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Making Sense of Nation-Level Bankruptcy Filing Rates

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I. INTRODUCTION

MUCH OF THE developed world has experienced a similar pattern of spending, debt, and insolvency over the last 20 years. First, as national income and consumer spending rise, the level of consumer debt inevitably increases. When consumer debt becomes commonplace, the incidence of household financial distress rises, with burgeoning rates of insolvency not far behind. What once was a problem only for merchants and businesses quickly becomes a risk that confronts all classes of the populace, rich or poor. As this pattern has played out, financial distress and insolvency have become front-page news around the globe.[1] European countries that did not even have bankruptcy systems 20 years ago now confront a rising tide of distress that overwhelms judicial and administrative processes as quickly as legislatures can create them.[2]

[1] See A Bennett, 'Bankruptcies on the Rise, Figures Show', <www.news.com.au>, 10 July 2007 (Australian story noting that '[t]he high cost of living and easy access to credit have led to the highest number of bankruptcies in [New South Wales] for more than 20 years'); 'Sounding the Retreat' (13 July 2006) *The Economist* (discussing rampant 'overindebtedness' associated with willingness of British to 'borro[w] with abandon'); 'The FSA Flinches' (7 September 2006) *The Economist* ('Reformers worry that too many Japanese are borrowing more than they can hope to repay'). Although the topic is newsworthy in Canada, Canadians find themselves in the unusual situation of congratulating themselves on a recent decline in filing rates. *Fewer Canadians Going Bankrupt Despite Rising Debt Levels*, 5 February 2007 (government press release suggesting that 'low unemployment allowed consumers to cope with higher debt levels').

[2] See J Niemi-Kiesiläinen, 'Consumer Bankruptcy in Comparison: Do We Cure a Market Failure of a Social Problem?' (1999) 37 *Osgoode Hall Law Journal* 473 (discussing new systems in Scandinavia); U Reifner, 'Thou Shalt Pay Thy Debts: Personal Bankruptcy Law and Inclusive Contract Law' in J Niemi-Kiesiläinen *et al* (eds), *Consumer Bankruptcy in Global Perspectives* (Oxford, Hart Publishing, 2004) 143 (discussing European developments). Jason Kilborn has produced an excellent series of case studies on new European systems: see J Kilborn, 'Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice' in J Niemi *et al* (eds), *Consumer Credit, Overindebtedness and Bankruptcy: National and International Dimensions* (Oxford, Hart Publishing, 2009), and the many other articles by Kilborn cited therein.

Yet despite a general upward trend in filing rates, stark differences in nation-level filing rates persist. For the most telling example, consider the United States and the United Kingdom, the two largest English-speaking economies. In 2004, 930 out of every million UK residents sought formal insolvency relief, but US residents sought such relief at a rate more than five times as high (5,500 out of every million).[3] Consider Canada and Australia, the two largest Commonwealth economies. Commentators note the similarity of their systems for providing bankruptcy relief,[4] but the rate at which Australians and Canadians seek insolvency relief differs sharply. As of 2004, there were 1,300 filings per million in Australia, but more than twice as many (3,100) filings per million in Canada.

Governments concerned about rising rates of financial distress can respond in various ways. They might try to alter individual behaviour, hoping to limit financial distress by discouraging spending.[5] Alternatively, they might intervene in credit markets, hoping to limit overindebtedness at the source.[6] Countries that ignore the problem face the possibility of ending up like South Korea, which recently spent billions of dollars to bail out leading financial institutions that faced crippling levels of default and insolvency,[7] or the United States, which faces a growing crisis centred on rapid increases in foreclosure rates.[8]

[3] I note Iain Ramsay's point that comparisons of filing rates across national boundaries are complicated not only by differences in the formal liquidation systems, but also by differences in the possibilities for seeking relief through the multifarious rehabilitation systems, which may be more or less formal or voluntary. I Ramsay, 'Comparative Consumer Bankruptcy' (2007) *Illinois Law Review* 241, 260–2. In this Chapter, however, I cannot undertake to examine all such systems. Instead, I focus on the major formal national-level systems. Thus, for example, I do not include county court administration orders in the statistics for the UK. A complete understanding of the UK pattern would require assessment of the interaction of those orders with the bankruptcy and IVA systems that I do consider. It is enough for this Chapter to suggest (based on the apparent magnitude of county court administration orders) that the UK filing rate would remain relatively low even if I included those filings in calculating the UK filing rate.

[4] See A Duggan, 'Consumer Bankruptcy in Canada and Australia: A Comparative Overview' in JP Sarra (ed), *Annual Review of Insolvency Law 2006* (Toronto, Thompson Carswell, 2007) at 857; JS Ziegel, *Comparative Consumer Insolvency Regimes: A Canadian Perspective* (Oxford and Oregon, Hart Publishing, 2003) at 96–7.

[5] That approach would not be congenial in many countries. The US, for example, has depended for decades on consumer spending to drive economic growth. L Cohen, *A Consumers' Republic: The Politics of Mass Consumption in Postwar America* (New York, Knopf, 2003). Similarly, Japanese reformers focused on consumer behaviour have worried that consumer spending has been too low, not that it has been too high. S Kozuka and L Nottage, 'Re-regulating Consumer Credit in Japan: Culture, Economics and Politics in Contemporary Law Reform' in J Niemi *et al* (eds), *Consumer Credit, Over-Indebtedness and Bankruptcy: National and International Dimensions* (Oxford, Hart Publishing, 2009).

