015）56（Defeng Xu, The Law of Bankruptcy: A Functional Comparative Study (Peking University Press, 2015)）56.
[9] Ronald Winston Harmer, 'Insolvency Law and Reform in the People's Republic of China' [1995] 64 Fordham Law Review, 2563.

have no prior relevant knowledge in a specific area of law, it is reasonable to borrow successful models from other jurisdictions.[10] To some extent, a transitioning state has no time "carefully to craft 'organic,' home-made legislation".[11] Accordingly, if legislators wish to achieve results in a short time, legal transplantation rather than original innovation may be a quick and effective means of promoting and improving legislation.[12] In other words, borrowing enables legislators to save time and costly experimentation.[13]

Though legal borrowing may have some cost-saving effects, a question may arise as to whether one legislation can transfer from one country to another country. In other words, is legal transplantation possible? Scholars have debated the possibility of legal transplantation for decades; Alan Watson was first to introduce the concept of legal transplantation.[14] Arguing from his personal experiences as a legal historian and Roman lawyer, Watson considered that the evolution of the law depended on the legal elites who made laws through writings and interpretation. As experts, these legislators were "distant from the social reality."[15] Furthermore, Watson argues that legal rules and concepts "can survive without any close connection to any particular people, any particular period of time or any particular place."[16]

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[10] Watson (n.2).
[11] Thomas W. Waelde and James J. Gunderson, 'Legislative Reform in Transition Economies: Western Transplants—a Short-cut to Social Market Economy Status?' [1994] 43 International & Comparative Law Quarterly 347,368-369.
[12] Alan Watson, *Legal Origins and Legal Change* (Hambledon Press, London, 1991) 73.
[13] Jonathan M. Miller, 'A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process' [2003] 51 The American Journal of Comparative Law 839, 845.
[14] Watson (n.2).
[15] Alan Watson, 'From Legal Transplants to Legal Formants' [1995] 43 American Journal of Comparative Law 469.
[16] Alan Watson, 'Legal Transplants and Law Reform' [1976] 92 Law Quarterly Review 79, 81.

Thus, according to Watson, the movement of the law is easy and law is not a mirror of society. In this respect, transferring a law from country to country is possible. However, Watson's argument has encountered some opposition. Pierre Legrand criticised his argument for being only concerned about the words found in the codes. For example, when Watson indicates those similarities existing between Roman law and subsequent laws of civil law nations, Legrand considers those similarities meaningless because they simply relate to words out of context.[17] Instead, Legrand claims that one should consider the meaning of the word and argues that 'meaning is a function of the application of the rule by its interpreter'.[18] Moreover, such interpretation will be influenced by the culture and mentality of a particular country and therefore Legrand considers law as a 'culturally-situated phenomenon'.[19] Based on this argument, Legrand defends the argument that legal transplantation is impossible: 'as the understanding of a rule changes, the meaning of the rule changes, and as the meaning of the meaning of the rule changes, the rule itself changes'.[20]

The main point emerging from Watson's and Legrand's arguments is whether culture matters during the process of legal transplantation. In effect, culture *does* matter but cultural differences do not necessarily lead to the impossibility of legal transplantation. Social scientists have recognised the close connection between law, culture and society.[21] Thus,

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[17] Pierre Legrand, 'What "Legal Transplants?"' in David Nelken and Johannes Feest (eds.), *Adapting Legal Culture* (Hart 2001)63-64.
[18] Ibid 57.
[19] Ibid 59,68.
[20] Ibid 61.
[21] Roger Cotterrell, Law, *Culture and Society : Legal Ideas in the Mirror of Social Theory* (Ash gate 2006); David Nelken, 'Comparative Legal Research and Legal Culture: Facts, Approaches, and Values' [2016] Annual Review of Law and Social Science 45; Carroll Seron and Susan S S ilbey ,'Profession, Science and culture: An Emergent Cannon of Law and Society Research'[200

Watson's idea that law is not a reflection of society may become problematic. However, although culture in a given society may influence the law that does not mean that legal transplantation is impossible. If law is culture, it is fair for us to hold the view that law, like culture, is the 'outcome(s) of [a] mishmash, borrowings, and mixture that have occurred, though at different rates, ever since the beginning of time.'[22] Accordingly, culture has an evolving character. Various cultures will interact and change through the transfer of cultural elements.[23] Therefore, the evolution of law may involve the process of absorbing foreign characteristics as the culture does; thus, legal borrowing is theoretically possible.

Despite debates on legal transplantation at a theoretical level, borrowing legal concepts from foreign jurisdictions exists in the practical world. Firstly, even though Watson and Legrand might have contrasting views on the possibility of legal transplantation, they seem to acknowledge that legislators sometimes copy legal texts from country to country.[24] Additionally, looking through history, both common law and civil codes have experienced some degree of diffusion around the word.[25] Therefore, the reality implies that the process of legal borrowing exists no matter whether there is a theoretical consensus on the probability of legal transplantation or not.

4] Blackwell Companion to Law and Society < http://anthropology.mit.edu/sites/default/files/documents/silbey_prof_sci_culture.pdf> accessed by 10 February 2020.

[22] Michele Graziadei, 'Comparative Law, Transplants, and Receptions' in Mathias Reimann and Reinhard Zimmermann (eds.), *The Oxford Handbook of Comparative Law* (2nd edition, Oxford University Press, 2019) 469.

[23] Ibid 470.

[24] Mathisa Siems, Comparative Law (Cambridge University Press, 2014) 196.

[25] Graziadei (n.616).

Although we can find examples of legal transplantation occurring at a practical level, it does not mean legislation can always successfully transfer from country to country. Then, the question as to whether the law can work as well in a new country as in the country of origin arises. However, in terms of legal transplantation, it is hard to create a clear line between a clear success and failure. Scholars, notably Margit Cohn, have established a typology: there are several types in cases where the legal transplants seem to be more or less successful: 'full coverage', 'fine-tuning' and 'pro-transplant transition'. [26] In circumstances where legal borrowings are not received well, the categories are 'counter-transplant cross-fertilization', 'distortion', 'mutation' or 'rejection'.[27] Therefore, whether a legal transplant is a success or failure does not have a clear, black-and-white answer.

Though it is hard to assume the failure or success of legal transplantation, scholars have discovered some factors contributing to evaluating how far the law can be received on new soil. In this sense, one general principle is that legal transplants should be compatible with national conditions.[28]For instance, transplanting a new concept may encounter constraints imposed by informal institutions in which norms, culture, values, and beliefs are located.[29] To understand the extent to which foreign rules are received, pre-existing informal institutions have to be examined. Also, researchers have pointed out the significance of the institutional

[26] Margit Cohn, 'Legal Transplant Chronicles: The Evolution of Unreasonableness and Proportionality Review of the Administration in the United Kingdom'[2010] 58 American Journal of Comparative Law 583, 592

[27] Ibid.

[28] Siems (n.24) 198

[29] Gretchen Helmke and Steven Levitsky, 'Informal Institutions and Comparative Politics: A Research Agenda' [2004] 2 Perspectives on Politics 725, 727. See also Oliver E. Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead' [2000] 38 Journal of Economic Literature 595, 596-597

environment supporting the new legislation.[30] Therefore, the way the transplants fit into the receiving country plays a crucial role in understanding how an imported legal rule works.

The above discussions on legal transplantation may provide some insight into the introduction of personal bankruptcy law in the Chinese context. The transplanting of debt relief law into the Chinese legal system is possible, at least, at the theoretical level. Moreover, the evolution of modern Chinese law can be seen as a history of legal transplantation. Legal adoption or legal borrowing has been one long exercise throughout modern Chinese legal history, although some scholars theoretically argue against legal transplantation in China.[31] The late nineteenth century witnessed the beginning of the process of legal borrowing in China. Since then, no matter who was the ruler in China, whether Qing, Republican, or Communist, lawmakers either directly copied foreign legislation or sought to blend foreign concepts with Chinese rules.[32] As a result of legal adoption, contemporary Chinese legal institutions have some characteristics, either borrowing from civil law traditions or learning from common law countries. In civil and criminal law, the German model dominated the lawmakers' agenda while American law plays a more important role in business and financial law.[33] Therefore, experiences from the past, at least, indicate that lawmakers do not resist legal transplants.

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[30] When discussing reform process in post-Soviet Eastern Europe, Waelde and Gunderson argued that nations needed help on 'the challenges of helping to build up the organizations required and the institutional environment within which a legal culture can emerge and flourish' Waelde and Gunderson (n.605) 361.

[31] Scholars, notably Zhu Suli, argue that Chinese law should be based on 'local recourses' and find its own path rather than transfer legal institutions from other jurisdictions. Taisu Zhang, 'The Development of Comparative Law in Modern China' in Mathias Reimann and Reinhard Zimmermann (eds.), *The Oxford Handbook of Comparative Law* (2nd edition, Oxford University Press, 2019) 247.

[32] Ibid.

[33] Ibid 244-245.

Furthermore, the enactment of the Chinese corporate bankruptcy law itself is an outcome of legal borrowing.[34] In this respect, borrowing legal rules related to personal bankruptcy is theoretically possible.

Then, we should take a further step and examine whether personal bankruptcy law can be 'successfully' transferred to China. Given the vagueness of the meaning of successful transplants, what we do is to explore whether the personal insolvency system can fit into Chinese society. To explain this, the first step is to review whether there are obstacles derived from the institutional environment which influence the enforcement of personal bankruptcy law in China. During the reform of the Chinese bankruptcy law in the 2000s, one of the reasons for the exclusion of natural persons was said to be the underdeveloped institutions including the banking internal operation system, credit rating system, and property registration system.[35] From the perspective of Chinese lawmakers, the establishment of the personal bankruptcy law did not fit into Chinese conditions which they viewed through the prism of the underdeveloped financial institutions. However, a decade on, when we discuss the introduction of individual insolvency law once again, the question is whether conditions have changed and whether personal bankruptcy law can fit into contemporary conditions. Therefore, section 3 will explore the changes in financial institutions including the credit scoring mechanism and property registration system in contemporary China. From that, we

[34] Nathalie Martin, 'The Role of History and Culture in Development Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' [2005] 28 Boston College International and Comparative Law Review 1.

[35] Another reason was the lack of major need because of the high saving and low consumption. Jianfu Chen, 'The Making of an Enterprise Bankruptcy Law in the PRC' [2007] 25 Law Context: A Socio-Legal Journal 77, 87.

can explore whether those so-called institutional obstacles still exist.

In addition to reviewing the institutional environment, informal institutions such as culture, beliefs and social norms will be reviewed in this chapter. Theoretical discussions on legal transplant have indicated that culture matters in the process of legal borrowing. In this perspective, Chinese scholars also recognise that social institutions are interconnected between formal and informal rules. Chen Jianfu argued that a given law at a particular time will be shaped not only by the environment of that time but also by the cultural heritage of the society.[36] Therefore, we need to examine whether a personal bankruptcy system can be consistent with Chinese culture. It is beyond the scope of this thesis to comprehensively examine the whole cultural heritage of a society with thousands of years of history. However, we can explore certain fundamental traditions persisting from past to present. In the context of China, Confucianism existed in ancient times and still has influence in contemporary China. Indeed, we cannot deny that the role of Confucianism in mainland China has experienced a change from orthodox ideology to a 'doctrinal furnishing' of feudalism and aristocracy since the 20th century.[37] As a result, its thoughts and values were critically weakened. Nonetheless, it would be premature to report the death of Confucianism as, on the one hand, most people still consider Confucianism as the mainstream Chinese culture.[38] On the other hand, elements

[36] Jianfu Chen, *Chinese Law: Context and Transformation* (Revised and Expanded Edition) (Brill Nijhoff, 2015) 5.
[37] Xinzhong Yao, 'Confucianism and its Modern Values: Confucian Moral, Educational and Spiritual Heritages Revisited' [1999] 20 Journal of Beliefs and Values 30.
[38] Sor-Hoon Tan, 'Modernizing Confucianism and New Confucianism' in Kam Louie, *The Cambridge Companion to Modern Chinese Culture* (Cambridge University Press, 2008).

of the Confucian heritage have been transferred to the present in many perspectives.[39] The innovative term "Confucian businessman/woman"[40], which combines both business ethics and Confucian values, is one representative example in contemporary China. Additionally, the 16th Central Committee of the Communist Party of China proposed to established harmonious society in 2004, which set the Confucian core value as the national strategy. Since then, it seems that the Confucian ideas are going deep into people's daily life.

Although we admit that Confucianism is undergoing a revival in modern China, one should question whether Confucian thought plays a role in the legal area. The answer to this question seems to be positive. During the May Fourth Movement 1919, Confucians were considered as the dregs of society,[41] Confucian thought was seen as being out of fashion. However, to an extent, the values of Confucianism continue to affect and even shape legal thinking and practice in modern China. The general influences of Confucianism are reflected indirectly: 'the traditional patterns of thinking (morality versus punishment), the structure of institutions (the family as a central unit), conceptions and assumption about the law (law as punishment), and the function of law (law as a political and administrative tool for maintaining social order).'[42]

Two specific examples may provide more detail on understanding the effects of Confucianism on China's modern law. The first case relates to the legal transplantation of intellectual

[39] Xinzhong Yao, 'Confucianism and its Modern Values: Confucian Moral, Educational and Spiritual Heritages Revisited' [1999] 20 Journal of Beliefs and Values 30.
[40] A Confucian businessman/ woman is a business leader, who is humaneness, trustworthy and sincerity. Those features of a leader are consistent with Confucian virtues. Ibid.
[41] Chen (no.36) 20.
[42] Ibid.

property law in China. Some scholars believe that Confucian thought may contribute to the resistance of intellectual property rights. Confucian thinking is seen as an ideology stressing collectivism rather than individualism and therefore will hinder the emergence of civil rights including intellectual property rights.[43] Additionally, the other example is that the preference for mediation as a dispute resolution mechanism in Chinese legal practice may be a demonstration of the influence of Confucian thinking. In Confucian thought, an ideal society is a place where there is no litigation (Wu Song);[44] disputes should be addressed by way of mediation. Rather, litigation should be the last resort. In doing so, society will be harmonious. This ideology has affected modern civil justice systems in China.[45] As a result, mediation is preferred by the judiciary even though the Supreme Court has stressed the significance of accurate judgments.[46]

Thus, to an extent, we can see the influence of Confucianism on Chinese modern law and therefore the question of how Confucian ideas will affect the legal transplantation of the personal bankruptcy law needs considering. Section 4 will explore whether the concepts of the personal insolvency system fit into a Confucian context.

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[43] Liguo Zhang and Niklas Bruun, 'Legal Transplantation of Intellectual Property Rights in China: Resistance, Adaption and Reconciliation' [2017] 48 IIC-International Review of Intellectual Property and Competition Law 4, 13.

[44] Peter C.H. Chan, *Mediation in Contemporary Chinese Civil Justice: A Proceduralist Diachronic Perspective* (Brill/Nijhoff, 2017) 20.

[45] Ibid.

[46] "From the perspective of the court leadership, the policy objectives of minimising social unrest arising from civil disputes could only be practically achieved by the active deployment of court mediation." Ibid 55.

7.3 Are old oppositions to personal bankruptcy law still valid?

When discussing the introduction of personal bankruptcy law in the 2000s, opponents argued that there was no economic need for this legislation due to the high savings and low consumption habits of Chinese households. Indeed, as the previous chapter has indicated, the Chinese consumer credit market was in its infant stage in that period; both demand and supply were constrained. However, things have changed considerably in the past decade. The previous chapter has indicated that both the volume of consumer credit and its growth rate are speeding up. As the growth of consumer credit continues, consumer over-indebtedness is an immediate concern for Chinese households. Therefore, the lack of the need for credit is not a strong argument anymore in contemporary China.

Besides economic factors, one opposing view focused on the underdeveloped financial infrastructures such as the credit reporting system and the property registration system. Given the information-sharing mechanism behind those financial infrastructures, they are considered as fundamentals to prevent debtors from escaping debts and to locate the debtors' property. Chinese policymakers held the view that financial institutions like the credit reporting system and property registration system were the foundation of personal bankruptcy law.[47] Therefore, they argued that the introduction of the personal bankruptcy system did not fit with Chinese conditions.

[47] Jianfu Chen, 'The Making of an Enterprise Bankruptcy Law in the PRC' [2007] 25 Law Context: A Socio-Legal Journal 77, 87.

However, it is questionable to view the credit reporting system and property registration system as prerequisites for personal bankruptcy law. Through history, the advent of bankruptcy law preceded the establishment of those financial supportive infrastructures. For instance, the earliest bankruptcy law was enacted in 1542 in the United Kingdom. However, according to a World Bank annual report, the formal institutions for credit information sharing only emerged in the seventeenth-century.[48] In other words, the establishment of a personal bankruptcy system is independent of whether there is a credit reporting system or not. Similarly, according to current English property law, land did not need to be registered until the Land Registration Act 1925. If the property registration system had been a prerequisite, English personal bankruptcy law might not exist.

