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On Legal Origins and Bankruptcy Laws:
the European Experience (1808-1914)

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**ON LEGAL ORIGINS AND BRANKRUPTCY LAWS:
THE EUROPEAN EXPERIENCE (1808-1914)**

Jérôme Sgard

SUMMARY

Over the last ten years, a growing body of research has emphasised the impact of legal origins, or legal traditions, on economic development. The basic intuition stems from standard neo-institutionalist economics, though the main innovation brought about i.a. by Rafael La Porta at al. (hereafter LLSV) was to rely upon large cross-country data-bases in order to test empirically these propositions.

In this attempt, however, they were confronted to a standard problem of endogeneity: legal institutions could be shaped by the process of economic development, rather than being a shaping factor, so that they would not help accounting for variations across countries. The solution was to use each country's "legal origin" as an exogenous variable: i.e. their belonging to either the Common law tradition, or to various currents of continental law – French, German or Scandinavian. As they measured the quality of legal institutions, this variable indeed came out as a significant factor in explaining different economic outcomes : already in their first joint paper, LLSV (1997) concluded that, other things equal, Common law countries better protect property rights and draw economic benefits from this; they are followed by Scandinavian, German and finally French law countries.

The main difficulty with the argument derives from the econometric and analytical interpretation of "legal origins", when used as a country-specific, time-invariant parameter, that is expected to have permanent effects on institutions *and* on economic performances. In this perspective, "legal origins" are supposed to have emerged in a given historical context (the Middle-Ages) and to have then crystallised : since then, their differential effect on actual laws and institutions would lie beyond the reach of either economic or political competition. A first problem is that, obviously, no empirical evidence has been presented so far that would support this proposition. Then, the actual indices used as a proxy for property and creditors rights, in the econometric regressions, are very narrow. In their early seminal papers, for instance, LLSV chose bankruptcy laws as a representative creditors' rights institution. And within these laws, they identify four critical items which were supposed to reflect the guarantees offered in general to creditors under the respective procedures. Measuring the quality of institutions thus become much vulnerable to country- or period- specific patterns.

This paper presents an original attempt at testing the proposition that legal traditions are a time-invariant, country-specific variable, that can actually work in a purely exogenous way in economic development. Following on the above-mentioned LLSV paper, it focuses on bankruptcy law in Europe during the nineteenth century, a rather large scope that offers a

lot of a priori variation across time and countries. 51 legal acts, statutes and codes, adopted in 15 countries between 1808 and 1914, have been collected and coded. In the majority of cases, the primary text has been consulted and in the other cases, nineteenth century legal treaties and textbooks were used. This contemporary legal literature also helped identifying the main themes in the legal and policy debates of the time. A series of simple, LLSV-type indices was then designed, that reflect actual trends in the evolution of bankruptcy laws, over time and across countries.

The notion of time-invariant patterns can thus be thoroughly tested against an alternate hypothesis: maybe lawmakers attempted primarily to address pragmatically emerging problems, or the demands formulated by social actors? Maybe the evolutions observed across countries reflected the economic challenges arising from capitalist development, rather than the respective legal histories?

This original approach, which has no equivalent in terms of either method or scope, brings about two main conclusions. First, under LLSV's own limited criteria, creditors' rights during bankruptcies were very strongly protected by law, during the whole century and in all countries – whatever their legal tradition; only England comes out *prima facie* with a somewhat weaker performance. Second, when one goes beyond the features selected by LLSV, available evidences confirm more broadly the notion that legal traditions would have had an exogenous, permanent, i.e. predictable effect on how the law is shaped.

Two specific topics come out strongly from the debates and the reforms of the time: the control over the debtor's moral hazard, including via imprisonment; and the capacity for the parties to re-contract on residual property rights after a default, i.e. to agree on an arrangement or reorganisation plan. Under both respects, an early century model was characterised by strong repression of failed debtors and highly regulated procedures of renegotiation. After a transition period from the mid-1860's to the mid-1880s', a more liberal model emerged in most countries: prison for debt was abandoned, rehabilitation became easier, and the parties got much more room to bargain on residual property rights. National or legal traditions only show up against the backdrop of these continent-wide trends

ABSTRACT

Since the early 1998 paper by LLSV, a growing body of research has argued that “legal origins” have a country-specific, time-invariant effect on property rights and economic development. Following the methodology of LLSV, an original data-base of 51 bankruptcy laws has been built: it ranges over fifteen European countries and more than a hundred years (1808-1914), and summarises how the rights and incentives of the parties were defined as the procedure unfold. The first conclusion is that, over the entire period, all legal traditions strongly protected creditors' rights; only English law comes out *prima facie* as less protective. Second, evidences suggests that the evolution of these laws was influenced less by their past than by continent-wide trends, arguably linked to capitalist development. An early 19th century model thus saw heavy repression of failed debtors and highly

regulated judicial procedures. After a transition period from the late 1860s to the late 1880s, prison for debt was abandoned, rehabilitation became easier, and the parties were given much more room to re-contract on property rights.

Classification JEL: G33, K12, N43

Keywords: bankruptcy, renegotiation, law history, legal origins

**LE DROIT DES FAILLITES ET LA QUERELLE DES 'ORIGINES LEGALES' :
L'EXPERIENCE DES LOIS DE FAILLITES EN EUROPE (1808-1904)**

RÉSUMÉ

Depuis un dizaine d'année, un nombre croissant de travaux ont souligné l'importance des « origines légales » dans le développement économique. En particulier, de manière structurelle, la tradition du droit civil défendrait moins bien les droits des propriétaires et des créanciers que la *Common Law*, ceci contribuant ensuite à des écarts permanents de performance économique. L'intuition première de cette approche dérive donc de l'économie néo-institutionnaliste ; mais l'innovation majeure, introduite par La Porta et al. (1998), vient de l'utilisation de très larges bases de données internationales qui leur ont permis de tester empiriquement ces hypothèses.

Ce projet se heurtait toutefois à un problème standard d'endogénéité: les institutions, notamment le droit, peuvent avoir un effet structurant sur le développement économique, mais a priori elles peuvent aussi être structurées par ce processus historique. D'où le recours à l'« origine légale » considérée comme une variable institutionnelle absolument exogène. De fait, en mesurant la qualité des institutions La Porta et al. ont observé un effet significatif de cette variable sur toutes une série d'indicateurs de performance économique. En particulier, de manière régulière, ils relèvent que (à la fin des années 1990), les pays de *Common law* protègent mieux les droits de propriétés et en dérivent des bénéfices économiques tangibles ; ils sont suivis, en règle générale, par les pays de droit allemand et scandinave, puis par les pays de droit français.