[6] For example, the UK's Office of Fair Trading and Department of Trade and Industry (recently superseded by the Department for Business, Enterprise and Regulatory Reform) have both been aggressive in this way in responding to the perceived problem of overindebtedness in the UK. See, eg, OFT, Consumer Credit (Advertisements) Regulations 2007 (SI 2007/827); DTI, *Fair Clear and Competitive—The Consumer Credit Market in the 21st Century* (White Paper) (Cm 6040, 8 December 2003).

[7] See RJ Mann, *Charging Ahead* (Cambridge, Cambridge University Press, 2006) 116–17.

[8] See Office of the Comptroller of the Currency *et al*, *Statement on Subprime Mortgage Lending* (29 June 2007), available at <http://www.fdic.gov/news/news/press/2007/pr07055a.html>.

Perhaps the most common response has been to amend the legal system for dealing with financial distress. Even if financial distress is an inevitable by-product of a modern capitalist economy,[9] differences in the formal legal system affect individual responses to financial problems. Most obviously, the rise of consumer debt in recent decades has led to the creation of new bankruptcy systems in several continental European jurisdictions.[10]

Even in countries that have had bankruptcy systems for many years, the rising levels of insolvency in recent decades have driven major reforms.[11] Policymakers have struggled with whether—and how—to alter their systems. Hence, the US has adopted reforms designed to limit access at the same time as the UK and Japan have implemented reforms to encourage more filings. Which approach is correct? Should legislators permit access by a greater number of debtors, to encourage entrepreneurial risk-taking? Or, should they limit access to a smaller number of debtors to lower the moral hazard of an easy release from obligations?[12] What is the best way to filter out the abusive filings from the 'honest but unfortunate' debtors for whom policymakers design the systems?[13]

The disparate responses reflect the likelihood that variations in filing rates rest on different factors in different countries. Some of the variation is attributable to different levels of indebtedness. Some of the variation is attributable to different cultural attitudes about financial failure. Some of the variation is attributable to the accessibility of the legal system as a remedy for irremediable financial distress. Some of the variation is attributable to the availability of informal systems of relief. Yet it is not easy to disentangle how those different attributes affect the aggregate nation-level filing rates. This Chapter explores the possibility that aggregate empirical data can shed light on that question, and analyses the policy implications of the differences in nation-level filing rates.

First, Part II explains why it is important as a matter of policy to understand whether high or low filing rates stem from economic, cultural, or legal causes. Without understanding why rates are high or low, it is impossible either to assess whether the rate of filing is too high or too low, or to design policies likely to move rates in the appropriate direction.

Drawing on prior work about credit card markets,[14] Part III uses aggregate data to distinguish between the economic explanations for filing rates and the cultural and legal explanations. Two findings are salient. First, the bulk of the uniquely high filing rate in the United States appears to be attributable to

[9] See MJ Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford, Oxford University Press, 2002).

[10] See sources cited above n 2.

[11] For a collection of papers on that subject, see Part IV of *Consumer Bankruptcy in Global Perspectives*, above n 2.

[12] See, eg, SA Rea, Jr, 'Arm-Breaking, Consumer Credit and Personal Bankruptcy' (1984) 22 *Economic Inquiry* 188; Barry Adler *et al*, 'Regulating Consumer Bankruptcy: A Theoretical Inquiry' (2000) 29 *Journal of Legal Studies* 585.

[13] The phrase is from *Local Loan Co v Hunt*, 292 US 234, 244 (1934).

[14] Mann, above n 7.

economic conditions, not cultural attitudes or the legal system. Second, after controlling for economic conditions, Canada's filing rate is by far the highest of any of the countries for which adequate data is available, the other countries being the United States, United Kingdom, Japan, and Australia.[15]

Part IV offers tentative hypotheses to explain the more robust findings in Part III. Thus, it considers both why Canada's propensity to file is so much higher than that of the US, and why Australia's is so much lower. The discussion of Japan and the United Kingdom is more tentative, primarily because of limitations in the data[16] that make the statistical findings considerably more ambiguous than they are for Canada, the US, and Australia. Generally, I hypothesise that 'back-end' issues related to the timing of a discharge and the payments required to obtain it are relatively unimportant. 'Back-end' issues matter primarily to the relatively small sector of bankruptcy filers with significant income or assets. For the great mass of potential filers who have little or no income or assets, the most important issues are 'front-end' barriers to filing, whether they come from procedural obstacles or from cultural attitudes about financial distress.

Part V concludes with a normative assessment of those 'front-end' barriers. Because those barriers tend to bar filings by the desperately insolvent (the 'low-income, low-asset' or LILA debtors), they reflect poor policy choices. The net social benefits of returning the LILA debtors promptly to productivity support a simple and effective system of relief for those debtors.

II. WHY THE REASONS MATTER

The first step in analysing nation-level filing rates is to confront the matrix of factors that affect those rates. Although a rigid categorisation is arbitrary, it is useful to distinguish among three different types of factors, each of which relates to financial distress and bankruptcy in a different way and each of which has different policy implications.

A. Legal Explanations

Although I am predisposed to doubt the importance of purely legal explanations,[17] I start there, primarily because of the conventional wisdom that legal

[15] I study these countries because they are the only ones for which I have been able to obtain a sufficiently long time series of data to permit meaningful quantitative analysis.