Nonetheless, we should acknowledge that a healthy and well-developed credit reporting system and property registration institution can support the enforcement of a personal bankruptcy system. Credit reporting may prevent moral hazard. First, it can offer organised information on the performance of debtors to both the credit industry and the market. This information-sharing device can help lenders to evaluate risks more accurately by easing the asymmetric information.[49] In addition, this system plays a significant role in reminding debtors that a default in repayment will have a negative impact on their records in the system. This borrower's discipline mechanism makes individuals more cautious before filing for

[48] The World Bank, Doing Business in 2004: Understanding Regulation< http://documents.worldbank.org/curated/en/724511468762587518/Doing-business-in-2004-understanding-regulation> accessed by 10 November 2019.

[49] Federico Ferretti, The Law and Consumer Credit Information in the European Community: The Regulation of Credit Information Systems (Routledge-Cavendish, 2008) 14.

bankruptcy. Furthermore, through gathering and sharing extensive data in the credit reporting system, lenders can fight against increasing consumer over-indebtedness.[50] In this sense, the credit information system may supplement personal bankruptcy law in the battle against over-indebtedness. With regards to the property registration system, it also plays a vital role in upholding personal bankruptcy law. In the context of personal bankruptcy cases, before obtaining debt relief, debtors must cooperate with the process stipulated in the legislation. One significant procedure is to clarify the debtor's financial conditions. If the property registration system works well, it will be easier for courts to trace back the property which is concealed, damaged or transferred by debtors. As a result of this, it will prevent debtors from escaping their financial obligations through concealing or transferring their assets.

Indeed, a credit information system and a property registration system can both functionally support the implementation of personal bankruptcy law. However, to back the enforcement of personal bankruptcy law, the extent to which these systems should reach is not clear. However, one fundamental measure may be that a system should be effective. A World Bank report proposed policy objectives for effective credit reporting systems as follows: 'credit reporting systems should effectively support the sound and fair extension of credit in an economy as the foundation for robust and competitive credit markets. To this end, credit reporting systems should be safe and efficient, and fully supportive of the data subject and consumer rights.' [51] According to the FIG (Fédération Internationale des Geomètres)

[50] Ibid 23.

[51] Specifically, the report discussed the principles from five aspects: firstly, data included in t

statement on Cadastre, an effective property registration system should have features including security, clarity, simplicity, timeliness, fairness, accessibility, low-cost and sustainability.[52]Although the abovementioned standards proposed by relevant organisations can contribute to understanding the effectiveness of a financial institution, one may question whether those standards are widely accepted. Moreover, they are theoretical and caution should be applied when using them to measure the effectiveness of a credit rating system and the property registration institution. Nonetheless, those principles have generally provided insight into estimating the effectiveness of specific financial infrastructure such as the credit reporting system and property registration mechanism.

We have described the general principles of an effective credit information system and property registration process. But the question remains whether the Chinese credit information system and property registration practice operate effectively. A system built following those theoretical principles is an ideal one. However, it is too ambitious to seek to make a system perfect. Acknowledging the imperfection of the system, the following will

he system should be relevant, accurate, sufficient; secondly, security and efficiency in the dat a process should be taken into consideration; thirdly, service and data providers should pay a ttention to the governance and risk management; fourthly, the overall legal and regulatory en vironment should be clear, predictable and transparent; fifth, the cross-border data flow shoul d be promoted. The World Bank Group, General Principles for Credit Reporting (2011) <http:/ /siteresources.worldbank.org/FINANCIALSECTOR/Resources/Credit_Reporting_text.pdf> accessed by 12 November 2019.

[52] FIG (Fédération Internationale des Geomètres), FIG Statement on the Cadastre <https://www.fig.net/resources/publications/figpub/pub11/figpub11.asp> accessed by 11 November 2019.

explore how current systems can support the implementation of a personal bankruptcy system.

7.3.1 Credit scoring system in China

To fulfil the debt collection mechanism of bankruptcy law, it is fair to assume that effective financial infrastructure should include as much regular detailed information as possible and that this information should be accessible. From this point of view, it seems that both the credit reporting system and property register institution are operating effectively. The development of the Chinese credit reporting system can be traced back to the 1990s although early progress mainly focused on corporate credit reporting.[53] By 2002, the State Council at the 16th CPC National Congress proposed that the People's Bank of China (PBOC) should develop a credit information system on individuals[54] and the establishment of the Credit Reference Center of PBOC (PBOCCRC) brought this into being. In 2006, the PBOCCRC built up a unified national personal credit information database. The established individual credit reporting system is a government-dominated model, with credit information supplied by commercial banks and non-bank financial institutions, as well as supplemented by data from other non-financial public bodies.[55] The personal credit report is mainly used by lending

[53] See more details about the early history of Chinese credit reporting system in 刘肖原，我国社会信用体系建设问题研究（知识产权出版社，2016) 81-87 (Xiaoyuan Liu, Research on Social Credit System in China, (Intellectual Property Press, 2016) 81-87 (in Chinese).)

[54] Nicola Jentzsch, 'An Economic Analysis of China's Credit Information Monopoly' [2008] 19 China Economic Review 537, 540.

[55] Those institutions include small loan companies, insurance companies and other financial intermediaries. Those public sector institutions contain tax bureaus, courts, environmental protection administrations and others. Zhuo Huang, Yang Lei and Shihan Shen, 'China's Personal Credit Reporting System in the Internet Finance Era: Challenges and Opportunities' [2016] 9 China Economic Journal 288, 293; By 2012, the number of included institutions achieved 629. 刘 (n.53) 131 (Liu (n.53) 131).

institutions for credit grants. Also, the report can be used as a part of pre-employment background checks and pre-rental background investigations. The data types and structures gathered in the report have become stable over time. A file for individual credit reporting includes four types of information: basic information, credit records, public record information, and query records.[56] Although the information included in the personal file varies from county to county, the content of a file in China seemingly reflects a general standard.[57] At present, the Credit Reference Center has become the largest credit system in the world in terms of the data held. By mid-June in 2019, CRC has collected data on 990 million natural persons.[58] In addition to the large data coverage, the CRC has established a convenient way to access the credit report; the present system has provided both online and offline methods for individuals to obtain a report.[59] Both individuals and lending institutions can voluntarily opt for an appropriate approach to the report. Zhu Hexin, who is the vice-governor of PBOC,

[56] According to the Credit Reference Center, "The basic information section lists an individual's identification information, such as name, ID type & number and marital status; The credit payment section contains the details of an individual's credit history on personal loans, credit cards, mortgage loans, guarantee and other credit accounts. It forms the core of the credit report; the public records section includes information on the individual obtained from public administration authorities which can show his/her creditworthiness in the areas of civil judgments and enforcements from courts, tax arrears and administrative penalties, etc.; the query records section lists each credit report query that has been made by creditors in the preceding two years." Credit Reference Center of the People's Bank of China <http://www.pbccrc.org.cn/crc/grzx/201310/d091b1b4236947fabe632c769324ed40.shtml> accessed by 12 November 2019.

[57] "The detail of the source and type of information collected and disseminated by CRAs varies from country to country. ... Each file usually contains: the name of the borrower, his/her date of birth, current address, previous addresses if any, linked addresses, marital and employment status, number of accounts, types, stage (loan under approval, withdrawn, denied) and terms of the accounts, amount of monthly installments, amount of residual installments, historical data, number of defaults, amount of arrears, name of granting institutions, payment history (both regulars and in default) dates" Federico Ferretti, The Law and Consumer Credit Information in the European Community: The Regulation of Credit Information Systems (Routledge-Cavendish, 2008) 15-16.

[58] China Banking News, PBOC Credit Reference Center Becomes World's Largest Credit Information System <http://www.chinabankingnews.com/2019/06/19/pboc-credit-reference-center-becomes-worlds-largest-credit-system/> accessed by 12 November 2019.

[59] An individual can choose to enquire at a local branch of the People's Bank of China; or, he can apply for the report online through the inquiry website (https://ipcrs.pbccrc.org.cn).

indicated in June 2019 that the current system deals with around 5.5 million inquiries on personal credit reports every single day.[60]

As a result of convenient access and large data coverage, China's credit information index performs well-above-average around the world. According to the data from World Bank "Doing Business 2020" report, the depth of the Chinese credit information index enjoys a score of 8, which is higher than the average score in other East Asian and Pacific and OECD high-income countries.[61] However, we should notice that the report only chose Shanghai and Beijing as comparative examples. Therefore, whether the World Bank's report reflects the general picture or not needs more exploration.

7.3.2 Property registration system in China

Turning to the property registration system,[62] it was found to be fragmented, repetitive and differs across China.[63] Chinese law has accepted a mandatory registration system for immovable properties and registration has been performed as a public sector duty by Property Registration Offices at the local government level. In the Chinese legal system, most land is

[60] China Banking News, PBOC Credit Reference Center Becomes World's Largest Credit Information System <http://www.chinabankingnews.com/2019/06/19/pboc-credit-reference-center-becomes-worlds-largest-credit-system/> accessed by 12 November 2019.

[61] The depth of credit information index enjoys a score of 4.5 in East Asia and Pacific and a score of 6.8 in OECD high income countries. The World Bank Group, Doing Business 2020 < https://www.doingbusiness.org/content/dam/doingBusiness/country/c/china/CHN.pdf>

[62] The property registration system discussed in this chapter refers to the system for immovable property, excluding movable property. The reason is houses take up a high proportion of the asset portfolio of Chinese households. Furthermore, a house is normally the most valuable asset for both debtors and creditors. Therefore, the operation of the immovable property registration system may influence the effectiveness of insolvency law's debt collection function.

[63] See more details in Lu Xu 'The New Real Property Registration Structure in China: Progress with Unanswered Questions' [2016] 5 Global Journal of Comparative Law 91.

owned by the State and some is collectively owned. The right to land mostly refers to the right to land usage and against this background, the house owner in urban areas has to register with two separate departments to obtain two entitlement certificates: a certificate of housing ownership and a certificate for the land-use right. Registration of the land-use right is operated by the land administration at the appropriate government level while the building and housing administration at county-level or above will be responsible for the registration of house ownership. As a result, any house owner in urban areas has to follow two different groups of rules. Furthermore, the land registration rules for rural land are also complex and separated. Land used for homestead (zhai ji di) must be registered with the land administration at the county level. In contrast, land used for farming is required to be registered with the county-level government or above as the right to contracted management (cheng bao jing ying quan). In addition, many municipalities, provinces and prefecture-cities create numerous local registration rules and practices. For example, while other urban areas distinguish between the certificate of land-use right and the certificate of house ownership, the practice in Shanghai is to issue a single certificate which includes both the right to land use and the housing ownership.[64]

The decentralised property registration system was considered as an inefficient institution because it could not provide reliable information on property.[65] To improve the system, in

[64] Lei Chen, 'Land Registration, Property Rights and Institutional Performance in China: Progress Achieved and Challenges Ahead' [2014] 44 Hong Kong Law Journal 841, 847.

[65] The property registration system was inefficient and led to the negative impact on Chinese economic development. See Han Su Lin, 'Secured Transactions Law Reform in China: Can a Commercial Law Serve the Needs of the Market' [2006] 3 China Law and Governance Review 1. In contrast, one research study drew on empirical observations and concluded the land registration

2014, the State Council issued the Interim Regulation on Real Estate Registration which was amended in 2019. This Regulation aims to unify and integrate the old real estate registration rules and establish a nationwide system. According to the Regulation, the P.R.C Ministry of Land and Resources[66] will be in charge of the establishment of the registration system. At the time the Regulation was signed off by Prime Minister Li Keqiang, the Chinese government announced an ambitious plan to build up this unified system in only several years. So far, it seems that the government is on track to meet the goal. At present, China's nationwide property registration system has achieved national coverage. The State Council has indicated that 3,001 property registration stations have been established in 335 cities and 2,853 counties.[67] In addition to establishing the service points, the State Council has required various government departments to promote the integration of information sharing to enhance data quality and utilisation efficiency.[68] In order to tackle the uncertainty of public access to information,[69] relevant regulation has also been issued. The Ministry of Natural Resources has issued rules to regulate the procedure of inspecting the registry records and the class of persons who are permitted to investigate the records etcetera.[70] The latest statistics showed that more than 300,000 companies and individuals are using the service

system in urban area was efficient. But one noticeable thing is that the case study in that paper was based on a strong second-tier city. Therefore, it may be not representative. Chen (n.64).

[66] This department was revoked and replaced by the Ministry of Natural Resources since 2018.

[67] The State Council of the People's Republic of China, China's Nationwide Property Database Comes Into Effect <http://english.www.gov.cn/state_council/ministries/2018/06/18/content_281476190239424.htm > accessed by 15 November 2019

[68] The State Council, 国务院办公厅关于压缩不动产登记办理时间的通知 (Notice by the General Office of the State Council of Shortening Time for Realty Registration)

[69] Chen (n.64) 852

[70] The Ministry of Natural Resources, 不动产登记资料查询暂行办法 (Interim Measures for the Inquiry of Real Estate Registration Information)

every single day.[71] In general, it is fair to say that the immovable property registration system in China has generally improved in terms of data collection and regulatory environment. Thanks to those developments, in the latest 2020 Doing Business Report, China's quality of the land administration index achieved a score of 23.5, which is higher than the average score of 23.2 in OECD high-income countries.[72] However, the World Bank report only explored the registration system in Beijing and Shanghai. Although the unified database has been built up, local administrations still have the room to create their own convenient practices. Therefore, local variations may still exist and the practice in Beijing and Shanghai may not represent the national standard.

7.3.3 Discussion

In sum, although the credit information system and the property registration institution in China are not perfect, both systems are greatly improved in terms of the information database and the access to information. Due to those developments, both individual property and individual credit records are traceable now. According to the report of the Supreme Court, courts can now, basically and effectively, inspect the main property information of individuals subject to enforcement proceedings.[73] In other words, the current information-sharing system including credit information and property registration can be competent to support

[71] The State Council of the People's Republic of China, China's Nationwide Property Database Comes Into Effect <http://english.www.gov.cn/state_council/ministries/2018/06/18/content_281476190239424.htm > accessed by 15 November 2019

[72] The World Bank Group, Doing Business 2020 <https://www.doingbusiness.org/content/dam/doingBusiness/country/c/china/CHN.pdf> 36

[73] The Supreme People's Court, *Report of the Supreme People's Court on the Work of the People's Courts in Solving the 'Difficulties in Enforcement* (Law Press, 2018) 86

the debt collection function of insolvency law. Therefore, the opposing views based on concerns about the lack of a credit reporting system and a property registration in China may have become out-of-date arguments.

7.4 Can personal bankruptcy law fit into a Confucian world?

The previous section has shown that the former opposition to personal bankruptcy law cannot be sustained because of the improvements in the supportive institutions including a credit information system and a property registration scheme. As we discussed above, in addition to the institutional environment, transplanting a new concept may be influenced by informal culture. A given law at a particular time will be shaped not only by the environment of that time but also by the cultural heritage of the society.[74] In practice, social institutions are interconnected by both formal and informal rules. Therefore, this part will explore whether the idea of a debtor's fresh start can fit into Chinese culture, particularly Confucianism.

7.4.1 A brief introduction to the Confucian ethical system

Confucianism has established a comprehensive ethical system. In Confucian teaching, the start point is the so-called "Five Relationship" (wulun 五伦): husband and wife, father and son, older brothers/sisters and younger brothers/sisters, ruler and minister, friend and friend.

[74] Chen (n.36) 5

Moral behaviour originates from those relations.[75] From the view of Confucianism, an ethical person is called a gentleman (jun zi 君子), a virtuous and ideal person. To be a gentleman (jun zi 君子), an individual should comply with both the Three Fundamental Bonds and Five Constant Virtues (san gang wu chang 三纲五常). The Three Fundamental Bonds consider those five relations as entirely vertical and one-sided: fathers are superior to sons, the husband to his wife, the lord to a minister.[76] The Three Fundamental Bonds imply that everyone should adhere to his social status. Consequently, a son should respect his parents, a wife should adhere to her husband and the retainers should be loyal to the lord. In fact, the three bonds have limitations in terms of absolute authority and absolute obedience.[77] Fathers and emperors are born with power and rights while the son and wife have the obligation of obedience. Therefore, Robert Bellah viewed that subordinate relationships in China "become absolutes".[78]

In addition to complying with Three Fundamental Bonds, a gentleman (jun zi) should cultivate the Five Constant Virtues. Those five virtues refer to benevolence (仁), righteousness（义）, propriety（礼）, wisdom（智）and trustworthiness（信）.[79] Benevolence is defined as

[75] Douglas C Smith, *The Confucian Continuum: Educational Modernisation in Taiwan* (Praeger Publishers 1991).

[76] In Mencius' time, he underlined the reciprocal basis of these five relationships: love between father and son, duty between ruler and subject, distinction between husband and wife, precedence of the old over the young, and faith between friends. (父子有亲，君臣有义，夫妇有别，长幼有序，朋友有信) D.C. Lau, *Mencius: Translated with An Introduction by D.C. Lau*(the Chaucer Press 1976). However, the reciprocal basis was changed in the Han dynasty and finally became a one sided model.