La principale difficulté soulevée par ces travaux découle de l'interprétation économétrique et analytique de la variable d'« origine légale » : présentée comme à la fois invariante dans le temps et spécifique à chaque pays, elles auraient émergé dans un contexte historique très ancien (par hypothèse le Moyen-Age), puis elles se seraient cristallisées ; elles auraient alors été placées hors de portée de tout effet de concurrence politique ou économique. Un premier problème est qu'aucun argument empirique n'est apporté à l'appui de cette hypothèse ambitieuse. Au-delà, des problèmes sont aussi soulevés par les indicateurs très étroits choisis pour mesurer concrètement comment le droit protège la propriété et les contrats. Dans leur premier papier, par exemple, La Porta et al (1998) sélectionne le droit des faillites comme une institution représentative du droit des créanciers, puis ils la décrivent au moyen de quatre indices élémentaires. Pour le moins, cette méthode restrictive est exposée au risque de sélectionner des indices étroitement attachés à l'expérience d'un pays ou d'une période spécifique.

Dans ce travail on présente une tentative originale de tester l'hypothèse d'invariance temporelle des « origines légales », c'est-à-dire l'hypothèse d'un caractère entièrement exogène du droit dans le développement économique. En suivant la même méthodologie que La Porta et al., on a collecté et codé 51 lois ou codes de faillite, adoptés dans quinze pays européens entre 1808 et 1914 ; ceci offre donc a priori beaucoup de variance, à la fois dans le temps et entre pays. On s'est appuyé sur les textes de lois et sur un grand nombre

de manuels et de traités de l'époque, qui ont permis aussi d'identifier précisément les enjeux soulevés par la réforme et le fonctionnement de ces lois. Une série d'indices descriptifs simples ont alors été construits, comparables à ceux proposés par La Porta et al.

Sur cette base, on peut alors tester l'hypothèse selon laquelle les lois de faillite, notamment la manière dont elles protègent les créanciers, seraient déterminée par l'«origine légale» ou bien par des caractères plus contingents. Peut-être les législateurs cherchaient-ils à répondre pragmatiquement aux problèmes rencontrés par les entreprises et les banques, sans que le passé de chaque règle de faillite pèse de manière tangible sur l'efficacité économique de la solution adoptée ? Plus généralement, peut-être l'évolution de ces lois au cours du XIX^e siècle s'explique-t-elle avant tout par les enjeux nouveaux posés par le développement capitaliste, plutôt que par l'histoire juridique de chaque pays ?

Cette approche originale, qui n'a pas d'équivalent tant en termes de méthode que de taille de l'échantillon, permet de tirer deux conclusions principales. D'abord, en suivant les critères limités de La Porta et al., il ressort que les droits des créanciers étaient très fortement protégés, tout au long de la période et dans tous les pays – quelle que soit leur tradition juridique. Seule l'Angleterre présente à première vue une performance moindre. Ensuite, et de manière plus générale, l'hypothèse que les traditions juridiques auraient un effet exogène, permanent et donc prévisible n'est aucunement confirmée.

Deux enjeux ressortent avec force dans le débat juridique et politique de l'époque, sur l'ensemble du continent. D'une part vient l'enjeu de l'aléa moral du débiteur, ce qui renvoie notamment à la question de la prison pour dette ; d'autre part, se pose la question des marges de liberté laissées aux parties (débiteur et créanciers) pour négocier des accords de restructuration, par opposition à la liquidation. Deux paradigmes successifs peuvent alors être identifiés à travers tout le continent, quelle que soit l'histoire juridique de chaque pays. D'abord un modèle très restrictif domine jusqu'aux années 1860, marqué par une répression intense du failli et des procédures très contraignantes vis-à-vis de l'autonomie des parties. Après une transition d'une vingtaine d'années émerge ensuite un modèle plus libéral ou plus moderne : la prison pour dette est abandonnée par la majorité des pays en dix ans (1866-1877), la réhabilitation du failli devient beaucoup plus facile, et les parties peuvent engager beaucoup plus librement des négociations complexes pour restructurer les entreprises.

RÉSUMÉ COURT

Depuis le premier article de La Porta et al. (1997), un grand nombre de travaux ont défendu que l'« origine légale » de chaque pays – son appartenance notamment à la tradition du droit civil ou de la *Common Law* – aurait un effet économique permanent : d'abord sur la protection plus ou moins forte des droits des propriétaires et des créanciers, ensuite sur le développement économique. En reprenant la méthodologie proposée par La Porta et al., on a collecté et codé 51 lois de faillites adoptées entre 1808 et 1914, dans quinze pays d'Europe. On a insisté notamment sur les droits et les incitations des parties et sur la dimension plus ou moins restrictive de la procédure.

Une première conclusion est que toutes les traditions juridiques défendaient très fortement les droits des créanciers face à une faillite, cela pendant toute la période ; seul le droit anglais peut apparaître à première vue moins protecteur. Ensuite, de manière plus générale, l'évolution des lois de faillite était moins influencée par leur passé respectif que par des tendances lourdes, observées sur l'ensemble du continent, liées par hypothèse au processus de développement capitaliste. Ainsi, un premier modèle de faillite, représenté notamment par le Code de commerce français de 1808, était caractérisé par une répression lourde des faillis et des procédures de renégociation très contraignantes. Puis, entre 1865 et 1885, a émergé un modèle plus libéral ou plus moderne : la prison pour dette a été abandonnée, la réhabilitation du failli est devenue plus aisée et les parties ont obtenu des marges de manœuvre beaucoup plus larges pour négocier des accords de restructuration.

Classement JEL : G33, K12, N43

Mots Clés : faillite, renégociation, histoire du droit

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1. INTRODUCTION

LEGAL ORIGINS' AND THE EVOLUTION OF BANKRUPTCY LAW

Over the last ten years, a growing body of research has emphasised the impact of legal origins, or legal traditions, on economic development. The basic intuition stems from standard neo-institutionalist economics: property rights, the integrity of contracts and the security of transactions matter for financial contracting, hence for investment and growth. The main innovation brought about i.a. by Rafael La Porta, Florencio Lopes-de-Silanes, Andrei Shleifer and Robert Vishny (hereafter LLSV) was to rely upon large cross-country data-bases in order to test empirically these propositions.

In this attempt, however, they were confronted to a standard problem of endogeneity: institutions, including legal ones, could be shaped by the process of economic development, rather than being a shaping factor, so that they would not help accounting for variations across countries. The solution was to use each country's "legal origin" as an exogenous variable: i.e. their belonging to either the Common law tradition, or to various currents of continental law – French, German, Scandinavian or Socialist. As they measured the quality of legal institutions, LLSV indeed observed strong covariance within these sub-groups of countries. And when included in regression equations, this variable came out as a significant factor in explaining different economic outcomes - bank intermediation, stock market capitalisation, the availability of equity finance, etc¹. Already in their first joint paper, LLSV (1997) concluded that, other things equal, Common law countries better protect property rights and draw economic benefits from this; they are followed by Scandinavian, German and finally French law countries. Comparable conclusions were reached in latter papers, and by other authors, which focussed on an ever increasing array of variables, generally with the same hierarchy among "legal origins"².

There is no question that bringing legal history into the economic debate was an important and welcome innovation. Neither will anybody contest that legal history belongs to the very long term: as stated by Gleaser and Shleifer (2001), the canonical opposition between English and French law had already emerged in the Middle-Ages.³ Yet, the main difficulty

¹ See LLSV 1997, 1998, 1999a, 2000.