[16] In the case of the UK, the apparent problem is that England and Wales have one bankruptcy system, Scotland another, and Northern Ireland no system at all. The data for my control variables extends to the entire UK and I have been unable to locate a time series of data for my control variables that is limited to England and Wales. In the case of Japan, the apparent problem is an unusually long recession that has lasted throughout the study period, so that the data does not include filings from the same mix of economic good and bad periods as the other countries.

[17] See Mann, above n 7, at 96–8 (explaining that differences in legal protections have little relation to the pattern of debit and credit card use).

explanations are central to the problem. The intuition relies on a rational actor conception of the debtor: fewer debtors file for bankruptcy in countries with bankruptcy systems that offer relief that is less generous, and more debtors file for bankruptcy in countries that offer relief that is more generous. The analytical premise is that the bankruptcy discharge provides an economic benefit to those that file, and systems in which the benefit is greater should produce more filings. The literature written from this perspective suggests that the key variables in explaining filing rates are the ready availability of a discharge, the types of debts excepted from the discharge, and the scope of required post-bankruptcy payments.[18]

That explanation is consistent with the US filing rate. The world's highest filing rate is associated with a system in which a discharge is almost automatically and immediately available and with no general requirement of post-bankruptcy payments to creditors. Similarly, Michelle White's work shows that the propensity to file is higher in US jurisdictions with higher exemption levels and thus more generous bankruptcy relief.[19]

The conclusion that the level of filing rates depends for the most part on the legal system makes it easy to adopt responsive policies. For example, countries like the UK and Japan seek higher rates of bankruptcy filings to speed the resolution of financial distress. Those countries need only provide a discharge more promptly, lower requirements for post-bankruptcy payments, or increase the level of exempt assets. Conversely, legislators concerned that spiralling filing rates reflect abuse should interpose obstacles to the discharge or increase the likelihood that filers will be obligated to make post-bankruptcy payments to their creditors.

B. Cultural Explanations

A second possibility recognises the interaction between the formal legal system and the society in which it is embedded. Cultural predispositions might affect the decision to file for bankruptcy, and those predispositions may differ from country to country. That perspective recognises that the decision to file for bankruptcy is a permanent one that will have lifelong consequences for the individual that makes it. Hence, if this explanation were important, filing decisions should diverge from those predicted by a rational-actor conception of the bankruptcy decision: individuals might refrain from filing for irrational 'emotional'

[18] Michelle White's work provides the most careful support for this line of reasoning, showing that more debtors file in United States jurisdictions in which exemptions are higher. MJ White, 'Why It Pays to File for Bankruptcy: A Critical Look at Incentives Under US Bankruptcy Laws and a Proposal for Change' (1998) 65 *University of Chicago Law Review* 685 (hereinafter White, 'Why It Pays to File'); MJ White, 'Why Don't More Households File for Bankruptcy?' (1998) 14 *Journal of Law Economics and Organization* 205 (hereinafter White, 'Why Don't More Households File?').

[19] See White, 'Why It Pays to File', above n 18.

reasons even if the benefits available to them from a bankruptcy filing exceeded the out-of-pocket costs connected with the filing.

Cultural attitudes about bankruptcy also should affect the legal system itself. Iain Ramsay reminds us that legislators adopt laws that reflect the cultural dispositions that prevail among their constituents and the interest groups that are influential in their jurisdiction.[20] For example, UK leaders could embrace bankruptcy reform because of a 'strong admiration' for a 'vibrant enterprise culture' that involved 'responsible risk taking.'[21] At the same time, concerns that relief for non-business debtors was an entirely different matter made it important for the Government to emphasise its opposition to 'a safety net for overindebted consumers.'[22] In this vein, Rafael Efrat argues that cultural attitudes about entrepreneurs explain a great deal of the variation in the formal legal systems for consumer bankruptcy.[23]

Although those types of effects are difficult to measure directly, proxies might shed light on the differing levels of cultural resistance to bankruptcy in different nations. In the existing literature, for example, cultural explanations gain powerful empirical support from data about United States filings. Specifically, Michelle White's work indicates that about 15 per cent of all households would benefit in economic terms from filing for bankruptcy, but only about 1 per cent file for bankruptcy in any given year.[24] The size of the gap suggests that the rational-actor conception captures little of the motivations for filing; it is reasonable to infer that a portion of the gap is attributable to cultural resistance to bankruptcy filing.

Although there is a long tradition of designing social programs in a way that stigmatises their use,[25] it is not clear how often legislators succeed. The mere existence of a national bankruptcy system legitimates bankruptcy filing to a considerable degree.[26] Similarly, high levels of overindebtedness are likely to create a culture in which bankruptcy filing necessarily becomes more culturally acceptable.[27] As more individuals use a bankruptcy system to resolve their financial problems and move forward with their lives, a larger and larger share

[20] See I Ramsay, 'Functionalism and Political Economy in the Comparative Study of Consumer Insolvency: An Unfinished Story from England and Wales' (2006) 7 *Journal of Theoretical Inquiries Law* 625 (hereinafter Ramsay, 'Functionalism and Political Economy').

[21] *Ibid* at 17–18.

[22] *Ibid* at 18.

[23] See R Efrat, 'Global Trends in Personal Bankruptcy' (2002) 76 *American Bankruptcy Law Journal* 81.

[24] See White, 'Why Don't More Households File?', above n 18.

[25] See Christopher Howard, *The Hidden Welfare State* (Princeton University Press, 1999).