[77] Jie Yang, Moral Education in the Emerging Chinese Society (2007) (Master Thesis).

[78] Robert N. Bellah, *Beyond Belief: Essays on Religion in a Post-Traditionalist World* (University of California Press, 1991) 94-95.

[79] Mencius firstly proposed the four virtues called Four Origins: "Everyone has the feeling of concern for the wellbeing of others; everyone has the sense of shame and disgust at their own evil; everyone has the sense to treat others respectfully; everyone has the sense to judge right and wrong. The feeling of concern for the wellbeing of others is Benevolence; the sense of shame and disgust is

"benevolently loving others", which includes love, kindness, friendliness, respect, caring and helpfulness.[80] Moreover, benevolence also specifies that you do unto others as you would have them do unto you.[81] Righteousness plays a role in protecting justice and goodness.[82] Righteousness will guide an individual on how to deal with others, underscoring 'the self-restraint to resist temptation and the fortitude to do one's duty'.[83] Propriety refers to proper manners and is a product of a hierarchical society. Individual behaviours are based on hierarchical differences both within one's family and in society at large.[84] Wisdom is one virtue that helps individuals to distinguish between right and wrong in human behaviour as well as to estimate the related consequences.[85] In the context of trustworthiness, it includes guidelines for an individual to be honest and trustworthy by keeping to his word.[86] According to the Confucian theory, when one of the two parties treats the opposite with genuine benevolence, the other party will repay the first party in the same way. If both parties behave according to the ethical rules of benevolence-righteousness-propriety, the virtue of trustworthiness will exist between these two parties.[87] Once an inferior person has learned

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Righteousness; the sense to treat others respectfully is Propriety, the sense to judge right and wrong is Wisdom." Lau (n.76); Later, Dong Zhongshu, a famous Confucianist in the Han dynasty, expanded the Four Origins into Five Virtues. Kwang-kuo Hwang, *Culture-Inclusive Theories: An Epistemological Strategy* (Cambridge University Press 2019).

[80] Li Deng, 儒家伦理'仁义礼智信'关系维度新探（ The Relation and Dimension of Confucian Ethic "ren yi li zhi xin"）(in Chinese) (Master Thesis).

[81] Yao-Chia Chuang, Effects of Interaction Pattern on Family Harmony and Well-being: Test of Interpersonal Theory, Relational-models Theory, and Confucian Ethics.' [2005] 8 Asian Journal of Social Psychology 272.

[82] Kwang-Kuo Hwang, 'The Deep Structure of Confucianism: A Social Psychological Approach' [2001] 11 Asian Philosophy 179, 188,189.

[83] Cited in Yang (n.77) 35.

[84] Derk Bodde, 'Basic Concepts of Chinese Law: The Genesis and Evolution of Legal Thought in Traditional China' [1963] 107 Proceedings of American Philosophical Society 375, 383.

[85] Deng (n.674); see also Lili Zhao and Juliet Roper, 'A Confucian Approach to Well-being and Social Capital Development' [2011] 30 Journal of Management Development 740.

[86] Yang (n.77).

[87] Hwang (n.82) 99-101.

the Five Virtues and obeyed the Three Fundamental Bonds, he will become superior.

7.4.2 Creditor-debtor relationship in the Confucian ethical system

The ethical system in Confucianism aims to encourage people to be superior through a series of rules. It is fair to say that a gentleman (jun zi) is the role model in the context of Confucianism. According to Confucian ethics, a defaulting debtor cannot be viewed as a gentleman (jun zi). Although the Three Fundamental Bonds have limitations on their stress on super obedience, it is implied that an individual should have proper manners in accordance with his responsibilities in a relationship. That is why some scholars posit that Confucian culture emphasises more on responsibility.[88] By recognising the role and position in a relationship, an individual should comply with the behavioural guidance, so-called propriety (li 礼) in the Five Constant Virtues. From this perspective, in the borrowing-lending relationship, both creditors and debtors should fulfil obligations based on their roles. As a debtor, the most significant responsibility is that a debt must be paid. In other words, once a debtor defaults, he has breached the promise which he must comply with. Such a breach is inconsistent with the Confucian norm stressing the obligation and appropriateness of behaviour within a relationship. Furthermore, a defaulter also breaches other virtues within the Five Constant Virtues. At first glance, it may be difficult to connect the breach of a promise with the violation of benevolence. However, if we probe more deeply, defaulters' behaviour contravenes the virtue of benevolence. Based on the idiom that 'you don't do unto others

[88] Xinzhong Yao, 'Confucianism and its Modern Values: Confucian Moral, Educational and Spiritual Heritages Revisited' [1999] 20 Journal of Beliefs and Values 30.

what you don't want done unto you',[89] benevolence encourages a person to be kind, friendly and caring. We can assume that when debtors become creditors, they will wish their debtors to keep their promise. Therefore, if they do not want their debtors to breach a promise, they should fulfil the obligation to other people. In this point of view, a defaulting debtor will contravene the virtue of benevolence because they are violating the golden rule, 'don't do unto others what you don't want done unto you'. In addition to benevolence, breaching a promise may be inconsistent with righteousness. Given that Confucian morality is based on status ethics, whether an ordinary person complies with righteousness depends on his respect for superiority.[90] Then, a further question concerns whether a creditor is the superior party in the loan relationship. The debtor-creditor relationship is an equal civil relationship which is not vertical and one-sided, even though we have justified that the creditor is a more superior insurer. Therefore, it is hard to state that creditors are the morally superior party. Nonetheless, breaching a promise is still unrighteous behaviour. Although righteousness mainly discusses the vertical relationship between father and son, lords and ministers, husband and wife, elder siblings and younger siblings, it also plays a role in guiding the behaviour between friends. Breaking a promise to a friend violates the principle of righteousness. Then, it is reasonable to infer that breaching an obligation to creditors is also unrighteous because the creditor-debtor relationship is similar to a friend-friend relationship, both of which are horizontal. As for

[89] Confucius, *The Analects* (Counterpoint 1998).

[90] "What are the things which humans consider righteous (yi 义)? Kindness on the part of the father, and filial duty on that of the son; gentleness on the part of the elder brother, and obedience on that of the younger; righteousness on the part of the husband, and submission on that of the wife; kindness on the part of the elders, and deference on that of juniors: benevolence on the part of the ruler, and loyalty on that of the minister. These are the ten things that humans consider to be right" Originated from The Book of Rite, cited in Hwang (n.82) 96-98.

wisdom, it refers to the mental process which can rationally judge right and wrong. A defaulting debtor has already breached the rules that he should obey. Such behaviour is wrong and should be corrected. Therefore, a defaulting debtor will be viewed as a person who is unwise and fails to distinguish right from wrong. In addition to that, a defaulting debtor is an unwise person and he will lose his trustworthiness in society. Trustworthiness between different parties is a consequence of the interaction of benevolence-righteousness-propriety. When a defaulting debtor has violated the ethical codes of benevolence-righteousness-propriety, the trustworthiness in the creditor-debtor relationship will not exist anymore.

After evaluating a defaulting debtor through the ethical rules of Confucianism, it is apparent that his behaviour is not one of a gentleman (junzi). People who cannot comply with Confucian ethics are viewed as small persons (xiaoren 小人). Although there is no clear definition of a small person (xiaoren 小人) in the Analects, in most cases, it is explained in accordance with moral standards.[91] In contrast to a gentleman (junzi), a small man is an ignorant, small-minded person or a person with low moral norms.[92] Additionally, a small person may also indicate a person who sacrifices the interests of others for their own benefits or an individual with no virtues.[93] Given that a defaulting debtor is crippled in the Confucian ethical codes, he can be viewed as a small man (xiaoren 小人).

[91] Peter R. Woods and David Lamond, Junzi and Rushang: A Confucian Approach to Business Ethics in a Contemporary Chinese Context <https://www.anzam.org/wp-content/uploads/pdf-manager/623_ANZAM2011-434.PDF>.

[92] Kwang-Kuo Hwang, 'The Deep Structure of Confucianism: A Social Psychological Approach' [2001] 11 Asian Philosophy 179, 196.

[93] Woods and Lamond (n.91).

When a defaulting debtor is viewed as a small man (xiao ren 小人), the question becomes how Confucianism treats those erring men. In the view of Confucianism, a human is naturally kind,[94] or at least is capable of learning goodness[95]. Confucianism believes that a person, even an inferior one, is educable and may become a gentleman after education. Therefore, from the perspective of Confucianism, the educational function of morality takes priority over harsh punishment in law.[96] However, it is a misperception that harsh punishment is completely abandoned in Confucianism. What Confucianism opposes is replacing the educational function of morality with draconian punishment. In effect, Confucianism accepts both moral education and punishment. Rather, it holds the view that moral education is the priority and punishment plays a supplementary role.[97] This viewpoint is stated more clearly in Hsun Tsu, saying that 'if people are punished without education, penalties will be enormous and evil cannot be overcome; if they are educated without punishment, evil people will not be punished'.[98] Moreover, Confucianism argues that an evil person should be educated first in morality before he is published.[99] Therefore, according to those abovementioned thoughts, it is fair to assume that a defaulting debtor, an inferior person, will be firstly educated through Confucian ethics. That is to say, debtors

[94] 'It certainly is the case that water does not show any preference for either east or west, but does it show the same indifference to high and low? Human nature is good just as water seeks low ground. There is no man who is not good; there is no water that does not flow downwards' D.C. Lau, *Mencius: Translated with An Introduction by D.C. Lau*（the Chaucer Press 1976） 160.

[95] 'As far as what is genuinely in him is concerned, a man is capable of becoming good' Ibid, 163.

[96] Chen (n.36) 10.

[97] Originated from Tung-Tsu Chu cited in Ibid 14.

[98] Originated from Xun-zi, cited in Ibid.

[99] Confucius said: 'To put the people to death without having instructed them; - this is called cruelty. To require from them, suddenly, the full task of work, without having given them warning; -this is called oppression' cited by Ibid 14.

will be instructed to pay their debt with the purpose of correcting their wrongdoing. Only if debtors never change their wrong behaviour, will they be punished.

7.4.3 Understanding the fresh start policy in the context of Confucianism

In addition to traditional debt collection mechanism, another feature of a personal bankruptcy system is the fresh start policy. Generally speaking, such a policy reflects the value of forgiveness. However, the above paragraphs have explained that a defaulting debtor as a small man (xiaoren) may be punished. Then, another question we should explore is whether the forgiveness originating from the fresh start policy can be accepted in the Confucian world. At first sight, it seems that forgiveness is consistent with the ethics of benevolence which stresses the concern for the wellbeing of others. After all, Confucianism proposed people to love all men.[100] Loving all men means putting oneself in another's position.[101] However, one issue that Confucianism does not clearly indicate is whether benevolence should apply to xiaoren. Therefore, it is unclear whether a creditor should put himself into a debtor's perilous circumstances and exercise benevolence upon him. However, Confucianism recognises that resources are limited and it is not realistic to give unstinting benevolence to all persons.[102] The benevolence which Confucianists adhere to is from the intimate to the distant. The virtue

[100] Confucius, *The Analects* (Counterpoint 1998) Yen Yuan.

[101] 'Wishing to be established himself, [he] seeks also to establish others; wishing to be enlarged himself, he seeks also to enlarge others' Ibid Yung Yey.

[102] Confucius said: a youth, when at home, should be filial, and, abroad, respectful to his elders; [he] should be earnest and truthful; [he] should overflow in love to all and cultivate the friendship of the good 60 huang; Similarly, Mencius proposed that 'there has never been a benevolent person who neglected his parents'; 'Of services, which is the greatest? The service of parents is the greatest. There are many services, but the service of parents is the root of all others' Confucius, The Analects (Counterpoint 1998) Hsio R

of benevolence is "based on an individual's love for the group or community he belongs to".[103] In a creditor-debtor relationship, it is apparent that those two parties belong to opposite groups. Therefore, in the Confucian world, it is unlikely that a bank will love their debtors by exercising benevolence. Furthermore, although Confucianism encourages people to be benevolent, not everyone can achieve such a moral standard in their whole life. It is ambitious to expect everyone in society to behave like a sage. A Chinese old idiom, a dutiful son is obliged to pay his father's debt, may shed more light on understanding the difficulty on forgiving a default debtor.

Nonetheless, forgiving defaulting debtors is still possible. As discussed above, one element of Confucian ethics encourages an ordinary person to be a gentleman (jun zi) rather than a small-minded person (xiao ren). But why should common people have to aspire to being a gentleman (jun zi)? The answer is to achieve harmony.[104] From the viewpoint of Confucianism, harmony is highly valued[105] and even takes priority over virtue.[106] However, if conflicting parties, such as gentlemen and small-minded persons, coexist in society, can that society still achieve harmony? Confucianism has provided a positive answer in that harmony can be achieved at

[103] Li Lau, cited in Kwang-Kuo Hwang, 'The Deep Structure of Confucianism: A Social Psychological Approach' [2001] 11 Asian Philosophy 179, 198.
[104] In order to achieve harmony, it is necessary to follow li (rituals), which are used to harmonize people. A gentleman (jun zi), who practises Five Virtues and complies with the responsibility based on the relations, is characterised as a loyal and ideal adherent to li (rituals). Therefore, being a gentleman (jun zi) can promote the establishment of harmony.
[105] When Mencius explains three essential things in human affairs ,he considers harmony among people to be the most significant, 'good timing is not as good as being advantageously situated, and being advantageously situated is not as good as having harmonious people'(天时不如地利，地利不如人和) Chenyang Li, 'The Confucian Ideal of Harmony' [2006] 56 Philosophy East and West 583, 587.
[106] Dong Zhongshu indicated "the greatest virtue is but harmony"（德莫大于和）cited in Ibid 588.

different levels even between two conflicting parties.[107] Confucian thoughts on harmony presuppose that there are differences among people and potential conflicts are hidden behind these differences.[108] To some extent, Confucian harmony is not a theory which absolutely avoids the existence of strife.[109] Confucianism recognises that achieving harmony is a dynamic process and conflicts can be used as a tool to establish greater harmony.[110]

But how can conflicting parties achieve harmony? One extreme approach is the elimination of strife. When the conflict is eliminated, the status of sameness will be achieved. However, Confucian harmony is based on the assumption that differences exist in society and if there are no differences, how can Confucian harmony exist? Therefore, Li Chenyang said 'for Confucians, elimination is not the prototypical path to harmony'.[111] Instead, Confucianism considers striking a balance between opposing parties as a more appropriate way to achieve harmony.[112] Parties in a relationship are 'both the condition for and the constraint against one another's growth'.[113] The harmonious relationship means one based on reciprocal support and mutual growth between parties.[114]

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[107] Li (n.105).
[108] 'Difference as such is already implicitly contradiction; for it is the unity of sides which are, only in so far as they are not one-and it is the separation of sides which are, only as separated in the same relation' Hegel, cited in Ibid 591.
[109] Ibid 592.
[110] Ibid.
[111] Ibid 591.
[112] '中者，天下之所终始也，而和者，天地之所生成也'董仲舒，*春秋繁露* （Zhongshu Dong, *Luxuriant Gems of the Spring and Autumn*）（艺雅出版社 2017）.
[113] Li (n.105) 589.
[114] Chung-Ying Cheng, *New Dimensions of Confucian and Neo-Confucian Philosophy* (Albany: State University of New York Press, 1991) 187.

By exploring Confucian thoughts on harmony, we can see at least a slight chance that the fresh start policy in insolvency law would be acceptable in Confucian culture. A personal bankruptcy case will involve debtors, creditors and even society at large. Unresolved conflicts between creditors and defaulting debtors will lead to social costs [115] and those costs will bring disharmony into society, which a Confucianist wishes to avoid. Given that personal bankruptcy law can reallocate defaulting risks more efficiently, it may be beneficial to strike a new balance between those two conflicting parties. Therefore, although it is hard for creditors to exercise benevolence upon a defaulting debtor in terms of Confucian ethics, in order to achieve the highest value, debt relief law would be acceptable.

Though the concept of debt discharge is acceptable, it may be hard to accept a swift discharge. As discussed before, breaching one's promise is a moral failure in the Confucian world. The reason for forgiving defaulting debtors is the pursuit of the harmonious society which requires that all should become good persons (君子). Confucians believe that small persons (小人) can be morally educated so that they may become good persons (君子). In this sense, the enhancement of morality may be the precondition of debt discharge. From a comparative perspective, in jurisdictions that stress the importance of morality, debt relief is not an easy way and the swift discharge may be rejected by lawmakers.[116] Therefore, compared with the quick discharge process, the repayment plan procedure might be more favourable in the

[115] The World Bank, 'Report on the Treatment of the Insolvency of Natural Persons' 35 <https://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf> accessed by 10 Jan 2020.