² See for example Beck and al. (2003), Beck and al. (2005), Demirgüç-Kunt and Maksimovic (1998), Djankov et alii (2006), Levine (1998). For a survey see Beck and Levine (2005)

³ Comparing legal traditions is an old field of research; see Lyon-Caen (1876), and its US edition the same year; Zweigert and Kötz (1998) for a recent survey and discussion.

with the argument derives from the econometric and analytical interpretation of this very notion: “legal origin” is used as a country-specific, time-invariant parameter, which is expected to have permanent effects on institutions *and* on economic performances. This assumption is actually required, if the endogeneity problem is to be solved neatly⁴.

Hence, the underlying paradox: whereas the overall approach comes with a strong smell of Northian historiography, the actual use of history, or duration, is profoundly a-historical. It does not and cannot account for phases or cycles in economic or political development. Nor are these propositions consistent with the standard assumptions of the Law and Economic school, which states that the law is shaped by market forces. On the contrary, “legal origins” are supposed to have emerged in a given historical context and to have then crystallised: they are interpreted as some essential hard-core identity, which would lie beyond the reach of either economic or political competition⁵.

This obviously raises concerns. To start with, no empirical evidence has been presented which would support this proposition. Historians have certainly identified different legal and institutional patterns, over sub-periods, which may have had diverging economic consequences. But this is different from the identification of permanent biases which would have tangible economic effects over all countries and centuries. Besides, the actual indices used as a proxy for those rights, in the econometric regressions, are very narrow. In their early seminal papers, for instance, LLSV chose bankruptcy laws as a representative creditors’ rights institution⁶. And within these laws, they identify four critical items which were supposed to reflect the guarantees offered in general to creditors under the respective procedures. This highly discriminating approach certainly goes against the grain of mainstream legal theory, which defines property rights as a complex bundle of rights, rather than a neatly defined, positive endowment. It also makes them more vulnerable to country- or period- specific patterns. Can for instance the criteria chosen by LLSV be applied to

⁴ A softer version of the argument could have stated that “legal origins” have had a significant economic impact during some periods and a more muted one during others; but such environment-contingent clause could then be extended to present-day countries, e.g. more or less developed ones. The whole argument would then loose much of its strength; in other words, by construction, it has to be epistemically universal.

⁵ A number of authors have presented this thesis in a less straight-forward manner. Berkowitz and alii (2003) for instance argue that the impact of ‘legal origins’ is contingent on whether their adoption is voluntary or not (ie colonial); Djankov et alii (2003b), though arguing from the standard LLSV viewpoint, underline that there is room for a country-specific trade-off depending upon e.g. its degree of development. From a mostly theoretical view point, Ayotte and Hayong (2004) defend a comparable idea, though with a different conclusion – developing countries should adopt more regulated or formalised law than developed ones; see also Berkovitch and Israël (1999). Standard opponents to the students of “legal origins” often argue that political (rather than legal) institutions are the key when defending property rights; see for instance Rajan and Zingales (2003), Acemoglu (2003), and of course Marx and Engels (1848).

⁶ Note that, historically, bankruptcy law in England and the US stems from statutory law, whereas case-law has never produce a coherent body of rules on this issue; the only major exception in this respect is the US equity receivership, which emerged in the late nineteenth century (see Skeel 2001 and Martin 1974). By the same token, French commercial courts, which have jurisdiction over bankruptcy, have almost always been staffed by elected, non-professional judges, both before and after the 1789. They are not State-controlled courts.

other historical periods ? Or should they merely be considered as a present-day expression for a more fundamental, underlying reality? But how should that reality then be identified?

This paper presents an original attempt at testing the proposition that legal traditions are a time-invariant, country-specific variable, that can actually work in a purely exogenous way in economic development. Following on the above-mentioned paper, it focuses on bankruptcy law in Europe during the nineteenth century, a rather large scope that offers at least three advantages: all Western legal traditions are represented in the sample; the period under review witnessed large-scale economic and institutional changes; and lots of reforms have been adopted in all countries⁷. In other terms, there is a lot of a priori variation across time and countries.

Two questions are then addressed: did “legal origins”, as defined by LLSV, have the same differentiated impact on 19th century creditors’ rights than the one they identify in the late 20th century? Did these “origins” also bear on other important features of these laws, when they were discussed and designed? Bankruptcy is indeed a very complex, multi-faceted institution: it thoroughly redefines the rights of the parties at the onset; it imposes on them binding, non-market rules of interaction, which are also dependent upon an array of pre-existing bodies; and the environment in which they operate utterly expose them to moral hazards and to threats of opportunistic behaviour : which situation could be actually more dangerous than one where all debt contracts are broken and market discipline is destroyed? Sensitivity to an evolving environment might indeed be a key factor beyond the common statement that bankruptcy laws are historically unstable⁸.

The notion of time-invariant patterns may thus be thoroughly tested against an alternate hypothesis: maybe lawmakers attempted primarily to address pragmatically emerging problems, or the demands formulated by social actors? In so doing, they would of course have had to deal with the existing legal institutions and professions, as with a specific legal grammar. But maybe these variables did not have such a tangible impact on how the eventual solutions did work? Maybe the evolutions observed across countries reflect much more the economic challenges arising from capitalist development than the respective legal histories?

Although providing complete answers to these questions is beyond the scope of this article, it presents a series of evidences which infirm at least some hypothesis. With this aim, 51 legal acts, statutes and codes, adopted in Europe between 1808 and 1914, have been collected and coded. In the majority of cases, the primary text has been consulted and in the other cases, nineteenth century legal treaties and textbooks were used. The contemporary legal literature also helped identifying the main themes in the policy debates of the time. A series of simple, LLSV-type indices was thus designed, which reflect actual trends in the evolution of bankruptcy laws, over time and across countries.

⁷ There has been on average 3,4 reforms per country during the period under review, with a maximum of eight in England.

⁸ The point comes up especially in the case of Common law countries; see e.g. Warren (1935), Berglöf and alii (2001), Skeel (2001). See also Percerou (1935, vol. 1, p. 36-37).

This original approach, which has no equivalent in terms of either method or scope, brings about two main conclusions. First, under LLSV's own limited criteria, creditors' rights during bankruptcies were very strongly protected by law, during the whole century and in all countries – whatever their legal tradition; only England comes out with a somewhat weaker performance. As a rule, the literature of the time indeed suggests that a bankruptcy code which would not aim primarily at protecting creditors' rights would have just been pointless. Second, when one goes beyond the features selected by LLSV, available evidences confirm the notion that legal traditions would have had an exogenous, permanent, i.e. predictable effect on how the law is shaped: how it attempts to define the incentives and constraints of agents. It is hard indeed to identify beyond the successive reforms the impact of a single, a-historical factor hypothetically anchored in an "origin".

Two specific topics come out strongly: how controlling the debtor's moral hazard, including via imprisonment; and the capacity for the parties to re-contract on their residual property rights after a default, i.e. to agree on an arrangement or reorganisation plan⁹. Under both respects, two continent-wide models emerged successively, during the first half of the period and then over the latter decades. Legal traditions only show up against the backdrop of these continent-wide trends. Of course, one could then try to re-link the successive reforms and adjustments made in each country, so as to write a history of national bankruptcy laws; but the identification of a time-invariant inner thread would be a wholly different proposition.