[26] The distinction from welfare is instructive, where stigmatised public assistance programs can be relegated to local authorities. The commitment to a bankruptcy system, by contrast, occurs at the national level. Interestingly, to the extent the United States system has delegated authority to the local standing Chapter 13 trustees, a case can be made that the result has been 'local legal culture' that in some locales stigmatises Chapter 7 bankruptcy filings. See T Sullivan *et al*, 'The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts' (1994) 17 *Harvard Journal Law Public Policy* 801.

[27] See Jean Braucher, 'Theories of Over-Indebtedness: Interaction of Structure and Culture' (2006) 7 *Journal Theoretical Inquiries Law* 323.

of the populace will be acquainted with people for whom that choice turned out to be a good one. This in turn will weaken norms that regard bankrupts as an 'other' class of people held in general disdain. Moreover, as suggested above, cultural predispositions motivate legislatures as well. Thus, in a society in which compassion for bankrupts becomes widespread, it may become increasingly difficult for legislators to treat bankrupts harshly.

C. Economic Explanations

The final possibility resonates with the opening paragraphs of this paper, connecting the increase in financial distress and bankruptcy filings to the rapid increase in consumer debt (and especially credit card debt) in most developed countries. The premise of this explanation is that bankruptcy filings for the most part are the result of exogenous shocks, which result in financial distress that would lead to filings in most cases without regard to legal or cultural factors.

If this explanation were important, the most significant predictors of nation-level filing rates would be consumer debt, credit card debt, and general economic conditions. Again, United States data support this theory. It is striking that the United States for years has experienced both the highest level of credit card debt in the world and the highest bankruptcy filing rate. Econometric models that scholars have used to illustrate connections between rising debt levels and increased filing rates buttress that intuition.[28]

Economic explanations would support intervention in the consumer credit markets. For example, a jurisdiction concerned about excessive insolvency might adopt regulations that limited the profitability of lending to those in severe financial distress, hoping to truncate that lending without undue distortion of the payment system or the broader lending market.[29]

III. ECONOMIC AND NON-ECONOMIC EFFECTS ON FILING RATES

The starting point in empirical analysis of consumer bankruptcy systems is the wide disparity in filing rates across national borders. Figure 11.1 illustrates the magnitude of the disparity, setting out the number of filings per million of population in each of five countries as of 2004 (the last year for which complete data is available). Figure 11.1 provides two data points for each country. The first number is the total number of all insolvency filings, which includes both the number of liquidation or 'straight' bankruptcy filings and also the applicable systems for 'rehabilitations' or 'proposals' or 'plans.'[30] Each of the five countries

[28] See Mann, above n 7, at 45–72 (summarising and extending that literature).

[29] *Ibid* at 119–206 (detailed proposals for intervention in consumer credit markets in the US).

[30] The Appendix includes a more complete set of charts showing a time series of those filings for each country from 1990 to the present.

has both types of system. The second number reports only the number of liquidation or straight 'bankruptcy' filings.[31]

In isolation, Figure 11.1 suggests that the US has by far the highest rate of filing, with steadily decreasing filing rates in Canada, Japan, Australia, and the UK. Although the disparity is striking, it should be clear from the discussion above that the raw numbers say little about the cause of the disparity. Without further information, it is impossible to tell whether the disparity relates to differences in the systems themselves or rather to cultural differences or differences in economic conditions.

As it happens, it is possible to identify the economic factors that affect the level of insolvency filings in a particular jurisdiction. In prior work focused on the relation between credit card debt and financial distress, I developed a model that documents a strong and significant relation between changes in the level of credit card debt and changes in bankruptcy filings. The model used credit card debt, credit card spending, total consumer debt, and unemployment (as independent variables) to explain the number of bankruptcy filings (as the dependent variable). Generally, the data suggest, an increase of $100 in credit card debt per capita will be followed one year later by an increase in bankruptcy filings of about 200 per million of population.[32] As the magnitude of the filing rates in Figure 11.1 illustrates, that effect is large enough to have substantial practical significance.

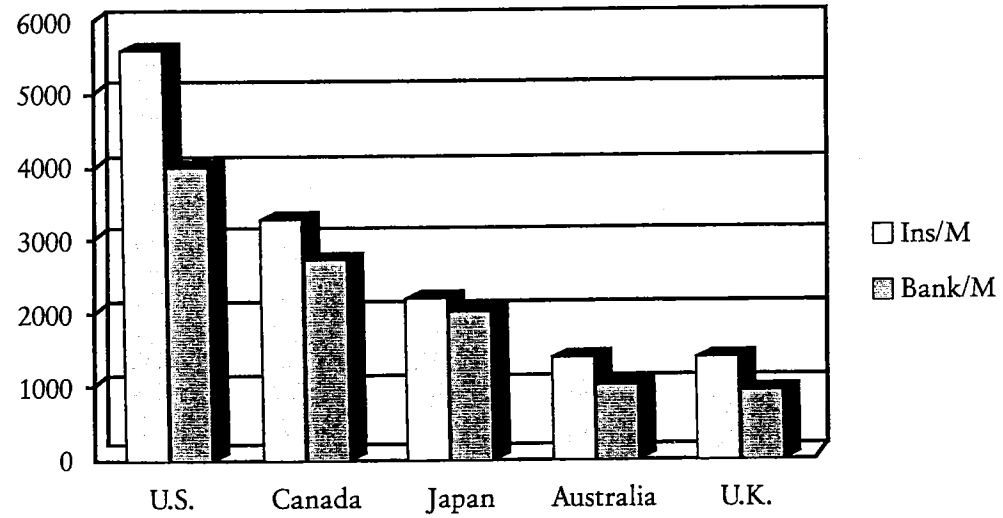

Figure 11.1 2004 Insolvencies per million of population

[31] As Figure 11.1 illustrates, including or omitting rehabilitation filings does not alter the relative number of filings for any country. However, in the United States there is a much higher percentage of rehabilitation filings than in other countries. The more common use of the rehabilitation system in the US may be attributed in part to the maturity of the Chapter 13 system and in part to the value of that system for retaining home and automobile ownership. In none of the other countries in my study would the rehabilitation filing interfere with the ability of a lender to pursue collateral such as a home or automobile.