[116] See the discussion of a Germanic liability model in Jan-Ocko Heuer, 'Social Inclusion and Exclusion in European Consumer Bankruptcy Systems' (Shifting to Post-Crisis Welfare States in Europe? Long Term and Short Term Perspective, Berlin, June 2013).

Chinese context.

7.5 Conclusion

During the bankruptcy reforms of the 2000s, whether to cover individuals by bankruptcy law was discussed on the government agenda. The result of the discussion was the exclusion of individuals from the bankruptcy system. The reasons given for the decision were that there was no economic need, and that supportive financial institutions such as the credit reporting system and property registration system were undeveloped. However, the previous chapter has outlined the development of the Chinese consumer market in the past decade and that the growth of consumer credit will continue to increase. Therefore, there is no case for saying that there is no economic need for credit in contemporary China.

Given that Chinese legislators have limited knowledge of personal bankruptcy law, legal borrowing or legal transplantation may be inevitable. However, borrowing a new formal institution from other jurisdictions needs to answer two specific questions: 'is legal transplant possible?' and 'how far can those new rules be accepted?' For the first question, though there is debate at the theoretical level, legal transplants already exist in practice. Furthermore, the history of Chinese legal reforms has demonstrated that legal borrowing is acceptable and possible in contemporary China. As for the second question, although the line between success and failure is vague in the context of legal transplants, whether the new rule fits into the conditions and culture of the society will influence how far the rule can be received.

Policymakers should consider whether there are institutions which support the enforcement of new legislation as well as whether the new law can fit into the local informal cultural environment.

In the context of the introduction of a personal bankruptcy system, a credit reporting system and a property registration institution can reduce asymmetric information and prevent debtors escaping financial obligations. Therefore, to enforce a personal bankruptcy system, those financial institutions are necessary. Through outlining the improvement of both systems in modern China, we find that both are well-developed though not perfect. However, even though they are not perfect, they are competent enough to support a personal bankruptcy system. Additionally, this chapter has examined whether the ideas of personal bankruptcy law fit into Chinese traditional Confucianism. It finds that even though forgiving a defaulting debtor is not reflected in Confucian thinking, the ideology of achieving a harmonious society may support the introduction of personal bankruptcy law. However, this chapter also argues that swift debt relief may not be introduced because Confucianism stresses the education of individuals to transform them from 'small men' to 'good persons'. Therefore, Chinese lawmakers may favour the debt repayment process as the solution to personal bankruptcy, which functions as a learning process.

Chapter 8 Judicial Experiments on Personal Bankruptcy in China

8.1 Introduction

The previous chapter has discussed whether transplanting personal bankruptcy law into China is feasible. It concludes that whether or not the credit rating system and property registration system are underdeveloped, this cannot be the reason to prevent the introduction of personal bankruptcy law. On the one hand, although a mature credit information system or property registration institution can enhance the implementation of bankruptcy law, they are not preconditions for the emergence of personal bankruptcy legislation. Even if the abovementioned financial institutions were necessary for the establishment of the personal bankruptcy system, the current contemporary credit information system and property registration mechanisms in China have improved a lot and achieved an above-average standard from an international and comparative perspective. Therefore, those improved financial infrastructures are competent to support the implementation of personal bankruptcy law.

In addition, whether a new law can fit into informal institutions such as the cultural environment or social norms has an impact on how far the new law can be received in the new soil. Hence, the previous chapter explored whether the idea of a fresh start is compatible with Chinese culture. However, the examination of compatibility was

limited as to whether bankruptcy discharge fits with Confucianism. It concludes that though forgiving defaulting debtors is not enshrined in Confucian ethics, the law's insurance function may contribute to the establishment of a Confucian harmony. Therefore, the previous chapter concludes that the introduction of personal bankruptcy law is acceptable in a Confusion world.

Apart from discussions about the feasibility of personal bankruptcy law in the Chinese context, recent official documents published by the China's Supreme People's Court (SPC) and other administrative departments have revealed their willingness to cover individuals in the bankruptcy system. Against this background, some local courts and local governments have taken further steps in exploring the institutional framework of Chinese personal bankruptcy law.

In previous chapters, we have examined how personal bankruptcy is addressed in various jurisdictions including the United States, Great Britain and Germany. Those three jurisdictions have chosen different paths for individuals to deal with their excessive debt. With regards to current experiments on personal bankruptcy at the local level, the institutional frameworks not only mirrored some features of other jurisdictions such as the UK, US and Germany but also reflect some Chinese characteristics. Under the Chinese model, debtor rehabilitation consists of two phases. The first stage permits debtors to be freed from their debt at the economic level but before obtaining a full rehabilitation, debtors must be subject to strict behaviour

restrictions for a certain period.

The current two-phase framework mirrors a hierarchy of policy priorities. Creditors are comprehensively protected but debtor recovery is limited. However, this chapter argues that present institutional designs are not based on empirical research focusing on the nature of over-indebted debtors. Instead, they are based upon factors including a public bias towards insolvent debtors, a path which ensures that creditors' interests are upheld and that an absence of pro-debtor narratives are established by interest groups. As a result, stressing creditor wealth maximisation but downplaying debtor rehabilitation is not seen here as a reasonable response to personal bankruptcy in the Chinese context.

This chapter also explains that current practices may not achieve the authority's goals, either addressing the unenforceable cases or enhancing economic activities. On the one hand, there is a preference for debt adjustment plans as the solution to personal insolvencies. However, experiences from other jurisdictions indicate the difficulty of reaching an agreement between debtors and creditors and the high failure rate of debt plans. Accordingly, a large number of enforcement failure cases will still stay in the judicial system, even though a personal bankruptcy system exists. On the other hand, the imposition of behaviour restrictions may exclude debtors from economic activities after the conclusion of insolvency proceedings. As a result, so-called entrepreneurs cannot quickly engage in productive activities and entrepreneurship cannot be

improved.

Behaviour restrictions are necessary mechanisms for safeguarding the bankruptcy system from abuse. However, this chapter argues that legislators should not overemphasise the danger of moral hazard and debtor fraud. First, the exclusion of moral hazard and debtor fraud are not achievable goals. Furthermore, the effects of moral hazard are difficult to measure and the real instances of debtor fraud are low. Therefore, legislators should be cautious when ensuring that strict safeguarding mechanisms do not undermine the greater benefits arising from the law's insurance function.

This chapter is structured as follows: the first section is a brief background explaining the establishment of personal bankruptcy practices in China. It will briefly describe the objectives which policymakers wish to achieve through personal bankruptcy law. Then, the next section describes present institutional designs at the local level. From a comparative standpoint, it finds that current institutional frameworks to personal insolvencies have reflected some features of other jurisdictions. At the same time, those designs also have some Chinese characteristics. Then, this chapter explains present practices that stress the protection of creditors' interests rather than debtor recovery. The chapter also examines whether the goals claimed by the authority are achievable under the present institutional framework. The last section is a brief conclusion.

8.2 A brief background to the personal bankruptcy experiment in China

Before exploring the institutional framework of personal bankruptcy practice, this chapter first introduces a brief background of those judicial practices. Through examining official documents, it enables us to understand how Chinese authorities view the personal bankruptcy law and what problems need to be addressed through the law.

First, we examine legislators' attitudes toward personal bankruptcy. The legislative process in China is a top-down style. Only those included in the policy agenda of the National People's Congress (NPC) will be deliberated. A delegation or a group of thirty or more co-signing deputies may propose a bill to the NPC and the Presidium shall determine whether the bill will be put on the agenda of a session. However, in order to save time and avoid a high workload, the bill will be proposed to specific committees controlled by the NPC in most cases. Those committees will examine the proposed bills and decide whether to put them on the agenda. Since the 2000s, there have been some proposals submitted for introducing a personal bankruptcy law. Table 1 is a summary of those recommendations. Proposals established during the 2000s on the introduction of personal bankruptcy system appear to be based on calls for protecting creditors and punishing debtors' dishonest behaviour, and early proposals did not clarify clear goals of a personal insolvency system. However, those proposals have never reached the NPC for deliberation, even though officials in specialised

committees recognised the importance of a personal bankruptcy law. Since the internal discussion process in the specified committee is private, the reasons for rejecting the introduction of personal bankruptcy law are not known.

Table 1: Proposals to the National People's Congress Financial and Economic Affairs Committee

Year	Proposals
2007	In order to prevent personal discredit behaviours, protect creditors' interests and enhance debtors' integrity, thirty deputies have proposed to recommend the introduction of a personal bankruptcy law.[1]
2008	Given that the Chinese credit system has been established, thirty-five deputies thought it was time to introduce the personal bankruptcy law.[2]

[1] "周晓光等 30 名代表（第 370 号议案）提出，为有效抑制个人失信行为、保护债权人利益、强化个人债务人的诚信观念，建议尽快制定个人破产法。财政经济委员会认为，个人破产是破产制度的重要组成部分，对于保护债权人和债务人利益，建立诚信社会，化解社会矛盾具有十分重要的作用。当前我国有数十万个人独资、合伙等无限责任经济组织和两千多万个体工商户，个人经营和消费活动日益广泛复杂，迫切需要对个人无力偿债等情形作出制度安排。建议将个人破产法列入常委会立法规划"全国人民代表大会财政经济委员会，《全国人民代表大会财政经济委员会关于第十届全国人民代表大会第五次会议主席团交付审议的代表提出的议案审议结果的报告》.

[2] '黄鸣等 35 名代表（第 350 号议案）提出，我国信用体系已初步形成，建立个人破产制度的时机已经成熟，建议尽快制定个人破产法' 全国人大财政经济委员会，《全国人民代表大会财政经济委员会关于第十一届全国人民代表大会第一次会议主席团交付审

2009	To fairly deal with the debt issue and protect interests of debtors and creditors, thirty-one deputies suggested the introduction of a personal bankruptcy law.[3]
2016	In order to deal with the changed circumstances in China's economy, to enhance the role of bankruptcy law in the supply-side reform as well as solve the deadlock resulting from cross-guarantee, thirty-three deputies proposed to reform and cover individuals in current bankruptcy law.[4]

In comparison, the judiciary and executive sectors have shown more interest in establishing a personal bankruptcy system in recent years. Table 2 summarises the

议的代表提出的议案审议结果的报告》.

[3] "徐景龙等 31 名代表（第 6 号议案）提出，为公平清理债权债务，保护债权人和债务人的合法权益，建议尽快制定个人破产法"全国人大财政经济委员会，《全国人民代表大会财政经济委员会关于第十一届全国人民代表大会第二次会议主席团交付审议的代表提出的议案审议结果的报告》.

[4] "黄作兴等 31 名代表、 绍峰晶等 33 名代表（第 228 号、第 423 号议案）提出为应对经济形势的变化，发挥破产制度在供给侧改革中的作用，解决债务危机频发，破解互保联保循环死结，建议将个人破产纳入法律调整范围，修改企业破产法" 全国人大财政经济委员会，《全国人民代表大会财政经济委员会关于第十二届全国人民代表大会第四次会议主席团交付审议的代表提出的议案审议结果的报告》.

attitude toward personal bankruptcy law from the perspective of the Supreme People's courts and other government departments. Both the Supreme Court and the administrative sectors specifically point out problems which should be addressed by the personal bankruptcy law. Firstly, the establishment of personal bankruptcy law is considered as the solution to enforcement failure cases in which the debtor cannot make payments to creditors. According to the Supreme Court's annual report, a significant number of cases relating to natural persons belongs to the 'enforcement failure' group, also called unenforceable cases, in which no property was available for enforcement.[5] Under the current Chinese legal framework, even though creditors have no hope of collecting those debts, the enforcement process can only be stayed rather than concluded. The court needs to investigate those cases every six months to find out whether there are any changes to the debtor's financial circumstances, which will waste judicial resources. In this sense, to protect the trustworthiness of legal instruments, the court becomes the party taking the 'unlimited liability'.[6] If there was personal bankruptcy law in China, a large number of enforcement failure cases could be diverted into bankruptcy proceedings. Thus, instead of creditors making individual efforts to pursue enforcement against a debtor, all creditors will be dealt with in one bankruptcy procedure, which can save judicial resources. Furthermore, due to the finality of bankruptcy process, enforcement failure cases can be concluded and excluded from the judicial system, which is viewed as an approach to protect the

[5] The Supreme People's Court, Report of the Supreme People's Court on the Work of the People's Courts in Solving the 'Difficulties in Enforcement' (Law Press, 2018) 79.
[6] Ibid 80.

State's credit.[7]

The Supreme Court does not specify the function of the law on debt recovery besides mentioning the legal objective of solving enforcement difficulties. Instead, the judiciary claims to 'promote the improvement of the enforcement assistance system and the judicial assistance insurance system, so that more parties in trouble from cases regarding people's livelihood can obtain assistance'.[8] In this sense, the rehabilitation function of insolvency law seems to be downplayed in the agenda of the Supreme Court.

In addition to dealing with enforcement difficulties, the establishment of a personal bankruptcy system can encourage economic activities and improve the market mechanism. Though there is a degree of dissent[9], the idea that personal bankruptcy law can facilitate entrepreneurship is prevalent around the world. William O. Douglas observed that the generous bankruptcy discharge contributed to US experimentalism [10] and the New Labour government in the United Kingdom

[7] Ibid.
[8] Ibid 109.
[9] David Primo and Wm Scott Green, Bankruptcy Law and Entrepreneurship [2011] 1 Entrepreneurship Research Journal 1; Robert Lawless, Striking Out on Their Own: the Self-Employed in Bankruptcy [2012] in Katherine Porter (ed.) *Broke: How Debt Bankrupts the Middle Class* (Stanford University Press, 2012); Additionally, the Insolvency Service in England and Wales found no link between a more generous discharge process and the business start-ups, the Insolvency Service, Enterprise Act 2002- The Personal Provisions: Final Evaluation Report November 2007 (London, Insolvency Service, 2007) 41-42.
[10] William O Douglas, 'Bankruptcy' *Encyclopedia of the Social Sciences* (London, Macmillan Publishing Co., 1937).

welcomed entrepreneurism at the beginning of 21st century made possible by the liberalisation of its discharge process.[11] In Europe, policymakers also showed interest in reforming their personal bankruptcy system for the purpose of promoting entrepreneurship. In December 2012, the European Commission appealed for the adoption of 'a new European approach to business failure and insolvency' in a communication.[12] It claimed that 'modern insolvency law in the Member States should help sound companies to survive and encourage entrepreneurs to get a second chance'.[13] The 2012 Communication was repackaged as a Recommendation in 2014.[14] The Recommendation reiterated the need to provide a timely discharge, and that debt relief should be applicable to all natural persons (including entrepreneurs and consumers). In 2019, the EU implemented a Directive on restructuring and insolvency, which aims to provide a full discharge for honest entrepreneurs.[15] In the Chinese context, recently published departmental regulatory documents recognise that 'the exit system for market participants is an integral component of the modern economic system, for the purposes of unblocking the exit channels for market participants, improving the market mechanism for the survival of the fittest, and promoting high–

[11] Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of The US and Europe* (Hart 2017) 173.

[12] Communication from the commission to the European Parliament, the Council and the European Economic and Social Committee Com (2012) 742 final (Dec. 12 2012) 2.

[13] Ibid 3.

[14] Commission Recommendation of 12.3.2014 on a New Approach to Business Failure and Insolvency, Com (2014) 1500 final (Mar.12 2014).

[15] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJ L 172/18.

quality economic development'.[16] The overall objective set in the regulatory document is to establish an efficient and orderly exit system covering various market participants such as companies, unincorporated organisations and individuals.[17] Given this, the document proposes to expand the coverage of the bankruptcy law.[18]

Table 2: The Supreme People's Court's and Other Government Departments' Opinions on Personal Bankruptcy Law

Year	Opinions
2018	Qiang Zhou, President of the Supreme People's Court, reported that 'reasons for difficulties in enforcement are complicated, and a collective expression of the intertwining of various social problems and contradictions. …Fourth, the law and supporting systems are not sound and complete. China has not yet enacted a

[16] Instrumentalities of the State Council, All Commissions, State Development & Reform Commission (incl. former State Development Planning Commission), Supreme People's Court, All Ministries, Ministry of Industry & Information Technology, Ministry of Civil Affairs, Ministry of Justice, Ministry of Finance, Ministry of Human Resources & Social Security, All Banks, People's Bank of China, State-owned Asset Supervision & Administration Commission of the State Council, All Administrations, State Taxation Administration, State Administration for Market Regulation, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, 'Notice by the National Development and Reform Commission, the Supreme People's Court, the Ministry of Industry and Information Technology and other Departments of Issuing the Reform Plan for Accelerating Improvement of the Exit System for Market Participants',No.1104 [2019] of the National Development and Reform Commission.

[17] Ibid.