Section two presents the data set its main analytical dimensions. Section three discusses how, on this basis, the sample of countries performed under the LLSV criteria of creditors' right; it also presents an enhanced LLSV index, which reflects more closely of 19th century reality though it remains close to the initial intuition. The next section discusses the continent-wide transition towards a non-punitive bankruptcy law to a more liberal, non-threatening one. Section five shifts to the liberalisation of rules regarding arrangements and re-contracting. Section 6 concludes.

2. ON RIGHTS, PROCEDURE, AND ENVIRONMENT

Bankruptcy is a complex and multifaceted institution that is not easy to describe with a limited set of discrete variables. What market outcome could actually be more confusing and dangerous than one where all debt contracts are broken, where the time horizon of actors may shorten dramatically, and where the disciplining effect of ongoing market transactions is extinct? Default and insolvency can actually be thought of as a paradigmatic example of a contractual failure that immediately raises major threats of a breakdown in collective action. If creditors are able to run on the physical assets or to freely pursue

⁹ The terms 'arrangements', 'compositions', 'continuation' or 'reorganisation' plans are used here as synonymous.

individual judicial remedies, the problems of common pool, or prisoners' dilemma may rapidly become uncontrollable : a tragedy of the commons is never far away when a private business with more than one creditor fails. The end-result may be altogether highly inequitable as regard the distribution of capital losses among individual creditors, and economically sub-optimal for them as a whole, typically if there are going concern issues.¹⁰

Hence the call for the intervention of a benign, Lockean sovereign, who would guarantee an orderly and efficient allocation of capital losses and help restore the conditions for secure contractual exchange. But in order to support such settlement it will have to infringe upon the rights of the parties will have and to redefine them, both individually and collectively¹¹. Binding rules of interaction will be imposed upon them, as they will be transferred into a non-market, procedural framework for collective negotiation; agents and officials will have to be dealt with and possibly monitored; remaining assets will be seized and possibly managed by an interim agent; lastly, individual choices will be substituted by qualified majority votes and judicial confirmation, that may forcibly reallocate property rights against the will of dissenting, minority creditors.

How far the Lockean state enters into contractual matters and regulates the post-default, non-market interactions between the parties can be thought of as the first main issue in the history of bankruptcy laws. Though wide variations are observed in this respect, at no point in modern times has the sovereign been taken completely out of the picture. In fact, there has never been such thing as a fully privatised bankruptcy procedure, a point that suggests that sanctioning insolvency is not endogenous to markets per se, but should be the eventual act of an agent of the sovereign – say a bankruptcy judge.

Of course, here as elsewhere, rent-seeking behaviours by stake-holders, officials and legal professions have been quite common. During the 20th century, non-contractual, special interests have often held sway over the rights of creditors. But the defining element of this institution is neither its quasi-fiscal dimension, nor its use as an instrument to affect market outcomes. Rather bankruptcy is part and parcel of any competitive, open-market, capitalist economy and tends to emerge as a policy issue when the economy is being liberalised, rather than when evolving in the reverse direction.

The interaction between this institution and its overall environment is thus a second, defining issue. The main underlying theme here is probably the more or less extended risks of moral hazards and opportunistic behaviours borne by this environment. Take for instance the quality of the signal for entering the procedure – i.e. when the debtor firm becomes illiquid and should stop contracting. If the payment system is poorly regulated and has a limited capacity to manage aggregate liquidity, due for instance to the absence of a modern

¹⁰ Jackson (1985), Hart (2000), White (1977).

¹¹ This is stated as one important reason why English bankruptcy law did not emerge from common law but from statutory law (Jones, 1979); its instability over time apparently derived, at least partly, from the contradictory principles embedded in the respective bodies of legal texts.

Central Bank armed with of lender of last resort function, then viable firms may be pushed into default too rapidly; conversely, overextended firms may also survive too long when creditors are exposed to large asymmetries of information.

Exiting the procedure also raises serious problem, that may as well bear on how bankruptcy works and which incentives it creates on agents. Since the Middle-ages, for example, liquidation typically calls for an open auction of assets against cash, which might not be readily available. Well into the 19th century owners of large plantations in the American South could survive insolvency for decades, just because of the impossibility to liquidate at a viable price their stock of assets (lands and slaves); Thomas Jefferson is a well-known example. Conversely, the success of the present-day *Chapter 11*, in the United States, cannot be accounted for unless the huge development and sophistication of domestic capital markets is brought into the picture (buy-outs finance, markets for mergers and acquisition, distress firm finance, etc.). By the same token, the slow resolution of the insolvency crisis in Japan, since the early 1990s, was also conditioned by the creation of a market that would help disposing of large stocks of real assets¹².

3. A DATABASE ON EUROPEAN BANKRUPTCY LAWS, 1808-1914

In order to analyse the evolution of national bankruptcy laws over the 19th century, 51 legal texts adopted in fifteen European countries have been collected (Annex 1).¹³ The series starts with the 1808 French *Code de commerce*, which was the main source of influence on the continent until mid-century, and then extends to World War I.¹⁴ Some countries, such

¹² Kazunari and Singh (2004).

¹³ The history of bankruptcy laws has attracted increasing attention since the 1980s, though this literature deals mostly with the US experience. At one end of the spectrum are various trends in cultural history that often centre on the “moral economy” of debt and default (Anderson 2004, Finn 2003, Mann 2003, Weiss 1986), plus various approaches in the social history of failure (Duffy 1985, Hoppit 1987, Lester 1995). Other authors have focused on the actual working of the institution during specific episodes: for instance, the short life of the second American federal law in 1841-1842 (Balleisen 2001), the role of the third federal law (1867-1878) in the economic reconstruction of the South (Thompson 2004), or the political economic history of the more recent 1978 U.S. law (Posner 1978, Carruthers and Halliday 1998). Before that, some early (mostly descriptive) works contributed to opening the field and identifying the main issues at stake; see Warren (1935) and Coleman (1974). A classic example is the conflict on bankruptcy reform and land exemption that opposed the rural West and the financial centres of the Northeast. In this perspective, Howard Rosenthal and his colleagues have provided new insights into the political economic determinants of bankruptcy reforms in the United States (Berglöf and Rosenthal 2000, 2004; Nunez and Rosenthal 2002; Berglöf, Rosenthal and von Thadden 2001 which also extends to some European experiences; Domowitz and Tamer 1997). This approach has been extended by David Skeel (2001) to 20th century trends and with an often close analytical language; Hansen and Hansen (2005) also follow along these lines, though emphasising as well the changes in the perception of the law, over time.

¹⁴ Austria, Belgium, Denmark, England, France, Finland, Prussia/Germany, Hungary, Italy, The Netherlands, Norway, Portugal, Russia, Spain, and Sweden. Greece, Malta, and Switzerland are mentioned occasionally but are not included in the data set.

as Belgium, the German Reich and Italy did not exist at the beginning of the period; but Prussia and the Kingdom of Piedmont are included in the database. Other countries did not have a unified bankruptcy law before mid-century, such as Norway, Finland, and a large part of the Northern German Confederation (outside Prussia); and in some cases only partial information was available. Two Europe-wide cycles of bankruptcy reforms can then be identified : first a minor upswing during the 1840s, then much more activity during the 1870s and 1880s.