[32] See Mann, above n 7, ch 5.

As I worked with the data I began to explore how the effect differed from country to country. Even when I added variables (country dummies) to isolate country-specific effects, however, the relation between credit card debt and bankruptcy filings remained significant. What led me to this project was the surprising finding that the US was *not* at the top of the scale. Specifically, controlling for economic conditions, the coefficient on the United States variable did *not* suggest that there is a higher propensity to file in the United States than in the other countries. Intrigued by that finding, for this project I updated the data used in that work (to reflect additional years of filings) and also segregated the data to permit separate analysis of liquidation filings, rehabilitation filings, and total filings. My intuition was that data about liquidation filings might be more useful than data about total filings, at least in part because rehabilitation filings in many countries are more closely related to informal or voluntary resolution schemes. Moreover, stark differences in the relation between rehabilitation filings and secured credit suggest that those filings might be used for such different purposes in different countries as to make cross-border comparisons meaningless.[33] Ultimately, the central inquiry should relate to total filings in countries (like the United States) in which the big step is to seek any type of formal insolvency relief. By contrast, in countries in which a rehabilitation filing is culturally and legally less significant (Japan, for example), it would be better to examine the smaller number of people that take the more complete step of filing a 'straight' or liquidation bankruptcy. The tables and regression analysis in this Chapter consider both metrics.

As summarised in Table 11.1,[34] Canada moves to the top of the list once the credit-related variables are accounted for, at least for total filings and liquidation filings. Table 11.1 reports whether the filing rates per million are higher or lower than Canada, when economic conditions are controlled. Table 11.A1 in the Appendix includes more detailed data.

As the more detailed information in the Appendix shows more fully, large standard errors suggest that the estimates of the coefficients on the country dummies are relatively imprecise.[35] The relations are statistically significant only for the United States and for Australia, and in Australia only for liquidation filings. Still, the pattern of negative coefficients is striking: the coefficients are negative for each country's total filing propensity and its liquidation filing propensity, when they are compared to Canada. This suggests that, faced with

[33] A Chapter 13 filing in the US is commonly used to prevent a foreclosure on a home or repossession of an automobile. In none of the other countries in this study would a rehabilitation filing bring with it an automatic stay that would grant that protection. This differential benefit from a Chapter 13 filing is a good explanation for why the rate of rehabilitation filings in the US is significantly higher than the rate in Canada, although the rates of liquidation and total filings are higher in Canada than in the US.

[34] Although Table 11.1 does not report it, the results confirm and extend the analysis reported in R Mann, *Charging Ahead*, above n 7, because credit card debt remains highly significant with a substantial positive coefficient in all of the different runs, generally significant at a .001 level.

[35] Minus signs indicate a negative coefficient; plus signs indicate a positive coefficient. ** indicates significance at the 1 per cent level, * at the 5 per cent level, and # at the 10 per cent level. Table 11.A1 in the Appendix includes more detailed information about the regressions.

Table 11.1: Country Effects On Individual Bankruptcy Filings[36]

COUNTRY	TOTAL	LIQU.	REHAB.
USA	—**	—**	+*
Japan	—	—	+
Australia	—	—#	—
UK	—	—	+
N	51	69	51
R2	.93	.93	.97

similar patterns of debt and unemployment, the bankruptcy filing rate would be higher in Canada than in any of the other countries. To put it another way, the data suggest that the high filing rate of the US is largely attributable to the economic conditions captured in the model. Once we control for those conditions, the US gives way to Canada as the nation with the highest propensity to file.

This presents a new puzzle for analysis: why, holding economic conditions equal, Canada should have such a higher 'propensity' to file than the USA and Australia. For convenience of exposition, the remainder of the Chapter uses the term 'propensity' to reflect this analysis—the extent to which the per capita filing rate in a country is affected by variables other than economic conditions. The next Part of the Chapter explores that puzzle.

IV. THE PATTERN OF INDIVIDUAL BANKRUPTCY FILINGS

The object of this Part is to resolve the two puzzles most clearly suggested by Table 11.1: why Canada's propensity to file is so much higher than that of the United States and Australia.[37] Because the cultural factors are harder to quantify, this Part begins by identifying features of the legal systems that are likely to explain the disparities set out in Table 11.1. The discussion generally rests on three hypotheses. First, the ease or speed of 'back-end' legal factors like the discharge is not useful in explaining filing rates. Second, the legal factors with the largest effect on filing rates are 'front-end' factors such as the procedural barriers or obstacles to filing; this factor is central to explaining the difference between Canada and the US.[38] Third, where no pattern of legal differences

[36] It would be surprising if the model did capture all of the variation because there have been substantial bankruptcy reforms in several of the countries during the period of the study. As discussed above, n 16, problems with the UK and Japanese data make it easy to see why the model does not produce significant results for those variables.