[18] Ibid.

	separate compulsory enforcement law. The enforcement procedure has only 35 provisions in the Civil Procedure Law, and many issues are not clearly stipulated. In terms of the supporting system, China has not yet established a personal bankruptcy system, and the aiding system related to enforcement cases is not sound. ' [19] 'In response to the new situation and existing problems in our current efforts to solve the difficulties in enforcement, four suggestions are hereby proposed: …Second, improve the legislation of enforcement , accelerate the formulation of the compulsory enforcement laws in accordance with the deployment of the Fourth Plenary Session of the 18th CPC Central Committee, and provide adequate legal protection for solving the difficulties in enforcement. We should promote the establishment of the personal bankruptcy system, improve current bankruptcy law,

[19] The Supreme People's Court (n.5) 78.

	and unblock the channels for 'enforcement failure' cases to exit according to the law. ……'[20]
2018	Wanhua Du, the vice director of the SPC Investigation and Punishment Advisory Committee, published an article in the People's Court Daily, indicating that 'Against the background of the implementation of Chinese corporate bankruptcy law, in order to preserve the function of corporate limited liability, effectively promote the role of individuals in the market, completely solve the difficulties in enforcement as well as maintain the stability of domestic relations, we should establish a personal bankruptcy system '[21]
2019	The Supreme People's Court and other governmental departments issued a Notice,

[20] Ibid 109.

[21] "随着我国企业破产审判制度的逐渐落实，从维护我国企业法人有限责任制度的科学性考虑，从有效推动以自然人为特征的市场主体制度的完善入手，从彻底解决执行难的角度出发，从维护我国婚姻家庭制度的稳定性着想，我国都应当建立个人破产制度" 杜万华，'结合当前形势，落实"纪要"精神 积极推进我国破产审判工作迈上新台阶'(人民法院报，2018 年 10 月 31 日) <http://rmfyb.chinacourt.org/paper/images/2018-10/31/05/2018103105_pdf.pdf > accessed by 14 December 2019.

	claiming that "the establishment of a personal bankruptcy system shall be researched, and the focus shall be on solving the problems of joint and several liability and security debts of natural persons arising from enterprise bankruptcy. It shall be specified that a natural person may be lawfully and reasonably discharged from liability for debts related to production and operations incurred for security and other reasons. It shall be gradually advanced to establish a system that a natural person may be lawfully and reasonably discharged from eligible consumer debts and to finally establish a comprehensive personal bankruptcy system." [22]; In addition, "a

[22] Instrumentalities of the State Council, All Commissions, State Development & Reform Commission (incl. former State Development Planning Commission), Supreme People's Court, All Ministries, Ministry of Industry & Information Technology, Ministry of Civil Affairs, Ministry of Justice, Ministry of Finance, Ministry of Human Resources & Social Security, All Banks, People's Bank of China, State-owned Asset Supervision & Administration Commission of the State Council, All Administrations, State Taxation Administration, State Administration for Market Regulation, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission (n.16).

	monitoring and early warning mechanism for the debt risks of natural persons shall be established. The analysis and monitoring of the debt level and debt structure of residents shall be strengthened, the assessment indicator and early warning mechanism for the debt risks of natural persons shall be improved, an education and training mechanism for the public management of financial risks and wealth management capabilities shall be established, a natural person's risk of excessive indebtedness shall be prevented, and the relationship between the protection of the rights and interests of creditors and that of the subsistence right of debtors shall be effectively handled."[23]

Against this background, several courts and local governments started their experimentation with personal bankruptcies. Shenzhen, a vibrant and innovative city, started to explore the introduction of personal bankruptcy law in the special economic zone and since 2013, the Shenzhen Bar Association has initiated research on individual

[23] Ibid.

bankruptcy law. As a result, a draft law of personal bankruptcy regulation, which may only take effect within the municipality of Shenzhen, has been proposed in 2016.[24] A preliminary review of the proposed law indicated a deep concern about opportunistic abusers.[25] Therefore, the law established strict prerequisites for accessing procedures and acquiring debt relief. To initiate the liquidation process, debtors are required to submit documents indicating five years of income and expenditures.[26] Additionally, debtors' current living standards cannot surpass a specific level equivalent to the local minimum wage.[27] In terms of obtaining a discharge, the grant of discharge is based on the unanimous vote of the creditors' committee.[28] However, this draft has not been officially submitted to the local congress and therefore has not become law. In 2020, a new draft law of personal bankruptcy regulation was officially submitted to Shenzhen's congress for discussion. Currently, this 2020 proposal has been passed in August 2020. It is much more liberal than the 2016 proposal. There are no rigorous and restrictive prerequisites for accessing debt liquidation or the debt repayment plan. The Shenzhen regulation has provided various solutions to individual insolvencies: bankruptcy with discharge after three years, but also the possibility of an early

[24] 卢林（主编），'深圳经济特区个人破产条例草案：建议稿附理由'（法律出版社，2016）（Lu Lin (ed.), A Propositional Version with Reasons for Shenzhen Special Economic Zone Personal Bankruptcy Regulation Draft, (Law Express China, 2016)）.

[25] Jason J Kilborn, 'The Rise and Fall of Fear and Abuse in Consumer Bankruptcy: Most Recent Comparative Evidence from Europe and beyond' [2018] 96 Texas Law Review 1327,1350.

[26] Lu Lin (ed.) (n.24) Article 95.

[27] Lu Lin (ed.) (n.24) Article 103.

[28] Lu Lin (ed.) (n.24) Article 158-159.

discharge if the undischarged bankrupt can make prescribed contributions to their creditors; a debt reorganisation where the debtor needs to pay a percentage of debt within less than five years; the compromise proceedings where debtors can voluntarily negotiate with creditors before the adjudication of bankruptcy.

In addition to Shenzhen, several courts in Zhejiang Province have made further efforts to explore the institutional framework of personal bankruptcy. Theoretically, in the civil law jurisdictions, legal rules are designed and enacted by legal writers or legislators and the Chinese legal system borrows heavily from civil law traditions. The primary source of law has been nationwide legal rules formulated by the National People's Congress (NPC) and its Standing Committee. Other subordinate legal rules are enacted by local congresses. In addition to the People's Congresses, administrative bodies also have certain rule-making powers conferred by the constitution and relevant law. Therefore, strictly speaking, the court only plays a mechanical role in applying the law rather than writing it. However, due to the transitional feature of Chinese society, it is inevitable for courts and judges to play an increasing role in interpreting the law or even in the legislative process.[29] At the national level, since the 1980s, the Chinese Supreme Court has officially been permitted to enact binding interpretations of primary laws passed by NPC and its committees.[30] At the local level,

[29] Chenguang Wang, 'Law-making Functions of the Chinese Courts: Judicial Activism in a Country of Rapid Social Changes' [2006] 1 Frontiers of Law in China 524.
[30] Chao Xi, 'Local Courts as Legislators? Judicial Lawmaking by Subnational Courts in China' [2013] 34 Statute Law Review 39, 41.

though there is no official permission, local courts in practice conduct so-called judicial innovation to handle certain novel cases.[31] Against this background, courts in Taizhou and Wenzhou published their implementing opinions[32] on personal bankruptcy cases and in practice accepted and resolved those cases. Reviewing the institutional framework of personal bankruptcy practice in Taizhou and Wenzhou can provide relevant insight in understanding how personal bankruptcy cases are practically addressed in the Chinese context.

8.3 The institutional framework of Chinese judicial experiments[33]

8.3.1 Taizhou model

The Taizhou regulation has made provisions for the liquidation process and the repayment plan procedure.[34] Under the liquidation process, debtors need to relinquish their non-exempt assets[35]and the administration determined by the court

[31] Ibid 42.

[32] 温州市中级人民法院，关于个人债务集中清理实施意见 （试行）（The Intermediate Court of Wenzhou, "The Implementing Opinions on the Centralized Clean-up of Personal Debt（Trial）"）；台州市中级人民法院，执行程序转个人债务清理程序审理规程（暂行）(The Intermediate Court of Taizhou, "The Guiding Rule for Transferring Compulsory Enforcement Cases to the Clean-up of Personal Debt"(Interim)).

[33] Given that Shenzhen regulation will not come into effect until 2021, this chapter focuses on practices which are currently effective.

[34]台州市中级人民法院，执行程序转个人债务清理程序审理规程（暂行）(The Intermediate Court of Taizhou, "The Guiding Rule for Transferring Compulsory Enforcement Cases to the Clean-up of Personal Debt"(Interim)).

[35] Taizhou courts have prescribed the categories of exemption property including essentials such as clothes, furniture, and cutlery but the aggregate value should be less than RMB 20,000 (around GBP 2300); necessary maintenance for the debtor and his dependents; fundamental goods for compulsory education; funds, aids, medical supplies for treating the debtor and his dependents; assets which are characterised as of a personal nature including disability grants, supporting pensions; low-value medals and other awards. Id Article 54

will have the power to distribute these assets. In cases where the number of creditors is less than 20, or individuals are no-income-no-asset debtors and the fact is clear and simple, or debtors' primary assets have been disposed of in enforcement procedure, a simplified liquidation process is applicable.[36] Under the simplified liquidation procedure, the creditor meeting is not compulsory and the court can decide the case by a written hearing.[37] However, dissenting creditors can apply to the administration for convening the creditor meeting. Although the administration needs to formulate the distribution plan in the simplified process, whether any distributions will be made to creditors depends on whether it is obvious that the debtor cannot pay. In this sense, the case of Mr. Ke exemplifies a simplified liquidation procedure without any distributions.[38] After the application of an administrator and the investigation of Mr. Ke's financial affairs, the court directly ruled out the cancellation of the debt and made no distribution between creditors.[39] However, although the remaining debt can be written off after the conclusion of the liquidation process, the debtor will be subject to disqualification restrictions and behaviour controls within a certain period.[40]

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[36]台州市中级人民法院，执行程序转个人债务清理程序审理规程（暂行） (The Intermediate Court of Taizhou, "The Guiding Rule for Transferring Compulsory Enforcement Cases to the Clean-up of Personal Debt"(Interim)) Article 49.

[37] Ibid.

[38] Shanwen Ke, an over-indebted debtor from Taizhou, can be historically marked as the first person whose liabilities are written off in modern China. Mr. Ke owed debts to three banks for several years. Creditors applied for the compulsory enforcement but the enforcement process was suspended due to the fact that Mr. Ke had no ability to repay any debts. By 2018 the total amount of debt was 480,000 yuan ($70,000) but Mr. Ke had no income, only a one-room apartment and no more than 100 yuan in savings. Given this, on 29th April 2019, the local court ruled that Mr. Ke's case was terminated and his liability cancelled. The Economist, 'A Way Out: China is Clamping Down on People Who Default on Their Debts. It Should Accept that Some of Them Also Need Help' (30th May 2019).

[39] 柯善文管理人破产民事裁定书 （2019） 浙 10 破 2 号之一.

[40] Those disqualifications and behavior restrictions including '1. The debtor cannot

However, if the debtor can pay more than 60% of his total debt, the period of restrictions can be shortened.[41]

In addition to the liquidation process, the other path is the repayment plan procedure. According to the Taizhou regulation, the debtor needs to submit his proposal to the administration.[42] In the proposal, the debtor needs to specify the amount of repayment, the period of the plan and the instalments.[43] Meanwhile, the rule prescribes that the duration of the plan should be below seven years.[44] If the majority of unsecured creditors (over 50% in value) vote in favour, the proposal will be accepted.[45] Then, the court will confirm the approved plan within three days[46] and debtors need to make payments in accordance with the plan. However, the Taizhou regulation does not make express provisions on the effects of the circumstance where the proposal is rejected. The regulation only stipulates that the administration or

undertake specific business in a prescribed period; 2. Within the stipulated period, the debtor cannot be the legal representative, the shareholder and senior executive of a company;3. the debtor should comply with the rules in high consumption restriction orders but he can take economy public transportation and stat at economy hotels if it is necessary for his daily life and work; 4. the debtor need to report his financial affairs to the administration in every six months within the restriction period; 5. the debtor shall report his business undertakings to administration in advance, he need to make payments to the administration from 60% of his operating income after deducting basic living costs living expenses, if there is a repayment plan, the amount paid by the debtor is accordance with the proportion specified in the plan. Those restrictions will last between four and six years.'台州市中级人民法院，执行程序转个人债务清理程序审理规程（暂行）(The Intermediate Court of Taizhou, "The Guiding Rule for Transferring Compulsory Enforcement Cases to the Clean-up of Personal Debt"(Interim)) Article 57.

[41] Ibid Article 60.

[42] Ibid Article 40.

[43] Ibid.

[44] Ibid.

[45] Ibid Article 41.

[46] Ibid Article 42.

stakeholders can apply for the transfer from the repayment plan procedure to liquidation in cases where debtors cannot implement in accordance with the plan.[47] In this sense, it may be possible for the debt repayment procedure to be transferred to the liquidation process if the plan is rejected by the creditors. When the plan is completed, the court will make the ruling announcing the termination of the procedure and the imposition of behaviour restrictions, which are the same as those in the liquidation process.[48]

8.3.2 Wenzhou model

The regulation designed by the Wenzhou court only provides the debt adjustment plan as the solution to personal bankruptcy cases. When filing for the debt arrangement procedure, the debtor needs to submit documents outlining basic information on matters relating to the application: the reasons for the application and relevant facts.[49] In addition, the applicant needs to attach a file indicating his financial affairs and the arrangement plan.[50] The arrangement plan should include, at minimum, terms indicating the living expenses needed by the debtor and his dependents; payment rates, how to make payments (for example, by instalments or in one lump sum), the application for credit rehabilitation and disposal plan for any assets which are

[47] Ibid Article 44.
[48] Ibid Article 57.
[49]温州市中级人民法院，关于个人债务集中清理实施意见 （试行）（The Intermediate Court of Wenzhou, "The Implementing Opinions on the Centralized Clean-up of Personal Debt（Trial）"）Article 9.
[50] Ibid Article 10.

temporarily unable to be disposed of due to current circumstances.[51] If the debtor chooses to make payments in instalments, the plan should be less than three years. After receiving the application, the court will investigate the debtor's financial affairs to determine whether the case is acceptable. Once the case is accepted, the court will gazette the acceptation of the case.[52] At the same time, appointments will be made to administer the case. The administration can be determined by the court or by negotiation between the debtor and his creditors.[53] Then, the administration will convene the creditor meeting. The regulation has made provisions that creditors can apply for the presence of a debtor's relatives to attend the creditor meeting and[54] the relatives' failure to attend will have the effect of dismissing the case.[55] The debtor's adjustment plan can be accepted in the circumstance where unsecured creditors unanimously approve the plan,[56] but the approval rate is changeable in accordance with the creditor's will. Therefore, if unsecured creditors agree to decrease the approval rate to 75% or 50%, the court will respect their decision. When a debtor's proposal is rejected by their creditors, the court will terminate the procedure.[57] Otherwise, the administration will supervise the implementation of the plan. When the debtor completes the plan, he will be subject to credit disqualifications[58] and

[51] Ibid.
[52] Ibid Article 19.
[53] Ibid Article 17.
[54] Ibid Article 25.
[55] Ibid.
[56] Ibid Article 22.
[57] Ibid Article 29.
[58] It prescribes that the period of disqualification will last for three to six years in general cases since the implementation of the debt arrangement plan. There are some circumstances when the period can be shortened. If the total debt amount is less than 2

behaviour restrictions for a period of time.[59] Although there are no express provisions indicating debt discharge, Cai's case[60] has implied the debtor can pragmatically write off the remaining debt after the completion of the plan. Though there is a chance of debt relief, the Wenzhou rule has made provisions on specific non-dischargeable debts.[61]

8.4 A comparative analysis of the Wenzhou and Taizhou models

Though regulations in Wenzhou and Taizhou are not nationwide, they at least convey a rudimentary image of the institutional framework of personal bankruptcy legislation

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million yuan and the payment rate is higher than 50%, the debtor's credit can be restored after 1 year from the date when the repayment plan is fully implemented. Where the debt amount is between 2 million yuan and 5 million yuan and the repayment rate is higher than 30%, the restriction period become 1-3 years. If the total debt is between 5 million yuan and 20 million yuan and the repayment rate is more than 10%, the restriction will last for 2-5 years. Ibid Article 34.

[59] Before the end of credit disqualification, the debtor will be subject to the high consumption restriction orders: he/she cannot be the legal representative and shareholder of a profit-seeking company, cannot be the legal representative, director, and supervisor of a state-owned enterprise and other behavior restrictions stipulated by the court. In addition, the debtor cannot go abroad for a business trip without the leave of the court. Id Article 35

[60] In this case, Mr. Cai, whose full name was not revealed by the court, had contributed 5,800 yuan (about $850) and owned 1% of share in a bankrupt enterprise. However, he had undertaken joint liability for the failed company, amounting to over 2 million yuan (around $290,000). After investigation, the court found that Mr. Cai had no ability to repay the debt. According to the press conference jointly hold by the Intermediate People's Court of Wenzhou and the Basic Court of Pingyang, Mr. Cai had an income amounting to 4,000 yuan ($580) a month. His wife also had a monthly income of 4,000 yuan (approximately $580). Additionally, Mr. Cai owns a broken motorbike and a few savings. However, he has some chronic diseases including hypertension and kidney-related issues. The regular medical expense was significant. Furthermore, he needs to support his child to go to university. Therefore, taking his income and spending into account, the court accepted his application. Then, he made a proposal that he would repay a lump sum of around 32,000 yuan within 18 months. In the meantime, within six years upon the completion of the repayment plan, if the household annual income were to exceed 120,000 yuan, Mr. Cai must pay 50% of his excess income to creditors. After the completion of the proposal, Mr. Cai can discharge from pre-existing debts.