The primary legal texts were used when accessible (often as a translation); as a second-best, a substantial number of 19th century legal treaties, commentaries and textbooks were used. Features of each law have been coded in a series of 0/1 digits reflecting how it defined both the rights of the players and the rules of the game. This database, however, reflects exclusively a formalistic and comparative history of the legal texts. It does not include any material relating to the social or economic history of bankruptcy, or on how agents actually interacted with this institution. Though this is certainly a restrictive approach, there is no doubt that bankruptcy laws were widely debated at the time and that reforms generally mobilised a large array of interests and opinions. In other words, agents certainly did not consider the law as un-consequential, whatever their actual practices.

The starting point is the four items chosen by LLSV (1998) to measure the protection of creditor's rights during bankruptcy. Namely, they consider that creditors' rights are better protected if :

1. the management does not stay during reorganisation procedure;
2. the management cannot seek protection from creditors unilaterally;
3. reorganisation procedures are not associated with an automatic stay;
4. the rights of secured creditors are protected during reorganisation.

A primary aim was thus to replicate or approximate this simple additive index, which ranks the protection of creditors' rights from 0 (minimum) to 4 (maximum). When working on 19th century texts, however, problems rapidly arise from the differences in economic and institutional contexts: many policy issues of the time fall just outside LLSV's quality criteria. Most obviously, bankruptcy laws concerned mostly personal entrepreneurs and small firms, rather than incorporated businesses, and this naturally affects many agency problems.

Take the case of going concern issues – for instance whether and how the firm can operate during the procedure. This point emerged only in the late 19th century, typically in the case of railway companies.¹⁵ Before that, the principal/agent problem *during* the procedure was

¹⁵ The point has been well documented in the case of the U.S. law; see Martin (1974) and Skeel (2001).

secondary: the priority for creditors, when a default was known, was to *immediately* take control of the remaining assets so that the bankrupt would not hide them, secretly transfer them or agree on side-arrangements with preferred creditors. Indeed, seizing the assets or the body of the debtor were long considered as two principal avenues to protect creditors against opportunism. On the other hand, how reorganisation plans were decided was certainly a major issue. But the core question in this respect was not whose voice would be decisive – there was no uncertainty on this – but rather the balance between the judicial guarantees offered to the parties and the relative autonomy they were left with when negotiating.

Thus, two main analytical issues are documented by the database, beyond those directly derived from LLSV's analysis. First is how the law addressed the risks of moral hazards, on the side of both the debtors and the creditors, in a rather *à la* LLSV, literal sense. Second, the emphasis is on the rules of interaction between the parties and the autonomy allowed to them, when bargaining or re-contracting; or, again, on the balance between the guarantees offered by the judicial procedure and the constraints it imposes on the parties.

4. LLSV AND THE QUALITY OF 19TH CENTURY BANKRUPTCY LAWS

If LLSV's four criteria are taken literally, then measuring the quality of European bankruptcy laws during the 19th century is neither difficult nor very informative: creditors' rights were strongly protected in all countries during the whole period. As already stated, a bankruptcy law that would not have primarily this aim, would have been considered pointless. On that basis, almost all countries would have probably received either a 3 or 4 mark, depending upon how the criteria are interpreted. Let's look in more details at how they applied in the 19th century context.

First, as a universal rule, a trader would lose control over, and often the legal possession of his assets (personal and commercial) on the day his bankruptcy was declared. But he would also lose the legal capacity to trade – that is to sell and buy, pay and borrow, and so forth; even a fresh start would not be possible unless he were rehabilitated (often a difficult feat)¹⁶. In this sense, there is no way that entering bankruptcy would have protected managing rights. Only two partial exceptions can be observed : first some early-century cases of judicially controlled individual moratoria; and a series of out-of-bankruptcy frameworks adopted at the end of the century that allowed the parties to negotiate under some judicial oversight though without incurring the financial and social costs of entering a full-blown bankruptcy procedure. If LLSV criteria are taken literally, these options actually weakened creditors' rights. But at the time, as shall be discussed later, they were explicitly

¹⁶

In other words, the opposition between manager-driven and manager-displacing bankruptcy law does not work during the nineteenth century; see Skeel (1998) as well as Armour, Cheffins and Skeel (2002).

envisaged as efficiency-enhancing options, that would support co-operation and early entry into negotiations.

Orthodox conclusions are reached again on the matter of secured creditors: 19th century laws emphatically protected their rights during bankruptcy. As expected, the sole contentious issue is that of the privileged (i.e. statutory, non-contractual) claims of third-parties on the bankrupt's estate: claims owned by the Treasury and churches, workers and servants, doctors and pharmacists, et cetera. But this was mostly a threat for junior creditors, which are not the focus of LLSV. Even though measuring the extent of such privileged claims is hard,¹⁷ the legal and policy literature of the time does not suggest that they were instruments for funnelling large extra-contractual interests into the distributive machine that is bankruptcy. As regards more generally the principle of absolute priority between investors, an interesting, albeit marginal, option was to offer some percentage in the proceeds of the liquidation to the benevolent, co-operative debtor: England, Württemberg, and Malta had such a clause.¹⁸ Literally taken, this prescription represented an explicit infringement in the creditors' rights, though again it was conceived as a pro-creditor incentive device.

The fourth LLSV argument deals, on stays, is more problematic. By definition, bankruptcy is a collective instrument of debt collection that substitutes for individual remedies when they threaten a loss of value for creditors as a whole. Bankruptcy is an extra-contractual institution that necessarily suspends or rewrites some private rights. Two common features of bankruptcy laws come up at this point.¹⁹

1. Stays on individual remedies during the procedure were general practice on the Continent, with some qualification in early century Austrian law, and some undocumented periods in Denmark for instance. Otherwise, as a rule, foreclosures were stayed when bankruptcy was declared, generally until liquidation was decided; when senior interest payments were dealt with, however, the law excluded them from the stay (i.e., they were served during the procedure). England did not adopt the principle of a stay on private remedies until 1869.
2. Qualified majority voting by all non-senior creditors was a standard feature of all reorganisation agreements. Typically, the vote would be counted both in terms of

¹⁷ The main difficulty encountered in this survey is that these clauses are most often to be found not in the actual bankruptcy text but in many different bodies of law – the fiscal and civil code, the laws on tenants and land lease, the emerging labour law, etc. However, provisions for wages and rents would typically be limited to a year or eighteen months, with a ceiling on the amount being reimbursed. Debt moratoria, a common U.S. practice during the 19th century (Alston 1984, Bolton and Rosenthal 2002), is also unknown in Europe.

¹⁸ This incentive varied within a 5-10%, 5-8.3% and 5-10% bracket respectively. The reference in the case of Malta is a 1815 ordinance on civil procedure; for Württemberg, see Saint Joseph (1844).