[37] Given the ambiguity of the findings related to the UK and Japan, I leave that subject to another day.

[38] For a similar argument about German filing rates, see W Backert *et al*, 'Consumer Bankruptcy in Germany', in *Consumer Credit, Over-Indebtedness and Bankruptcy: National and International Dimensions*, above n 5.

appears, it is reasonable to consider whether the residual cause is a strong cultural predisposition.

A. Why Is the Canadian Propensity to File Higher than the US Propensity?

The most intriguing problem is to explain the disparity in filing propensity between Canada and the US. Examining the two countries' systems at a very high level of generality, they provide a good empirical test of the hypotheses about front-end and back-end factors. First, the US discharge is considerably more generous than the Canadian discharge, which would support a lower Canadian filing propensity if the terms of discharge were the most important factor. Conversely, the Canadian bankruptcy process is relatively more accessible than the American process, which would support a higher Canadian filing propensity if accessibility were the most important factor. My conclusion is that the data support the hypothesis that accessibility is a more important predictor of propensity than the generosity of the discharge. Canada has a greater propensity to file, once we account for the markedly higher level of credit card debt in the United States, because Canada's relatively accessible bankruptcy system discourages fewer filers than the relatively inaccessible US system.

On the first point, the United States system offers a faster and almost unconditional discharge, with a stay automatically effective upon filing[39] and a discharge available in theory immediately and in practice after a few months.[40] By contrast, Canada, like most countries, does not permit an immediate discharge. Rather, the discharge cannot be considered for nine months and often involves an unstructured judicial assessment of a report filed by the bankruptcy trustee.[41] To be sure, challenges to discharge are infrequent, apparently affecting far less than one-fifth of the cases.[42] Yet, the fact remains that the delay of the discharge

[39] BAPCPA did introduce revisions that limit the automatic effectiveness of the stay, but those apply only to repeat filers. See 11 USC § 362(c) (3) (automatic stay against certain creditors lasts only 30 days for certain repeat filers) and (4) (no automatic stay for certain multiple repeat filers).

[40] To be sure, the United States has more exceptions to discharge than the other countries I study. See WC Whitford, 'Changing Definitions of Fresh Start in American Bankruptcy Law' (1997) 20 *Journal of Consumer Policy* 179. But those exceptions seem to me back-end issues less likely to affect the decision to file.

[41] Bankruptcy and Insolvency Act § 170, RSC 1985, c.B-3; S Ben-Ishai, 'Discharge' in S Ben-Ishai and A Duggan (eds), *Canadian Bankruptcy and Insolvency Law* 357, 358–60 (Markham, Lexis Nexis Canada, 2007); Duggan, above n 4, at 873–6. Similarly, the Canadian process includes rules under which debtors with substantial 'surplus' income must make periodic payments to their creditors. Apparently about one-fourth of Canadian debtors make such payments. *Ibid* at 864; S Ben-Ishai, 'Means-Testing' in *Canadian Bankruptcy and Insolvency Law* at 343, 353. Ben-Ishai emphasises that this leaves the system more accessible than the US system 'because debtors with surplus income are still able to move through the bankruptcy process, they are not directly prevented from accessing the fresh start offered by a liquidation bankruptcy or forced into an enforced payment plan.' *Ibid* at 355.

[42] Ramsay reports 1994 data in which about 15 per cent of applications were opposed. I Ramsay, 'Individual Bankruptcy: Preliminary Findings of a Socio-Legal Analysis' (1999) 37 *Osgoode Hall Law Journal* 15, 24. Ziegel reports 1998 data indicating that out of 83,000 discharge applications,

and the risk that it will not be granted unconditionally are quite different from the US experience, where objections to discharge are rare.

On the other hand, the procedures for instituting a bankruptcy in Canada are much simpler than the United States procedures. The prospective bankrupt initiates the proceeding by filing a simple standard-form assignment. The fee is CAN$75 for summary administration (cases with less than $10,000 in assets, more than 90 per cent of all cases[43]) and CAN$150 for regular administration.[44] The typical consumer bankrupt does not retain an attorney, though it must pay the fees of the trustee.[45] There is no mandatory examination by creditors, and no 'abuse' provision that might force the debtor to use the alternative 'proposal' system.[46] There is a mandatory counselling requirement (introduced in 1992), but it occurs after the filing, not before.[47] In the United States, the process is much more cumbersome. The forms are considerably more complex, and BAPCPA has only made them more so. Indeed, it is clear that the timing of bankruptcy filings is affected to a considerable extent by the need to collect the information necessary to complete the requisite forms.[48] Thus, although there is no legal requirement that filers retain an attorney or trustee, the overwhelming majority choose to do so.[49]

The juxtaposition of those distinctions with the substantial difference in propensity to file provides powerful support for the hypotheses about legal precursors. If the economic features of the discharge and future income payments—the 'back-end' effects of bankruptcy—were an important precursor of a high propensity to file, then it is surprising that there is a relatively high propensity to file in Canada. Conversely, the difference between Canada's streamlined procedures and the burdensome procedural obstacles in the United States cuts in the same direction as the propensity data presented in Part III.

B. Why Is the Canadian Propensity to File Higher than the Australian?

The second puzzle is how to distinguish Australia from Canada. As Part III illustrates, Australia has a lower propensity to file after accounting for economic

93 per cent of debtors received an unconditional discharge, 7 per cent a suspended discharge, and less than 1 per cent received conditional discharges or were denied discharges. Ziegel, above n 4, at 39.