[61] Debts for personal injury and debts for statutory alimony cannot be discharged. Ibid Article 30.

in the Chinese context. Accordingly, what follows is a comparison of current personal bankruptcy regulations with the American, English and German debt relief laws.

First, we focus on the liquidation process designed by the Taizhou court. At first sight, the Taizhou liquidation procedure resembles the American Chapter 7 and bankruptcy procedure in England. Since the commencement of the liquidation, the debtor needs to relinquish his non-exempt assets for distribution. However, there are distinctions between the Taizhou liquidation process and the American or English counterparts. Firstly, both American and English debtors can voluntarily choose the liquidation process or other alternatives. However, under the Taizhou regulation, debtors have no idea whether their case will be accepted as a liquidation proceeding or a repayment procedure. Instead, the court will decide which procedure fits the debtor's circumstances. The eligibility examination is based on the possible amount of a debtor's future income.[62] However, this eligibility is not as straightforward as the American means-test which has a complex but clear formula. Therefore, whether the debtor has possible future income is decided at the judges' discretion. In addition, there are provisions for a simplified liquidation process. This simplified proceeding is speedier than the general liquidation in some aspects including a shorter period for the proof of debts, less time for investigating a debtor's financial affairs and less time for submitting the distribution plan and a non-mandatory creditor meeting. Except for those abovementioned differences, this simplified proceeding is the same as the

[62] Ibid Article 39.

general liquidation process in terms of gathering, collecting and distributing debtors' assets. However, in the case of Mr. Ke there are no contributions to creditors. This implies that the simplified liquidation procedure also has some characteristics of the English Debt Relief Order (DRO), where debtors will not contribute to their creditors. However, the English DRO is an administrative procedure while the simplified liquidation process is a judicial one. Moreover, the zero-distribution case is determined by the court's judgment on debtors' financial affairs not by a clear eligibility test. Therefore, compared to the institutional framework of DRO, making no contributions to creditors in the simplified liquidation procedure may be an exception.

With regards to the legal and practical consequences following the liquidation process, Taizhou's regulation shares more commonalities with the German and English models. Under the German debt relief law, discharge is a separate proceeding for which the debtor must file a petition. Furthermore, the discharge period, namely the good-behaviour period, is six years, though there is the possibility of an earlier discharge. During this period, the debtor needs to assign his surplus income to his creditors and in addition, the debtor must devote himself to keeping employed during the good-behaviour period. At the end of the assignment period, the court will examine whether there are reasons for the denial of discharge. It is only after the debtor has complied with all the obligations and no reasons to refuse the discharge have been submitted, that the court will grant the debt relief. Comparatively, under the Taizhou rule, at the end of liquidation, the court will announce the termination of the proceeding. The

effect of this announcement is for the debtor's pre-existing financial obligations to be written off. However, while the liquidation is terminated by the court, behaviour restrictions and disqualifications will start to be imposed on the debtor. Those restrictions and disqualifications will last for between four and six years. This period is similar to the German good-behaviour period. Contravening those rules will lead to the dismissal of the case or the denial of debt discharge. However, there is a distinct difference between German debt relief law and the Taizhou rule in that no express provisions require that debtors should keep employed during the restriction period. With regards to those behaviour restrictions and disqualifications, they are similar to the range of English bankruptcy disqualifications or a bankruptcy restriction order. Under English bankruptcy law, the undischarged bankrupt is subject to certain legal restrictions and disqualifications.[63] Some of the legal restrictions stipulated in the Taizhou regulation are similar to its English counterpart. For instance, the debtor cannot be the senior director of an enterprise and cannot obtain credit over a prescribed amount without the leave of the court. However, legal restrictions have an effect on all debtors for several years. Comparatively, British restrictions last for one year in most cases and will be extended only under circumstances where the debtor has violated the rule of bankruptcy law.

When considering the repayment plan procedure, except for the difference in approval

[63] There is a summary of legal restrictions and disqualifications in Ian F Fletcher, *The law of insolvency* (5th edition, Sweet & Maxwell, 2017) 346-348.

rate, there are no substantial distinctions between the Taizhou and Wenzhou models. The rules of the insolvency plan in both models more closely resemble those of the English IVA where the courts are reluctant to get involved.[64] The terms of IVAs are purely determined contractually. The court cannot cram down an arrangement in English personal bankruptcy law. On the other hand, both American and German models have the cram-down mechanism overruling the minority of creditors. In Wenzhou and Taizhou models, neither regulation has provisions providing that the court can approve a repayment plan on behalf of the debtor when minor creditors reject the plan. However, there is one significant difference between English Individual Voluntary Arrangement (IVA) and current arrangement plan procedures in Wenzhou and Taizhou. When the debtor completes the debt settlement plan, legal restrictions and disqualifications will be imposed on him under Taizhou or Wenzhou regulations. To some extent, this institutional design can be seen as a Chinese feature. From a comparative perspective, none of those three jurisdictions has provisions imposing legal restrictions or disqualifications on debtors who have fulfilled a debt arrangement plan.

From the comparative analysis of current Chinese personal bankruptcy regulations, we can find that the institutional framework of regulations embodies a mix of characteristics. It is difficult to argue that current legislations imitate one specific

[64] Joseph Spooner, *Bankruptcy: The Case for Relief in an Economy of Debt* (Cambridge University Press, 2019) 137.

model. Instead, it seems that both Wenzhou and Taizhou regulations have learnt from various jurisdictions including the United States, England and Germany. American personal bankruptcy law is known for its immediate discharge through Chapter 7. Under the Taizhou liquidation process, we can see elements of American swift discharge. Regarding the NINA debtors, the Taizhou regulation incorporates a specific simplified liquidation process and in general, this simplified process has elements in common with English DRO. Additionally, there are provisions which are similar to German good-behaviour rules and English legal restrictions and disqualifications. However, beyond imitating other jurisdictions, regulations in Wenzhou and Taizhou have indicated one distinct Chinese feature. No matter whether in a liquidation process or a debt repayment plan, all debtors will be subject to legal restrictions and disqualifications. This distinct feature implies that Chinese debt discharge is a 'two-phase' model. The first phase is the cancellation of excessive debts at the financial level; when the liquidation process is terminated or the repayment plan is completed, debtors will not be responsible for the pre-existing debt. In the second stage, the debtor will be subject to legal restrictions and disqualifications within a certain period. Only after the restrictions elapse can we say the debtor has obtained a fresh start. Given this, it is fair to say that current Chinese personal bankruptcy regulations have hybrid characteristics mixing foreign experiences and a distinct Chinese feature.

8.4.1 Debt collection or debtor recovery?

The comparative analysis of regulations designed by local courts implies that the

institutional framework has absorbed experiences from other jurisdictions while retaining a distinct feature. This section will examine the law's influence on the creditor-debtor relationship. In other words, it will explore whether current regulations provide debtor recovery or offer creditors another form of debt enforcement.

To a certain extent, the regulations in Wenzhou and Taizhou objectively offer debtors a chance of rehabilitation. Firstly, both regulations make no distinction between merchants and consumers and in this sense, all types of debtors can apply for the process. Furthermore, the Taizhou liquidation process has considered NINA debtors; a simplified process is introduced, which offers NINA debtors a speedier solution to over-indebtedness. In terms of the repayment plan procedure, both regulations limit the period of the plan. The Wenzhou regulation requires that the duration of a repayment plan does not exceed 3 years while Taizhou prescribes the plan shall be less than 7 years. Given this, the debtor may not suffer from a lengthy repayment plan.[65]

However, behaviour restrictions and disqualifications following the liquidation and repayment plan discount debtor recovery. From the comparative perspective, it is observable across the countries that certain legal and practical consequences will be imposed on debtors during a bankruptcy proceeding.[66] For instance, undischarged

[65] Ibid 164.
[66] European Commission, Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States Relevant Provisions and Practices, 355.

bankrupts in England are subject to prohibitions on accessing new credit, holding certain offices and practising certain professions. The Taizhou liquidation process has introduced behaviour restrictions which are similar to the English framework. However, unlike the English one-year discharge period, the length of restrictions in the Taizhou regulation is between 4 and 6 years. Moreover, both Wenzhou and Taizhou regulations have prescribed behaviour restrictions following debt settlement procedures. Though English IVAs also impose some restrictions on debtors including obtaining new credit and the obligation to disclose any change in their financial affairs, behaviour restrictions designed in the Wenzhou's and Taizhou regulations have a wider range on restricting debtors' high consumption. Furthermore, the behaviour restrictions and disqualifications will come into force once the debt arrangement plan is completed. By contrast, those restrictions following IVAs will not work upon the completion of the plan. Concerning the negative consequences of lengthy restrictions in relation to liquidation and debt arrangement procedure, they may impose a strong stigma on debtors. Due to the imposition of those behaviour restrictions, the overall process to obtain a fresh start will take a long time. From the perspective of debtors, it becomes less certain whether they will eventually obtain full rehabilitation with the result that it is unclear whether they can effectively re-enter the community.

Compared with allowing re-admission into the community and debtor recovery, creditors' interests have received more comprehensive protection. Firstly, the debt repayment procedure is more favourable to them. In the Wenzhou regulation, only the

debt payment plan is available for over-indebted individuals. In this sense, it implies the principle that creditors should share the fruits of a debtor's future labour. This principle is also embodied in the Taizhou regulation. Though the Taizhou institutional framework provides a liquidation process and debt arrangement procedure, debtors cannot voluntarily choose between them. Instead, only the court has the power to decide which procedure applies to the filer. The criterion is whether the debtor has prospects of future income. Debtors having future income must enter the debt repayment procedure. However, given the absence of a clear definition of future income, debtors having low income or low net income also fall into the group having forthcoming income. As a result, most debtors may enter the debt adjustment procedure. By limiting access to the liquidation process, creditors may have more returns. In addition to the preference on debt payment procedure, other mechanisms aim to enhance creditors' returns. Taking the Taizhou regulation as an example, it prescribes that the debtor needs to semi-annually report his financial affairs to the administrator during the behaviour restrictions period. Possibly, if the debtor's financial circumstances improve, he may make voluntary contributions to creditors for shortening the period of behaviour restrictions. However, if the debtor undertakes business during the behaviour restriction period, he must share the income earned from his operation with creditors. To an extent, the abovementioned mechanism is similar to the English income payment order or income payments agreement directing that the bankrupt needs to contribute part of his income to the trustee for a period of time. However, unlike both income payment order or income payments agreement

following the bankruptcy procedure, Taizhou provisions apply to debtors who complete their repayment plan. As a result, even though the debtor has fulfilled his contractual repayment plan, he may be subject to a further mandatory repayment programme. In this sense, we can see the court has made the greatest efforts to maximise creditors' returns. With the Wenzhou regulation, there are no provisions prescribing the obligation to report financial affairs after the termination of the repayment procedure. At the same time, the rule does not compulsorily require debtors to make contributions to creditors after the termination of the repayment proceeding. Instead, it creates certain incentives, including a reduction of the duration of behaviour restrictions, in an attempt to encourage more contributions after the completion of the payment plan. In this respect, compared with the Taizhou's rule, the Wenzhou institutional design does not mandatorily require debtors to make distributions if they are undertaking business or employed. Notwithstanding, it is by no means accurate to say that the Wenzhou regulation is pro-debtor. Ensuring creditors' interests is still a priority. According to the Wenzhou rule, the court will establish a list publicising information on a debtor and before the expiration of the behaviour restrictions, he/she will be subject to supervision from creditors, courts and the public. During this period, anyone discovering any misconduct on the part of the debtor (for example, the violation of behaviour restrictions, concealing property and misrepresenting financial affairs) can report to the administration. Then, the administration will report to the court and apply for the resumption of compulsory enforcement procedure. In this sense, through imposing strict supervision on debtors'

behaviour, the court safeguards creditors' interests comprehensively.

8.5 Rethinking Chinese judicial experiments on personal bankruptcies

8.5.1 Why is debt rehabilitation downplayed?

Through examining the institutional designs of current Chinese personal bankruptcy practices, it seems that maximising creditor returns is a priority over debtor rehabilitation. This leads us to ask why creditor wealth maximisation became the core identity in Chinese personal bankruptcy practices. Firstly, there is a bias towards the image of an insolvent debtor. Under the circumstance in which a debtor cannot comply with his financial obligations, he will be called a 'deadbeat' (老赖). In the English dictionary, "deadbeat" means "a person or company that tries to avoid paying their debts".[67] In this sense, this word assumes that debtors can repay but they are not willing to pay. Generally speaking, such an assumption implies a defaulting debtor to be a dishonest person. Furthermore, the media often report negative news relating to defaulting debtors, which describes how they are sanctioned.[68] Hence, there is a public perception that defaulting debtors are mostly keen on dodging financial obligations. Based on this image of defaulting debtors, we can understand why Chinese personal bankruptcy experiments in Wenzhou and Taizhou impose strong

[67] *Oxford Advanced Learner's English-Chinese Dictionary* (the 6th Edition) (The Commercial Press and Oxford University Press, 2004) 433.

[68] Caixin, Deadbeats Denied Seats on Airliners, Sleeper Trains< https://www.caixinglobal.com/2016-09-13/deadbeats-denied-seats-on-airliners-sleeper-trains-101053006.html > accessed by 20 January 2020; 新华网 1400 多万人次身陷"老赖"的背后< http://www.xinhuanet.com/2019-11/12/c_1125223915.htm > accessed by 20 January 2020

stigma on defaulting debtors. Additionally, path dependency contributes to the preference for creditor asset recovery. Path dependency theory has indicated that historical choices may have long-term and influential effects making an institutional framework hard to change.[69] In fact, bankruptcy law is traditionally considered as a commercial law[70] dealing with creditor 'common pool' problems.[71] Creditor asset recovery is seen as the law's sole goal.[72] In addition, as discussed in the previous chapter, the institutional designs of Chinese enforcement processes are dedicated to making every effort to maximise creditors' returns. Therefore, it is quite natural that insurance function of insolvency law became an ancillary goal.

Moreover, no particular interest groups have campaigned for pro-debtor narratives in the Chinese context and therefore the authority lacks the incentives to swing the pendulum towards debtor rehabilitation. As summarised before, the SPC and other administrative departments did not regard the plight of debtors as the motivation to introduce a personal bankruptcy law. Instead, they consider personal bankruptcy law as a tool to address existing enforcement failure cases, protect the limited liability mechanism in corporate law and enhance economic activities. Therefore, debtor recovery is not the core objective in the authority's agenda. However, personal

[69] Paul Pierson, *Politics in Time: History, Institutions and Social Analysis* (Princeton University Press, 2004) 44-53
[70] Spooner (n.64) 69
[71] Thomas H. Jackson, *The Logic of Limits of Bankruptcy Law* (Beard Books, 2001) 11
[72] Adam J Levitin, 'Bankruptcy Politics and the Politics of Bankruptcy' [2011] 97 Cornell Law Review 1399, 1404-1405; Rizwaan J Mokal, 'The Authentic Consent Model: Contractarianism Creditor's Bargain and Corporate Liquidation' [2001] 21 Legal Studies 400, 401-402.

bankruptcy law has attracted the interest of scholars. Law professors have an incentive to participate in the legislative process of a certain law, which can enhance academic reputations and bring financial benefits.[73] For this reason, many law professors now focus on the institutional framework of personal bankruptcy law[74] and make proposals based on the framework in other jurisdictions such as the United Kingdom, United States, Japan and Germany. Unlike the establishment of corporate bankruptcy law where legal scholars debate on certain aspects of its institutional framework,[75] there seems to be more agreement on the structure in the context of individual bankruptcy regulation. Chinese professors tend to appreciate a repayment plan as the condition of discharge, legal restrictions and disqualifications following with insolvency proceedings, a cost-effective procedure for NINA debtors, a good-behaviour period and granting discharge.[76] Scholars usually claim that their proposals take Chinese cultural characteristics into account and can strike a balance between creditors' interests and debtors' protection.[77] However, those institutional designs

[73] Zuofa Wang, 'The Political Economy of the Implementation of the Bankruptcy Law of China' [2015] 6 Asian Journal of Law and Economics 249, 278.