¹⁹ As a simplification, both options are considered here together.

number of creditors and sums of claims, with majority thresholds of three quarters and two thirds respectively; judicial confirmation was conditional upon positive votes and was a prerequisite for the agreement to become binding.²⁰

A different issue arose when debt discharge could be imposed upon (some) creditors, as had been the case in England. Since 1702 a qualified majority of creditors had been able to relieve the honest and co-operative debtor of her debt after the assets had been auctioned off. This clause has generally been presented as reflecting a remarkable pro-business bias in English law,²¹ though continental creditors could generally make the same decision. The difference is that it would be part of a generally more comprehensive arrangement of a rather private nature, instead of being addressed at the end of the official procedure as a single-issue vote.²² It may well be that eventual discharge was easier to obtain in England in the 18th and early 19th centuries; probably the rights to trade were likewise easier to recover. But as far as creditors' rights are concerned, the major divergence with continental practices only emerged in 1843: discretion on discharge was then transferred to the courts, with no veto power to the assembly of creditors. This step toward weaker property rights, as a counterpart to easier fresh start for failed entrepreneurs, has never been taken by any other country during the whole period under review.

In order to summarise these various elements, an index has been calculated that tries to adjust the LLSV variables to 19th century rules, while remaining as close as possible to their view of what should, and should not do a bankruptcy procedure. Selected items are the following (annex 2):²³

- regulations on stays explicitly preserves interest payments on secured debt;
- opening negotiations on reorganisation plan is not associated with a stay;
- no money incentive to the debtor (rule of absolute priority);
- no capacity by the court to declare a debt discharge.

²⁰ No statute provided the judge with the right to impose an agreement on creditors if they failed to agree (as with the "cram down" provision of the present US Chapter 11).

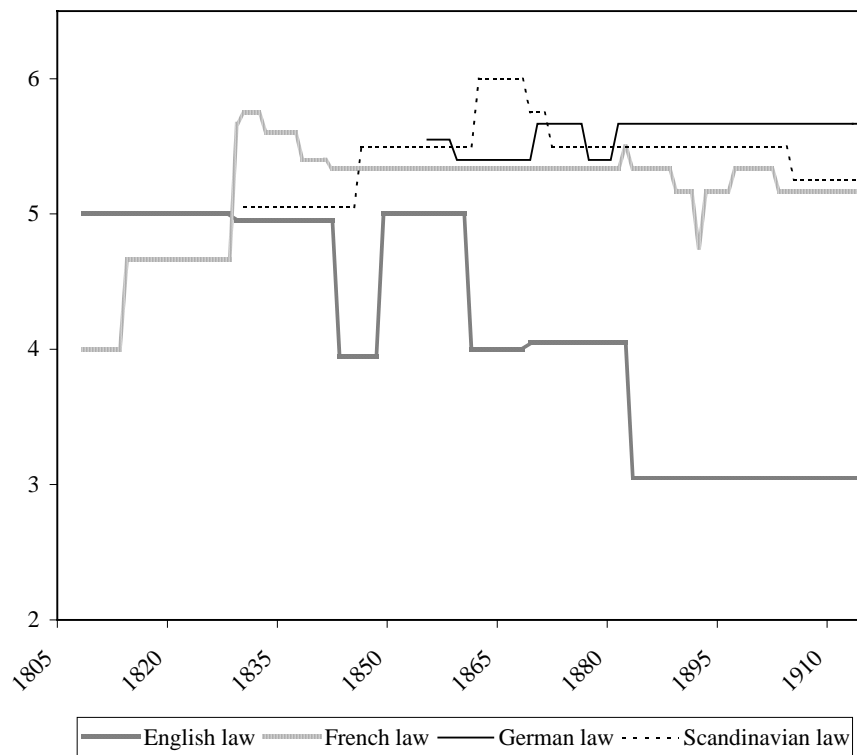
²¹ "Thus the bankrupt becomes a clear man again; and (...) may become a useful member of the commonwealth" (Blackstone 1811, p. 488). On the English debt discharge, see Holdsworth (1925), Tabb (1991), and McCoid (1996). Note that courts also had discretion when confirming discharge.

²² A corollary issue is the common law-specific debate on whether bankruptcy should be only involuntary (i.e. initiated exclusively by creditors) or also voluntary (initiated by the debtor); see McCoid (1987, 1988). This dispute has no equivalent on the Continent, where both parties have traditionally had the capacity to initiate the procedure.

²³ Items close to LLSV intuition, but that are not much differentiated across 19th century statutes have not been included (e.g. on issues of senior creditors).

Graph 1 shows that creditors' rights were strongly protected during the whole period in all countries, whatever the respective legal traditions. Only English law comes out as an exception under the adjusted criteria, as its performance declined over time and ended the period clearly below average.

Graph 1: Creditors' rights during bankruptcy, an enhanced LLSV index



source : own database

5. FIGHTING MORAL HAZARD: PRISON FOR DEBT AND “LA MORT CIVILE”

Bankruptcy procedures aim at enforcing a rule-based distribution of residual assets, at a time when the incentives on all actors are to run and grab or to escape the consequences of commercial failure and capital losses. In past centuries the challenge arguably was magnified by acute problems of information and communication because contracts, accounting books, property titles, instruments of payment and judgements were all much less formalised than today and circulated much more slowly. The room for opportunistic behaviour was thus arguably larger than in more recent period, on the side of both the debtor and the creditors.

Starting with the first case, one can hypothesise that high transaction risks were a factor behind the strong repressive features observed in all early statutes, which indeed defined bankrupts as outright criminals : *publicos ladrones y verdaderos robadores*.²⁴ Apparently the protection of commerce and debt markets could not do without heavy-handed instruments of social discipline, whatever the costs for the proverbial “honest but unlucky trader”.²⁵ The 1808 Napoleonic *Code de commerce* probably marked the high point in the reliance upon repressive instruments as a substitute for apparently insufficient market institutions: all failed debtors were jailed at least for a short exemplary period, and rehabilitation was highly conditional. Shame and infamy were part and parcel of contractual discipline. Remarkably, however, this bias was not specific to France or even to civil law countries: in all Europe (as in America), many debtors ended up in jail in the early 19th century.²⁶

This early pattern of convergence across countries was followed after a short transition period by a second one: whereas in 1866 no country had yet suppressed prison for debt, thirteen countries, of all legal traditions, had taken that step in 1877. At the time, many argued (in today’s language) that moral hazard would become uncontrollable and that credit markets would decline. But they lost the argument, *inter allia* to humanitarian militants and to those who believed that prison unduly increased the risk of entrepreneurship, at a net loss for the economy. In other words, in most countries it was finally agreed that the unconditional, hard-headed defence of creditors’ rights – whatever the instruments - might not always be consistent with economic development. Investors may be indeed willing to take a calculated risk if they assume that the underlying economic opportunity is worth it. A corollary is that one could indeed become insolvent, in a fast-growing, Darwinian market