[43] Ziegel, above n 4, at 19.

[44] Bankruptcy and Insolvency Act § 132, RSC 1985, c.B-3; Duggan, above n 4, at 870.

[45] Ziegel, above n 4, at 18. It is difficult to generalise about the levels of Canadian trustee fees, which in some cases might approximate the fees of US attorneys. See below, n 49.

[46] Ziegel, above n 4, at 20–1.

[47] Bankruptcy and Insolvency Act §§ 66.13, 157.1, RSC 1985, c.B-3; Duggan, above n 4, at 887–90.

[48] This also has become more significant after BAPCPA. R Mann and K Porter 'Saving up for Bankruptcy' (forthcoming 2010) 98 *Georgetown Law Journal* (Section V (c)).

[49] Interestingly, it is not clear that the out-of-pocket costs of filing differ substantially in the two countries. Although the US filing fees are much lower, the costs of trustees in Canada well might exceed the costs of attorneys in the US. At the same time, it appears that US attorneys are much more likely to require up-front payment than Canadian trustees. J Ziegel, 'Indigent Debtors and Financial Accessibility of Consumer Insolvency Regimes', in JP Sarra (ed), *Annual Review of Insolvency Law* (Toronto, Thomson Canada Limited, 2005) 500–4.

conditions. The next question is whether legal or cultural factors can explain the difference.

i. The Failure of Legal Explanations

As other scholars have noted, it is difficult to discern credible explanations based on the bankruptcy systems themselves.[50] First, the 'back-end' portions of those systems are quite similar. For example, the Australian discharge (historically available after 12 months of surplus income payments)[51] closely resembles the Canadian discharge available after nine months.[52] Because Australia's propensity to file is so much lower than Canada's, it is hard to put much weight on the discharge as an explanation.[53] Nor do procedural obstacles offer anything to explain the distinction.[54] Australia's system for initiating bankruptcies is for the most part quite similar to that of Canada; if anything it appears to be *more* accessible than Canada's, not less.[55] Professor Ziegel explains, 'the important point worth stressing here is that it is even easier—and certainly much cheaper—for Australian debtors to initiate bankruptcy proceedings than

[50] See authorities cited above, n 4.

[51] Surplus income payments are even less common in Australia than in Canada. See J Braucher, 'A Comparative Study of Repayment Forms of Individual Bankruptcy' in J Niemi-Kiesiläinen *et al*, *Consumer Credit, Over-Indebtedness and Bankruptcy: National and International Dimensions*, above n 5 (reporting a substantial increase in payments, up to 12 per cent of all filings, as compared to more than 20 per cent of filings in Canada).

[52] Australia's discharge period was lengthened to three years in 2002. See Duggan, above n 4, at 877. But Australian rates were much lower than Canada's even before that change. Moreover, as Figure 11.A1 illustrates, the slight (and apparently temporary) decline in filings after 2002 is a small fraction of the aggregate difference between Canadian and Australian filing rates.

[53] Recent Japanese reforms (intended to *encourage* bankruptcy filings) suggest that the nature of the discharge is similarly unimportant in explaining the low Japanese filing rate. See J Matsushita, 'Comprehensive Reform of Japanese Personal Insolvency Law' (2006) 7 *Journal of Theoretical Inquiries Law* 555, 560–4 (summarising those reforms). Although it is too early to be sure (because of the slow process Japan follows for issuing bankruptcy statistics), the early evidence—a substantial *decline* in 2005 bankruptcy filings—at least suggests that these reforms will solve little of Japan's problem. To be sure, the improvement in Japan's economy beginning in 2004 might have caused some of that decline. However, an obvious alternative hypothesis supported by the experience in other countries is that the 2004 reforms—which emphasise increasing exempt assets and broadening the discharge—do little to address the heart of what keeps Japan's filings low: the expensive and cumbersome process for gaining access to bankruptcy.

[54] Procedural obstacles do offer a potential explanation for the low filing rates in the UK and Japan. See Ziegel, above n 4, at 112–13 (discussing onerous procedures in Great Britain); K Anderson and M Ito, 'Insolvency Law for a New Century: Japan's New Framework for Economic Failures' in D Foote (ed), *Law in Japan: A Turning Point* ([Seattle, University of Washington Press], 2007) (discussing onerous process for instituting consumer bankruptcy in Japan, which includes judicial scrutiny for eligibility and traditionally has not included an automatic stay); Matsushita, above n 53, at 561. Pre-screening of consumer bankruptcy petitions is not unique to Japan. It also is a common feature of Nordic bankruptcy systems. See J Kilborn, 'Out With the New, In With the Old: As Sweden Aggressively Streamlines Its Consumer Bankruptcy System, Have US Reformers Fallen Off the Learning Curve, (2007) 80 *American Bankruptcy Law Journal* 435, 443–4 (hereinafter, Kilborn, 'Sweden').