[74] 刘静，'个人破产制度研究－以中国的制度构建为中心'（中国检察出版社，2010）；刘冰，论我国个人破产制度的构建，［2019］4 中国法学 223 （Bing Liu, The Institutional Designs of Chinese Personal Bankruptcy Law, [2019] 4 China Legal Science 223）；马哲，论个人破产余债免除制度在我国的适应性及其构建，［2019］4 中国政法大学学报 171 （Zhe Ma, On the Adaptability and Construction of Individual Bankruptcy Residual Debt Exemption System in China, [2019] 4 Journal of China University of Political Science and Law, 171）；卜璐，消费者破产法律制度比较研究 （武汉大学出版社，2013）（Lu Bu, A Comparative Research of Consumer Bankruptcy law, (Wuhan University Press, 2013)）；

[75] Those debates focus on bankruptcy administrator, priority between employee claim and secured claim. Wang (n.73) 252-255

[76] Liu (n.74); Bu (n.74); Ma (n.74).

[77] Ibid.

proposed by legal scholars have nothing to do with Chinese characteristics. There are no statistics on reasons for over-indebtedness in the Chinese context but such data is important because it may construct the image of an over-indebted debtor and recommend the policy response.[78] Living beyond one's means suggests disciplining of debtors or inhibiting the access to credit. By contrast, unemployment and severe illness may justify a more lenient bankruptcy law which can supplement other social insurance programmes. Due to the absence of a clear profile on Chinese over-indebted individuals, the policy responses proposed by legal scholars are not fact-based but feeling-based. This lack of research into facts on over-indebtedness leads to the failure to form pro-debtor narratives in personal bankruptcy cases. Given this, it is hard for legal scholars to campaign for a personal bankruptcy law which considers the insurance function as a core objective.

8.5.2 Can the current institutional framework achieve legislative goals?

The introduction of personal bankruptcy law aims to eliminate the unenforceable cases as well as improve the business environment. However, we argue that the present judicial practice fails to achieve those two goals. First, as we have discussed before, both the Wenzhou and Taizhou regulations favour the repayment plan as the main solution to personal bankruptcies. The plan is a contractual model whereby terms are negotiated by debtors and creditors and the court is seldom involved. German experience is that it is hard to reach an agreement between debtors and

[78] Ramsay (n.11) 21

creditors. In most cases, the negotiation will fail because debtors do not have sufficient assets to offer creditors or one main creditor objects to the plan. Though the judge may cram down a repayment plan, data has shown that only a small number of cases are settled through a debt payment plan since the enactment of the Insolvency Code.[79] In the Chinese context, there is no evidence that Chinese insolvency filers have a better capability to make payments than their German counterparts. In effect, Chinese applicants may be poorer because debtors in enforcement failure cases are those who have lost the ability to pay. Furthermore, the court does not have the power to overrule the minority of creditors. Given this, it is hard for debtors to reach an agreement with creditors. The rejection of the plan signals the end of the adjustment procedure. As a result, the enforcement process will restart and the enforcement failure cases will remain in the judicial system. In addition, assuming that creditors accept the repayment plan, it is very likely that debtors cannot complete the plan. Comparatively, the repayment plan procedure is similar to English IVAs where terms are decided by the bargaining between debtors and creditors. There is a 'general agreement that IVA terms are currently overly dictated by creditor groups'[80] and that 'the debtor is effectively powerless'.[81] Creditors have strong incentives to obtain higher levels of repayments from debtors; however, arrangements requiring high

[79] Statistisches Bundesamt,< https://www.destatis.de/EN/PressServices/Press/pr/2017/06/PE17_201_635.html > accessed by 13 Apr 2020

[80] Susan Morgan, Causes of Early Failures in Individual Voluntary Arrangements 41 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1393808 > accessed by 1 April 2020.

[81] Michael Green, Individual Voluntary Arrangements Over-indebtedness and the Insolvency Regime: Short Form Report (University of Wales 2002) 8.

contributions are more likely to fail. In relation to IVAs, surveys have found unaffordable contributions as a leading cause of failure.[82] Furthermore, there is an upward tendency in the failure rate of IVAs and over 40 per cent of IVAs initiated in 2008 have failed.[83] English experience implies that even though debtors' proposals can be accepted, it is likely that a significant number of plans will fail. As a result of this, a large number of enforcement failure cases will remain and the policymakers' purpose may not be achieved.

With regards to improving the business environment, current personal bankruptcy practices may fail as well. The establishment of individual bankruptcy law can encourage the hopelessly indebted debtors to reengage with social activities. Researchers have found that the reinvigoration and reinsertion of over-indebted debtors have at least two positive impacts.[84] On the one hand, debt relief can free debtors from the weight of creditor pressure, which 'encourages regular income production' and 'enhance(s) debtor's willingness and desire to be creative, even entrepreneurial'.[85] On the other hand, strengthening entrepreneurism and activating as many citizens as possible can promote national economic activity and contribute to the establishment of a vibrant society.[86] However, to achieve the abovementioned

[82]Morgan (n.80) 42; Insolvency Service, Survey of Debtors and Supervisions of Individual Voluntary Arrangements (Insolvency Service, 2008) 12; Insolvency Service, Review of the Impact of the IVA Protocol (Insolvency Service 2009) 18.
[83] Spooner (n.64).
[84] The World Bank (n.304) 38.
[85] Ibid.
[86] Ibid.

objectives, one assumption is that the personal bankruptcy system should function effectively. One of the significant characteristics of debt relief law is the debtor's economic rehabilitation. Therefore, whether or not the debtor can build up his economic rehabilitation can reflect the effectiveness of an insolvency system for natural persons.

At first sight, we can see that the Wenzhou individual bankruptcy experiment permits debtors to write off their debts, though they may need to complete a payment plan. In previous paragraphs, we have argued that creditors may extract extreme levels of contributions from debtors' future income and the failure rate of a payment plan may be high. Therefore, it is uncertain whether debtors implementing a payment plan can secure a release from excessive debts. However, the Taizhou regulation moves away from requiring the payment plan as the condition of debt relief for all debtors, offering debtors having no future income a straight liquidation process. In this sense, the Taizhou regulation may function better on building up a debtor's economic capability. However, rehabilitation does not only mean that the debtor can be released from excessive debt but also that he/she should be 'treated on an equal basis with non-debtors after receiving relief'.[87] This equal treatment of discharged individuals is an important support for the concepts of discharge and rehabilitation.[88] However, both Taizhou and Wenzhou courts stipulate strict behaviour restrictions after the

[87] Ibid 115.
[88] Ibid 116.

termination of insolvency procedures. Those restrictions influence debtors' post-discharge life including access to credit, the ability to undertake business and their career options. As a result, there is a danger that the discharge will not be respected after the procedure has concluded. Experiences from other jurisdictions imply that imposed legal restrictions and disqualifications may lead to strong stigma and discourage debtors' willingness to actively participate in economic activities.[89] Furthermore, one report published by the European Commission's Enterprise and Industry Directorate-General suggested that: 'a modern system for discharge is paramount to reduce the stigma of bankruptcy. In this system discharge should be as automatic and as reasonably limited in time as possible.'[90] Therefore, benefits including the enhancement of entrepreneurism and market vitality will be discounted.

8.5.3 Overemphasis of the fear of abuse

Theoretically and practically, we should admit that moral hazard and debtor fraud exist in a bankruptcy system.[91] Therefore, the law should have some mechanisms to discourage those counter products arising from the law's insurance function. In this sense, the introduction of behaviour restrictions and disqualifications may be justified.

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[89] To migrate the stigma resulting from insolvency proceedings, English personal bankruptcy law lift many disqualifications since 2002. Ian F Fletcher, *The law of insolvency* (5th edition, Sweet & Maxwell, 2017) 346-348.

[90] European Commission, Enterprise and Industry Directorate –General (2011) A Second Chance for Entrepreneurs Prevention of Bankruptcy, Simplification of Bankruptcy Procedures, and Support for A Fresh Start (Final Report of the Expert Group) 11.

[91] The World Bank, 'Report on the Treatment of the Insolvency of Natural Persons' 40 <https://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf> accessed by 10 Jan 2020.

However, our point is that policymakers should not overemphasise those concerns. Firstly, the concept of moral hazard is curious and it is difficult to measure its effects.[92] The *ex-ante* effects of moral hazard assume individuals will take on more debt than they can afford. However, there are many factors as to why debtors need to borrow. To measure the *ex-ante* effect, an assumption that debtors have a comprehensive understanding of the bankruptcy law should be established. However, the public is not necessarily familiar with bankruptcy.[93] Additionally, we cannot neglect that the final lending decision is made by creditors. In other words, creditors have strong incentives to monitor and control those reckless behaviours and furthermore, current information technologies have enhanced creditors' monitoring abilities. The development of Big Data and algorithmic calculation has enabled more advanced market segmentation.[94] As a result, creditors can have a better knowledge of borrowers' repayment capacities. Therefore, whether debtors can obtain excessive credit is more likely to depend on the decision of creditors. Regarding the *ex post* effect, an individual would be supposed to calculate the costs and benefits of the insolvency processes. This argument is based on one necessary assumption, that all costs and benefits can be measured in dollars. However, in reality costs and benefits are not purely economic. For a defaulting debtor, costs also include the loss of reputation and stigma resulting from the failure to repay. Therefore, measuring the *ex post* effects of

[92] Ramsay (n.11) 23.
[93] Ibid 16.
[94] J. Lauer, *Creditworthy: A History of Consumer Surveillance and Financial Identity in American* (Columbia University Press, 2017).

moral hazard is not a simple mathematical question of calculating financial benefits and costs.

In relation to debtor fraud, indeed, debtors might commit fraud in various ways to evade financial obligation, including concealing assets or income and hiding the truth about financial circumstances. Preventing the bankruptcy system from debtor fraud should be seriously taken into consideration. However, policymakers should not excessively worry about the danger of debtor fraud. In the World Bank report, though most empirical observations are informal, researchers argue that the instances of real fraud are low in many existing insolvency systems.[95] Furthermore, prudent monitoring by administrators and creditors can play the most effective role in minimising debtor fraud.[96] More importantly, even though the exclusion of debtor fraud is impossible, nevertheless a debtor's rehabilitation can pass on greater benefits to debtors, creditors and society.[97] Therefore, the risk that some limited amount of fraud will be present in bankruptcy law and some unworthy debtors will take inappropriate advantage of the law, deserve appropriate but not undue attention.

8.6 Conclusion

In order to promote economic activity and resolve enforcement failure cases, the

[95] The World Bank (n.91) 42.
[96] Ibid.
[97] See the summary of the benefits of insolvency proceedings for natural persons in the World Bank report (n.91)19-39.

Chinese authority has shown interest in the establishment of a personal bankruptcy system. Against this background, even though the NPC has not commenced the legislative process, judicial experiments have sprung up at the local level. Two local courts located in Zhejiang province have accepted personal bankruptcy cases and published their practical guidance on those cases. Those practices provide insights into understanding the institutional framework of Chinese personal bankruptcy law.

Reviewing those institutional designs, this chapter finds that the present regulations not only share some commonalities with other jurisdictions including Germany, the United Kingdom and the United States but also have uniquely Chinese features. The comparative analysis with Chinese personal bankruptcy experiments implies a Chinese model where debtor rehabilitation is a two-phase process. The first phase permits debtors to write off the debt when the proceedings are concluded. However, the second phase requires debtors to be subject to strict behaviour restrictions for a certain period of time before obtaining full rehabilitation.

This chapter argues that creditors' interests are comprehensively protected but debtor recovery is limited under present practices. However, this hierarchy of policy priorities is not informed by research focusing on understanding the nature of debt and the circumstances of debtors in the Chinese context. Instead, it results from the negative bias towards insolvent individuals, the path dependence on ensuring creditors' interests and the absence of pro-debtor narratives established by interest groups.

Therefore, present practices may be not be the best policy responses to personal bankruptcy.

Additionally, current personal bankruptcy experiments may fail to achieve the goal set by the authority. Experiences from other jurisdictions have indicated the high failure rate of the payment plan. Therefore, a significant number of enforcement failure cases will remain in the judicial system and waste judicial resources, signalling the failure of the SPC's objective. Besides, present practices have imposed strict behaviour restrictions upon debtors after the conclusion of insolvency proceedings. Those restrictions may impede individuals from engaging in social and economic activities. Accordingly, boosting economic vitality may become illusory. With regards to behaviour restrictions, they are expected to function as the safeguard of the bankruptcy system. However, legislators should not overemphasise moral hazard and debtor fraud. By contrast, legislators should be cautious as strict restrictions may squeeze out the rehabilitation function of insolvency law.

Chapter 9 Conclusion

9.1 Necessity and feasibility of Chinese personal bankruptcy law

Traditionally, the introduction of bankruptcy law has been to act as a debt collection device, which aims to maximise creditors' returns. However, when the insolvent debtors are natural persons, bankruptcy law offers honest but unfortunate individuals a second chance or a fresh start. The personal bankruptcy law permits debtors to be discharged from their excessive debts when they surrender non-exempt assets or a certain amount of future income in a specific period. Normally, after the grant of discharge, creditors will not collect those remaining debts from debtors. This debt relief mechanism, at least financially, rehabilitates debtors and enables them to re-enter into social life.

However, debt relief operates in contrast with the dominant *pacta sunt servanda* - 'common sense' belief that one must pay off one's debts. In the context of corporate bankruptcy, companies will be dissolved and their legal personality will not exist upon the conclusion of the liquidation process. As a result, companies will be freed from pre-existing debts. However, natural persons cannot 'be liquidated' and they continue to participate in daily social life. In this sense, individuals must pay off their debts if and when they continue to work. They are not permitted to be discharged from debts because they are deemed capable of paying. Due to conflicts between debt relief and *pacta sunt servanda*, the question as to why individual debtors should be granted a

fresh start may arise.

For years, certain scholars have provided insightful explanations of the fresh start policy. Some scholars argue that debt relief embodies forgiveness, mercy and cultivates a virtuous society. They contend that permitting debtors to be discharged from debt encourages debtors' cooperative behaviours. In addition, a bankruptcy discharge is expected to enhance entrepreneurship in the market as well as promote social utility. Though those theories provide valuable explanations on the benefits of debt relief, the question of how those benefits can be achieved may arise. The mechanism for achieving the benefits of debt relief is by enacting a bankruptcy discharge act as social insurance, insuring individuals against financial difficulties. Accordingly, the insurance function of insolvency law transfers more defaulting risk from debtors to creditors.

Reallocating risk between creditors and debtors can be justified from several perspectives. First, in the creditor-debtor relationship, creditors are more capable of evaluating and spreading default risks since they deal with many individuals. Second, individuals may suffer from psychological and cognitive weakness, which may skew their borrowing decisions. Furthermore, profit-seeking creditors may exploit the borrower's weakness. Therefore, there is a need for consumer protection from the law. Third, prioritising debt collection in the context of personal bankruptcy is challengeable. Based on the market efficiency hypothesis, strengthening the debt

collection objective reflects the idea of legislation as a market boosting device and the view that the outcomes of pre-bankruptcy debt contracts should involve as few dislocations as possible. However, to some degree debt contracts in the modern credit market do not align with an efficient exchange providing mutual benefits. Not only are creditors better informed than debtors concerning credit products, but also debtors may 'involuntarily' enter debt contracts in order to maintain a basic living. Therefore, the assumption about maximising creditors' recovery is questionable.

Fourth, individual and structural consequences may arise if debtors bear all the default risks. Personally, individuals will suffer from mental and physical issues resulting from excessive debt pressure. Furthermore, individual over-indebtedness will also bring externalities to society, including systematic financial risks and the reduction of productivity. Last but not least, moral hazard arising from the insurance function of insolvency law should not be viewed as anathema. By contrast, moral hazard is controllable and inevitable. Therefore, care should be paid to avoid sacrificing the benefits of the insurance function simply because the system is not perfect.

The theoretical analysis provides valuable insights into understanding the function of personal bankruptcy law, which reallocates default risks between debtors and creditors. Though models of personal bankruptcy law are distinct in various jurisdictions, the insurance function is acknowledged. The following section summarises why debt relief law should be introduced into China. There are two

reasons for this proposal. In the first place, consumer over-indebtedness is closer to Chinese households than policymakers realise. Since the early 2000s, consumer credit has dramatically expanded in China and this increasing level of household credit has attracted some attention from the authorities and academia. Both of them currently focus attention on how consumer credit influences the overall financial system, arguing that the current level of consumer credit is healthy and sustainable. Discussion of household over-indebtedness in the Chinese context is scarce in the literature. Although there is no consensus on the definition of over-indebtedness, one of its distinct features is that individuals have no ability to pay their debts. Factors such as the costs of debt, income fluctuation and the cost of living have an impact on debtors' ability to comply with financial obligations. As the development of the consumer credit market advances, more and more vulnerable households continue to gain access to credit. Profit-seeking financial institutions may impose unaffordable interest rates on those vulnerable consumers. Therefore, the expansion of credit indicates a certain number of individuals are more likely to fail to meet their financial commitments. In addition, as the Chinese economy continues to slow, household income may not keep increasing with the result that previously unproblematic credit can become unmanageable resulting from the decline in income. As a result, consumers may suffer from over-indebtedness. Furthermore, by restricting the debtors' capability on servicing debts, the rising cost of living in China also increases the possibility of household over-indebtedness. Since the likelihood of becoming over-indebted is increasing, it is necessary to think about how to tackle potential over-indebtedness.