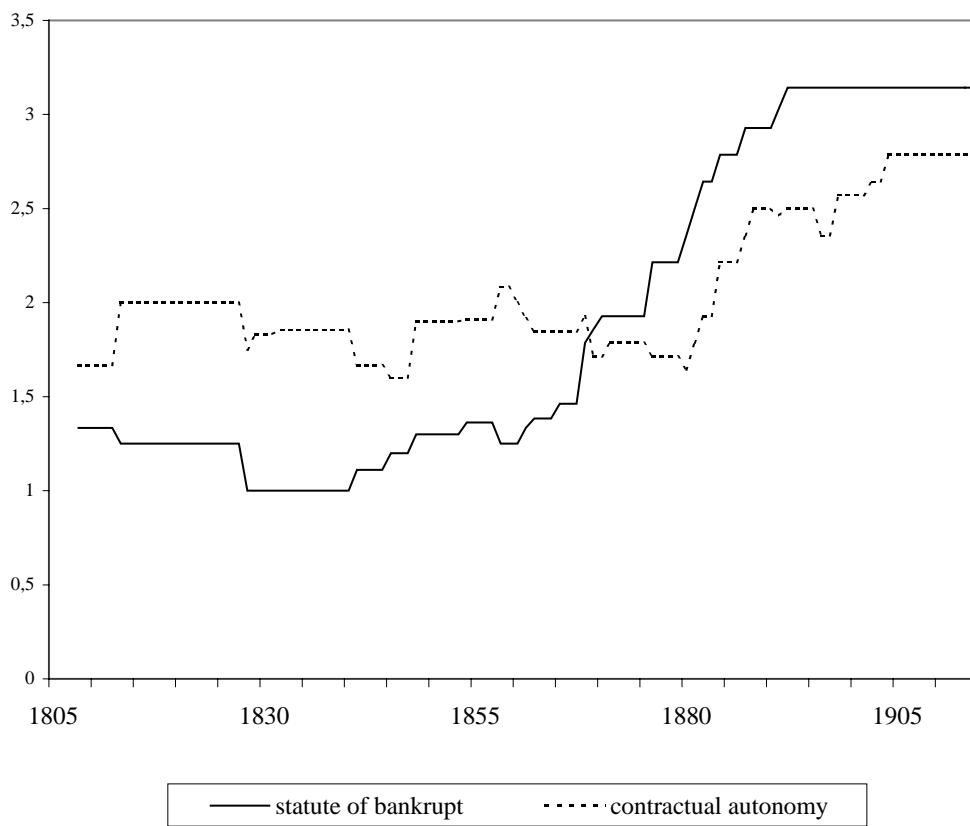
²⁴ Spanish act of 1502, in *Novissima recopilacion de la leyes de Espana* (1831).

²⁵ This ever-present figure is the hero of Balzac’s novel *César Biotteau* (1837).

²⁶ See i.a. Sacré et Houdin (1874), Thaller (1887), Coleman (1974), Hoppit (1987), Lester (1995). Note that imprisonment could be the penal consequence of fraud, but also an instrument in the hands of creditors in order to pressure debtors so that they would release their assets – i.e. “prison on mesne”. Imprisoned debtors then insisted on not being mixed with convicts and were often sent to specific prison. See Mann (2003) on the late 18th, US experience.

economy, without one's civil and political rights being heavily affected. Rules governing the market place and the public space became more independent one from the other, as the market institutions strengthened.

Graph 2 : Statute of the bankrupt and contractual autonomy



source : own database

The decline of repression as an instrument of market discipline is illustrated by an index that reflects the reliance upon prison for debt and the conditions for rehabilitation (see Annex 3). The average, cross-country index indeed confirms the account of a twice-in-a-century convergence pattern across Europe is illustrated by Graph 2 (as in the case of the autonomy to renegotiate, discussed latter). After having shared a repressive approach, most countries eventually agreed that commercial failure should not cause “la mort civile” - provided the law had been respected. This evolution was, however, not unanimous; differences between legal families arose within this broad trend (Graph 3).

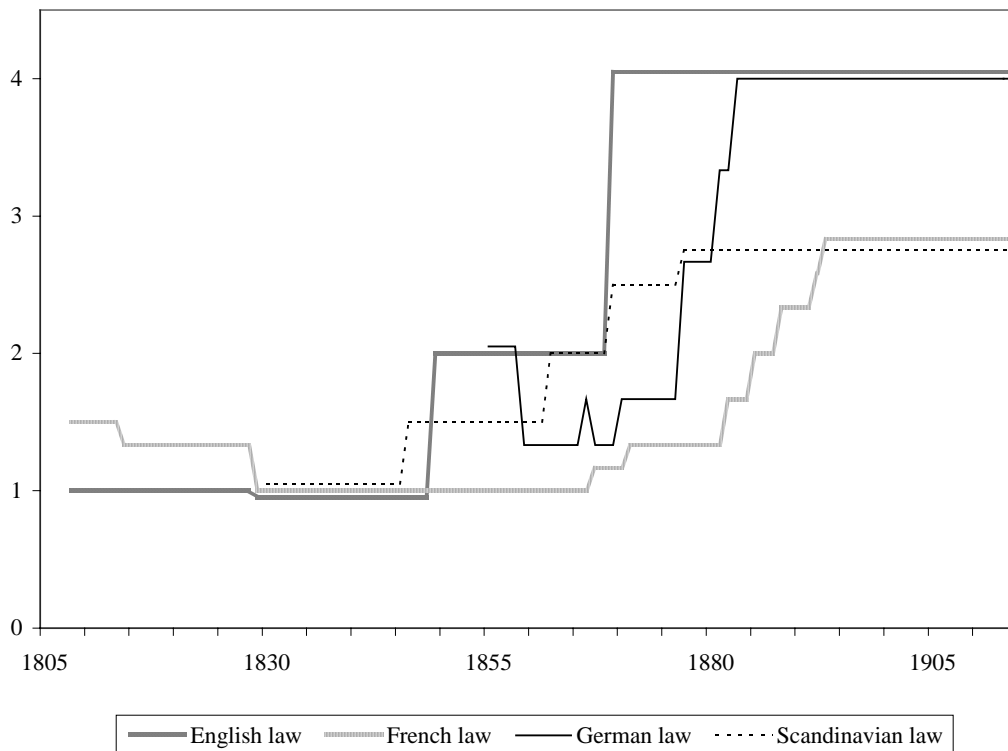
1. England already had a tradition and reputation for allowing bankruptcies to have limited social costs (at least for entrepreneurs). As a rule, however, commercial rights were easier to recover than civic or political ones, which in England were still affected by bankruptcy at the end of the 19th century. On the other hand, prison for small debtors – now called consumer debtors - was still widespread in this country before World War I, in stark contrast to the situation in most Western countries.²⁷
2. The landmark German 1877 code then provided a model for a bankruptcy law without any repressive feature, modelled as an almost purely procedural and problem-solving instrument. Its belonging to a civil law tradition and its large influence in neighbouring countries made this, in the eyes of many commentators, the true successor of the 1808 French code.²⁸
3. France (together with Austria) was the first to put an end to prison for debt, but it then had more difficulty than others distancing itself further from the Napoleonic repressive bend: only in 1888 did France adopt a new status for lawful debtors with limited professional costs, but some political stigma remained until the early 20th century.²⁹ More generally, it took more time on average for countries with French and Scandinavian law to evolve towards a more liberal model, though they did eventually converge.