[55] Ziegel repeatedly notes the difference in filing rates, but does not undertake to explain it. Ziegel, above n 4, at 94, 106.

it is for a Canadian debtor.'[56] For example, a bankrupt commences a case by completing a short standard form of assignment. The only substantive filing requirement is that the debtor be insolvent. Australia offers a summary administration process with no creditors' meeting for cases with less than $10,000 in assets (which applies to about 90 per cent of Australian cases). Moreover, debtors typically do not use attorneys or private trustees; rather the Official Trustee administers the case, collecting its fee from the estate and relying on a public subsidy to administer no-asset cases.[57]

ii. Cultural Explanations

If neither economic explanations nor legal explanations are fruitful, an obvious possibility is that cultural explanations provide an explanation for the observed pattern. Because cross-border cultural explanations are inherently nebulous (like dark matter), any such explanation necessarily is speculative. That is particularly true here, where the cultural factors would have to be remarkably powerful to explain the disparities identified in Figure 11.1 and Table 11.1. Still, the juxtaposition of nearly identical legal systems and similar economic conditions with starkly different filing rates justifies exploration of the possibility.

One objective place to look for indicators of a strong cultural disposition against bankruptcy is statutes that impose substantial legal disabilities on those who file for bankruptcy. Such statutes could persist only in a society with a strong cultural disposition against bankruptcy.[58] Here, there is some evidence to suggest that Australian society takes a harsher perspective than Canada. In contrast to Canadian law, which imposes no substantial disabilities, Australian bankrupts forfeit their passports when they file.[59]

One intriguing suggestion comes from Iain Ramsay, who argues that we observe high filing rates in countries (like Canada and the US) in which private professionals assist bankrupts in initiating proceedings because those professionals have an economic incentive to raise awareness of the bankruptcy process. By contrast, Ramsay argues, we observe low filing rates in countries (like Australia and the UK) that rely entirely on public officers to assist filers, because those officers have a significantly lower incentive to publicise the

[56] Ziegel, above n 4, at 96–7. Tony Duggan and Jean Braucher share Ziegel's perspective. Duggan, above n 4, at 869–72; Braucher, above n 51.

[57] See *Ibid*; Duggan, above n 4 at 868–9; R Mason and J Duns, 'Developments in Consumer Bankruptcy in Australia', in *Consumer Bankruptcy in Global Perspectives*, above n 2, at 227, 232–4.

[58] The UK provides a startling example. Until the Enterprise Act reforms in 2004, the UK bankrupt was subject to numerous serious civil disabilities, akin to those typically imposed on felons. Among other things, British bankrupts (at least before the 2002 Enterprise Act became effective in 2004) could not be a Member of Parliament, Justice of the Peace, company director, chairman of a land tribunal, school governor, estate agent, charity trustee, or even a practicing solicitor or insolvency practitioner. See A Walters, 'Personal Insolvency Law After the Enterprise Act: An Appraisal' (2005) *5 Journal of Corporate Law Studies* 65, 82–3.

[59] Bankruptcy Act 1966 § 272. See Duggan, above n 4, at 892. It is unclear how important this ban is in practice. Apparently Australians usually can travel abroad after seeking permission from the trustee. Still, the formal requirement is quite stigmatising.

process.[60] It is difficult to evaluate that perspective as an overarching explanation. For example, given the low esteem for lawyers and the legal process in the US, many would regard the practical need for lawyers in the US bankruptcy process as an obstacle. A purely administrative process might in practice be much more accessible.

On the other hand, I take Ramsay's central point to be that the private professionals are central in increasing public awareness and receptivity to the bankruptcy process. Even in the US advertising by lawyers appears to play a role in developing a cultural perception of bankruptcy as a routine solution to financial distress.[61] If that is the significance of private professionals, then it is hard to be sure that their appearance is not an effect of a relatively receptive culture rather than a cause. In either case, Ramsay's thesis is consistent with the pattern I identify here.[62]

C. Summary

In a way, the central puzzle the data presents is why Canada's propensity to file is so high, given relatively low levels of debt. One possibility could be that Canadian debt is riskier or more perilous in some way that aggregate data cannot reveal, so that the same level of credit card and other borrowings in Canada would result in higher bankruptcy filings than in other countries. However, the best evidence about global credit card markets makes that hypothesis implausible. If anything, Canada's use of payment cards appears to be considerably more benign than the use in the United States and Australia.[63] That suggests that we must look to legal or cultural explanations. With respect to the United States, the most salient distinction that would explain a relatively higher propensity to file is Canada's decision to make its bankruptcy system so accessible, particularly for those in more desperate condition. With respect to Australia, distinctions are even more elusive because it is difficult to identify any feature of the legal system that makes Canada's bankruptcy system more accessible than Australia's. Recognising that the inquiry is speculative, it does suggest that cultural predispositions against bankruptcy are remarkably stronger in Australia than in Canada, reinforced by the greater presence of marketing and advertising in Canada.

[60] Ramsay, above n 3. See Duggan, above n 4, at 893 (tentative endorsement of Ramsay's hypothesis).

[61] That certainly is something for which consumer bankruptcy lawyers routinely are criticised. See RJ Mann, 'Bankruptcy Reform and the "Sweat Box" of Credit Card Debt' (2007) *Illinois Law Review* 375, 375.

[62] As Tony Duggan has pointed out to me, Ramsay's thesis leaves unexplained why a culture that is by hypothesis so opposed to bankruptcy would embrace a legal system that on its face is so receptive to bankruptcy. One obvious possibility is that Australia tolerated such a system *because* filing rates remained low. When filing rates rose in the late 1990s to levels that were remarkably high by Australian standards (though still far below typical rates for the US and Canada), Australia responded by restricting the relief available to those that file. As suggested above n 52, it is not yet clear that those reforms will have a permanent or substantial effect on filing rates.

[63] Compared to the US market, Canada's use of debit cards is much more common and its level of borrowing in payments transactions is much lower. See Mann, above n 7, chs 9–10.