To address over-indebtedness arising from the expansion of credit, personal bankruptcy law is considered as an effective institution which insures individuals against financial difficulty by transferring some default risks to creditors as the superior risk bearers. Given that Chinese bankruptcy law does not apply to individuals, this thesis argues that the introduction of personal bankruptcy law is necessary for China. However, the validity of this argument depends on the assumption that no other institutions currently undertake the function of individual bankruptcy law. In this sense, this thesis explores current approaches to over-indebtedness in the Chinese context. In the first place, the Chinese individual enforcement system has been reviewed. Even though Chinese lawmakers have established a participation-in-distribution system to deal with cases involving multiple creditors, the mechanism cannot act as effectively as a personal bankruptcy law. Additionally, ensuring creditors' interests and preventing debtor fraud are core objectives of enforcement procedures. Given this, a series of institutions and safeguards have been introduced including the list of dishonest judgment debtors and high consumption restriction orders. In addition, except for extreme cases, unfulfilled enforcement cases are not terminated; they can only be suspended. Courts will review and resume those suspended cases according to debtors' capability of making payments every six months. Under this legal framework, debtors' rehabilitation is secondary and downplayed. The absence of a nationwide compulsory enforcement Act and the lack of debt relief enable creditors to have broad powers outside the court. Some debt collectors take advantage of legal lacuna so that

debtors suffer from aggressive debt collection. Therefore, through reviewing current legal procedures which debtors are subjected to, it is obvious that the Chinese legal framework does not provide any institution which is similar to personal bankruptcy law reallocating risks between creditors and debtors. Instead, debtors eventually bear all the default risk.

In addition to examining the current enforcement system, this thesis has reviewed the existing Chinese welfare system. Bankruptcy discharge is viewed as a substitute for other social insurance programmes. Therefore, provided that other programmes provide effective protection for individuals who encounter financial difficulties, the enactment of personal bankruptcy law is not necessary. However, after reviewing the structure and performance of Chinese social welfare institutions, the introduction of individual bankruptcy law may be justified. Though the Chinese authorities have made efforts to provide universal social insurance, significant differences between urban residents and the rural population and between employees in the formal sector and other types of workers exist. As a result of this, the benefit distribution is unequal. Individuals including rural residents or workers outside the formal sector have fewer social benefits. Ironically, those individuals may be the most vulnerable risk bearers and need more protection from the state. However, the absence of a universal social insurance system means vulnerable groups depend more on the market and their families. Some families may fall over the financial edge resulting from serious illness or wage interruption. Given this, the establishment of personal bankruptcy law can, to

a certain extent, function as a ‘universal social insurance’ protecting those vulnerable individuals against financial difficulties.

After demonstrating the necessity, this thesis turns to explain the feasibility of a personal bankruptcy system in China. Chinese lawmakers have no prior relevant knowledge in individual debt relief and in this sense, Chinese legislators are assumed to borrow legal concepts from other jurisdictions. This legal borrowing also refers to legal transplantation and some scholars have studied the possibility of legal transplantation at a theoretical level. Despite the continuing debate, legal borrowing continues to occur in the real world. The modernisation of Chinese law is an exercise in legal transplantation. Therefore, transplanting personal debt relief law into the Chinese legal system is theoretically possible. However, the hypothetical possibility of doing so does not mean specific legislation can successfully be received. Therefore, the question as to whether the law can work as well in China as in the country of origin arises. To evaluate how far an imported legal rule works, one general principle is that it should fit into national conditions. The so-called national conditions not only refer to systems supporting the enforcement of a new law but also indicate those informal institutions such as culture or social norms. Hence, this thesis has demonstrated that personal bankruptcy law can be enforced in China and the concept of debt relief is consistent with Chinese culture. In the 2000s, it was proposed that Chinese bankruptcy law be extended to cover individuals. However, the suggestion failed as critics pointed to the lack of a well-developed financial infrastructure such as a credit reporting

system and a property registration system. This viewpoint is now out-of-date. Though the current Chinese credit scoring system and property registration institution are not perfect, both have greatly improved in terms of the information database and access to information. In this sense, they are competent to support the enforcement of personal insolvency law.

Regarding the impact of informal institutions such as culture or social norms, this thesis links Confucianism with the idea of debt relief law. Under the ethical system built up by Confucianism, to be a gentleman (junzi 君子), one should retain one's social status. Therefore, an individual should have proper manners in accordance with his responsibilities in a relationship. This rule implies that a debtor should comply with his financial obligations in the creditor-debtor relationship. A person who has broken his promises will be considered as a small man (xiao ren 小人). In the Confucian world, a small man will be educated to correct his wrongdoings and if that education fails, he will be punished. Forgiving a wrongdoer is not expressed in the Confucian ethical system. Therefore, it is likely that over-indebted debtors will be instructed to pay off their debt with the purpose of correcting their misconduct. However, debt relief is still possible in the Confucian world. From the Confucian viewpoint, harmony is highly valued and is even prioritised over virtue. In this sense, if debt relief can contribute to the establishment of a harmonious society, it is feasible in the Confucian world but we should take note that a swift discharge may encounter resistance in Confucianism. The establishment of harmony requires everyone to become good persons (君子).

Confucians believe that small persons (小人) can be morally educated so that they may become good persons (君子). In this sense, the enhancement of morality may be the precondition of debt discharge. A swift discharge may not reflect the necessary learning process in the Confucian context. Therefore, a quick debt relief may encounter some cultural resistance. Instead, obtaining debt relief through the debt repayment plan may reflect that debtors are trying to correct their wrongdoings, a sign of the enhancement of morality.

9.2 Some thoughts on the institutional framework of Chinese personal bankruptcy law

After explaining the necessity and feasibility of personal bankruptcy law in the Chinese context, this thesis has indirectly explored an answer to the question of a proper institutional framework. It first explored different models of personal bankruptcy law around the world.

The learning process begins with studying American consumer bankruptcy law. Under the Bankruptcy Code, two paths are provided for over-indebted individuals. One is Chapter 7, a liquidation process, and the other is Chapter 13, the debt adjustment plan. The American institutional framework seems unique and pro-debtor due to the swift discharge granted by Chapter 7, in contrast to what obtains around the world. As the

number of bankruptcy cases increases, consumer bankruptcy law has become a field of conflict. The growth in bankruptcy filings is explained by two contrasting theoretical frameworks. One is that debtors are opportunists who will calibrate their behaviours to maximise financial gain from bankruptcy; based on this assumption, individuals are abusing the bankruptcy system and the law should introduce mechanisms to sort out those abusers. The opposite conceptual framework argues that factors, including the retreat of social entitlement, rising economic insecurity and the unpredictable daily perils such as illness or divorce, have fuelled the growth of bankruptcy filings. In this respect, bankruptcy discharge functions as the last resort for vulnerable individuals and therefore, bankruptcy protection should not be restricted. The result of these debates is that American debt relief law has gradually shifted in favour of creditors, culminating in the introduction of 2005 BAPCPA. The purpose of the 2005 Act is to exclude otherwise eligible debtors from the bankruptcy system. However, while the Act fails to filter out potential abusers, it establishes new hurdles for bankruptcy discharge. As a result, the insurance function of the law is limited.

By studying the American personal bankruptcy law, Chinese legislators may gain some useful insights. Consumer bankruptcy law itself has conflicting and contrasting ideas. Therefore, debate surrounding this legal regime is inevitable. However, lawmakers should not be over concerned about the moral hazard arising from bankruptcy discharge. Much of the literature supporting the pro-creditor argument relies primarily on the economic model rather than the empirical research on debtors. There is no

solid evidence that a liberal bankruptcy system will be heavily abused by debtors. Overreacting based on an unclear hypothesis may limit the law's insurance function, as the 2005 BAPCPA did. Therefore, Chinese legislators should take care not to sacrifice the benefits of personal bankruptcy law due to the fear of moral hazard.

After examining the liberal American consumer bankruptcy law, this thesis examined personal bankruptcy law in the UK and Germany. The institutional designs in both jurisdictions are different from the American model. In England, individuals are provided with several legal procedures to address debt issues: bankruptcy with a fresh start after one year but where a debtor may be subject to income payment order if he has surplus income; a debt relief order (DRO) designed for 'no-asset, no-income' debtors, granting a discharge after one year; an individual voluntary arrangement (IVA) in which debtors promise to pay a percentage of their debt over a certain period (normally five years). Under German debt relief law, the insolvency proceeding is divided into several stages: first, consumers should attempt to negotiate with creditors for an 'out-of-court debt settlement'; secondly, when the first step fails, the court-based insolvency proceedings will commence -then, the court will seek an in-court debt adjustment plan; thirdly, if the in-court plan cannot achieve results, the liquidation procedure will start -in addition, debtors will enter into a 'good behaviour period'; fourth, debtors can apply for the discharge when the 'good behaviour period' ends.

Differences in institutional framework reflect the extent to which lawmakers embrace the insurance function of insolvency law. A swift discharge is described as the most effective form of relief in the 2013 World Bank Report. At first sight, English personal insolvency law is close to the most effective form of relief, especially the Debt Relief Order where individuals do not make any contribution to creditors. However, to some degree, English policymakers have limited or conditioned, both formally and practically, debtors' access to liberal proceedings including bankruptcy and DRO. Instead, an increasing number over-indebted debtors are diverted into the IVA which eventually dominates in insolvency proceedings. Rather than protecting debtors, the market-based IVA providers care more about profits and thereby, restrict the law's insurance function. As for German debt relief law, the good news is that a discharge policy has been introduced but it is a long route for over-indebted individuals to obtain a debt-free life. Under the German model, enhancing good payment morals is more important than debtors' fresh start. The insolvency proceedings are assumed to inculcate healthier and more responsible borrowing. As a result, the 4-step framework is not only far away from the most effective form of relief but also economically inefficient.

Through studying German and English debt relief law, this thesis observes how interest groups and their narratives in personal bankruptcies shape the institutional framework. Narratives embody the objectives of a policy, the issues addressed and the proper instrument to reach the purpose. Critical junctures may provide opportunities for

reexamining existing narratives and forming new ones. In this sense, the expansion of credit beginning in the late 20th century and subsequent individual over-indebtedness warrants the re-examination of narratives in personal bankruptcy cases and the formation of new ones such as debtor rehabilitation. Given that policymakers may respond to those changed narratives, the reform of personal bankruptcy law may occur. During the reform, the dominant narrative is determined by influential interest groups, which have an incentive to maximise their utility in the reform. Therefore, how domestic interest groups narrate personal bankruptcy plays an important role in the extent to which the fresh start policy is accepted. As a result, the institutional framework reflects an equilibrium among interest groups with their own narratives.

After studying personal bankruptcy law in other jurisdictions, the Chinese model of debt relief law was explored. However, this thesis does not make specific proposals on legal texts or provisions. Instead, given that personal bankruptcy law acts as a form of social insurance, this thesis evaluates the extent to which judicial practices in Wenzhou and Taizhou embrace the insurance function. In terms of the institutional framework of local practices, Taizhou practice has made provisions for liquidation proceedings and the debt adjustment procedure but the Wenzhou court only provides the debt payment plan as the solution to personal bankruptcies. The institutional framework in Taizhou and Wenzhou to a certain extent, have drawn on experiences from America, Germany and the UK, making Chinese judicial innovations hybrid models. However, those practices have indicated one distinct characteristic: debtor rehabilitation is a

two-phase process. The first phase permits debtors to write off the debt at the time of the termination of liquidation or the completion of a debt adjustment plan. Then, no matter which procedure the debtor is subject to, he/she must comply with strict behaviour restrictions for a certain period. This 2-step framework heavily influenced the effects of the fresh start. During the behaviour control period, debtors are uncertain whether they will ultimately obtain the discharge; additionally, a heavy stigma may be imposed upon debtors. As a result, it will be difficult for individuals to return to productive daily life. Compared with debtor rehabilitation, this thesis argues that creditor wealth maximisation is the priority of local judicial practices. On the one hand, from the perspective of the court, the debt repayment plan is a more favourable procedure. Wenzhou practice does not provide the liquidation process for individuals. In addition, though the liquidation process is available in Taizhou, whether or not debtors are eligible for the liquidation process is determined by the court. Individuals with future income must enter into a debt repayment procedure. However, this eligibility test seemingly leaves debtors' expenses out of consideration and there is no clear definition of future income. Therefore, this strict criterion may prevent debtors from entering the liquidation process. In addition to the preference on debt payment procedure, other mechanisms aim to ensure creditors' interests. For instance, under Taizhou practice, debtors are obliged to report changes in financial circumstances during the restriction period. However, behaviour controls follow from the termination of insolvency proceedings, whether it is the debt adjustment procedure or liquidation process. As a result, it seems as though another invisible income payment order will

be imposed upon debtors. In comparison, the Wenzhou court does not establish the obligation to report. Instead, it has made provisions for publishing debtors' information during the restriction period and encourages creditors, trustees and the public to supervise debtors after the completion of the debt repayment plan.

Preferring to pursue creditors' interest over debtor rehabilitation in the current institutional framework is the result of several factors. First, bias against defaulting debtors is widespread. Hence, whether debtors are honest but unfortunate or culpable, they are blamed equally. Secondly, path dependence makes it difficult to make changes. On the one hand, the traditional objective of bankruptcy law is seen as creditor wealth maximisation. On the other hand, current treatment of household over-indebtedness stresses debtor responsibility, ensures creditors' interests but downplays debtor protection. Given this, debtor rehabilitation is considered as an ancillary goal. Lastly, due to the absence of a critical juncture, no particular interest groups have developed pro-debtor narratives in the Chinese context. As a result, dealing with the plight of over-indebted consumers is not the main concern on the authority's agenda.

Assuming the institutional framework of current personal bankruptcy practices comes to apply nationwide, the question of whether those practices are the proper models for the Chinese context then arises. This thesis does not consider the current framework appropriate because current practices cannot achieve the authority's

legislative objectives. According to the SPC and other government departments, the introduction of personal bankruptcy law aims to eliminate the enforcement failure cases as well as improve the business environment. If the debt adjustment plan is considered to be the main solution to personal bankruptcy, comparative experiences have indicated the high failure rate of the debt plan. In other words, a large number of enforcement failure cases will remain. Regarding the enhancement of the business environment, the stigma arising from the behaviour restrictions prevent debtors from participating in productive activities. Therefore, the objective of promoting the business environment may also fail.

9.3 Issues for future research

This thesis has outlined two research questions regarding Chinese personal bankruptcy law. One concerns the necessity and feasibility of the law; the other is related to the institutional framework of Chinese personal bankruptcy law. However, this thesis does not directly answer the question, 'What is the appropriate model of Chinese personal bankruptcy law?' The answer to this question is too far-ranging. Nonetheless, this thesis at least provides some insights into understanding the objectives of personal bankruptcy law in general. It advocates the necessity for a Chinese personal bankruptcy law and the feasibility of its introduction. For future research, this thesis considers that three specific issues should be addressed:

First, scholars should carry out research on the reasons for over-indebtedness in the

Chinese context as more empirical research is needed. Living beyond one's means would require the disciplining of debtors or inhibiting the access to credit. By contrast, unemployment and severe illness may justify a more lenient bankruptcy law which can supplement other social insurance programmes. Therefore, understanding why Chinese households become over-indebted is important to constructing the image of the debtor and recommending appropriate policy responses.

Secondly, the role of courts and insolvency practitioners in consumer bankruptcy should be studied. Current practices in Wenzhou and Taizhou reflect the significant role of the courts in personal bankruptcy cases. From a comparative perspective, though this court-based system can deliver impartial judgment, it may be costly and lead to significant delay. A court-based system normally cooperates with trusted insolvency practitioners to assist debtors and supervise the repayment plan. The insolvency practitioners can reduce the transaction and error costs through ensuring a reasonable repayment plan, checking the debts and giving useful advice to debtors. In this sense, the question of who will be responsible for supervising the implementation of the plan will arise. Primarily relying on profit-seeking private practitioners may give rise to principal-agent problems, and thereby debtors may not obtain effective protection. Furthermore, given that most personal bankruptcies are trivial cases, private practitioners may have less interest. As a result, debtors may not obtain the necessary legal assistance. However, when specific public bodies act as the practitioners, the establishment and maintenance of such an organisation may lead to

some cost and resource concerns. Hence, research on the role of insolvency practitioners and the court in personal insolvency cases will contribute to the establishment of an efficient and fair personal bankruptcy administration.

Lastly, as a significant component of the fresh start, the exempt property issue deserves to be studied. The scope of exempt property plays an important role in whether the debtor will live a dignified life. In the Chinese context, the imbalance in various areas of ownership and expenditure may make the meaning of ‘dignity of life’ inconsistent Therefore, how to formulate a fair and acceptable range of exempt property should be deliberately studied.

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