²⁷ Lester (1995).

²⁸ « ... *une manifestation très sérieuse et probablement durable du génie juridique allemand* » (Thaller 1887, p. 87)

²⁹ Percerou (1935).

Graph 3 : The debtor's status, by legal traditions



source : own database

6. ARRANGEMENTS AND THE CONTRACTUAL AUTONOMY OF PARTIES

Entering new contractual commitments with a once-failed entrepreneur clearly requires a leap of faith. But re-contracting may also be highly beneficial if there is a going concern value in the stock of assets; or, for instance, if the expected return of liquidation is brought down by the poor liquidity of the markets for property and capital goods – a common feature of early-capitalist economies. Given these type of incentives, one might expect that the trade-off between re-contracting and liquidation should be entirely for the parties to settle.³⁰ Yet, historically, transaction risks have always called for at least a degree of

³⁰ Jackson (1982). The terms “arrangements”, “composition”, “continuation agreement” and “reorganisation” are being used as synonymous.

regulation. Some creditors may be better or earlier informed than other, or some may agree on discriminatory, hidden arrangements with the debtor, or the latter may reimburse some creditors before others, or social leverage may bear on transactions.

Until the end of the 18th century, arrangements between debtors and creditors on the Continent had been mainly private affairs, subjected to qualified majority voting and rather light supervision (though often an increasing one, as in France);³¹ this was a direct legacy of Middle-Age Italian communal practices exported by Italian traders via the major European fairs, such as in Lyons³². The 1808 *Code* then arrived as a counter-model : arrangements, now called *concordats*, were to be negotiated and concluded within a minute judicial process. The parties could certainly negotiate on reorganisation plans and then obtain confirmation, but the law stated most exactly when, where, and under which conditions they could speak up, and the creditors had limited oversight on how the assets were managed. This, however, was not perceived as an undue state intervention – imprisonment for debt apparently raised much more protest. The *Code de commerce*, just as the more famous *Code civil* (1804), were indeed the legal foundations of a bourgeois, liberal society based on private property and contract, that would strive in the forthcoming decades. In this context, the rationale for a highly regulated bankruptcy law was again to offer strong guarantees against fraud, dissimulation, and corruption – which were seen as the hallmarks of work-out techniques during the Ancien Régime and the Revolutionary years. There was indeed a demand for procedural formalism as a way to address *inter allia* inter-creditors equity concerns when recontracting³³.

The striking fact, however, is that again, in most other European countries, private parties interacted in procedures that did not left them with much flexibility. As a rule, European traders in the six first decades of the 19th century could only bargain under the close control of judges and officials, within the long, costly and shameful single-entry process of bankruptcy. The only exceptions were the above-mentioned *judicial stays*, or individual moratorium, that aimed at addressing short-term liquidity problems.³⁴ Path-breaking

³¹ See Savary (1749), Denisart (1771), Renouard (1857), and Hilaire (1985) for France; Josephus II (1781) on Austria ; Ricard (1722) for Amsterdam; the *Ordenanzas* (1794) for Spain; and for the indications on 18th century Hamburg law, see Saint-Joseph (1844).

³² Hilaire (1985).

³³ « ... if, by a fatal negligence, the bankrupt and the debtors are allowed to cast off any [legal or procedural] provision, the aim of the lawmakers will be missed: fraud will come together with the impudence of impunity, it will seize the sanctuary of justice and flout its authority » (Laurens, 1806, p. 152). On this period see also Renouard (1857), Picard (1910), and Percerou (1935).

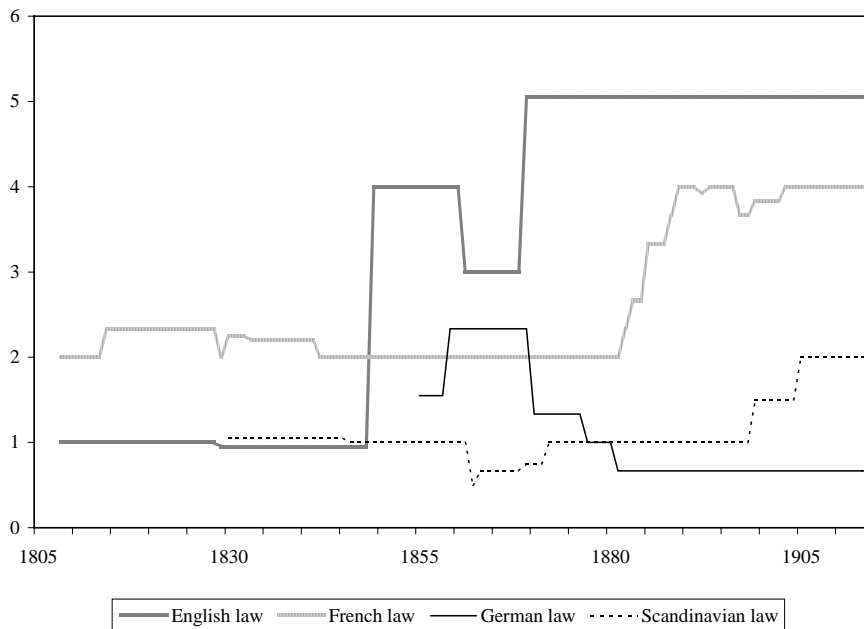
³⁴ As a rule, the rejection of this option was grounded again on risks of opportunism by either the debtor or some creditors ; see e.g. Renouard (1857) or Füger and Wessely (1841). Legislation allowing such moratoria was introduced in France both in 1848 and 1871, but then rapidly withdrawn, though in the later case some jurisdictions in trading cities apparently kept sanctioning the practice for some years. See Silvian (1915).

reforms emerged only during the last quarter of the century, in a context marked *inter alia* by the emergence of big corporations, developed financial markets and growing problems of going concern.

In order to account for this evolution, an index of creditors' autonomy has been designed that adds six variables (Annex 3). Its main aim is to reflect how the rules of the game between judicial institutions and private interests evolved, hypothetically toward a less intrusive and less constraining model. A first issue is whether judicial confirmation of arrangements was contingent upon substantive pre-conditions or the discretionary judgement of the court. Another is the possible shift toward a more differentiated institutional set-up, where agents are offered a menu of options, under more or less judicial oversight, as opposed to a single-entry bankruptcy process. Finally, the possibility of actively managing the assets during the procedure is added.

The average, cross-European index of contractual autonomy offers again a bipolar view. The average country offered a low degree of contractual autonomy until mid-century before allowing more discretion to the parties after 1870 (Graph 4). Three countries that belonged to each, main legal traditions come out as major innovators : England, Belgium, and Germany.

Graph 4 : Contractual autonomy, by legal traditions



Source : own database

England's emergence as a legal innovator is surprising. Although common-law countries are generally considered more supportive of market forces and institutional innovation, no statutory guarantee to arrangements was possible in England before mid-19th century³⁵. Until that time, the law offered much less support to re-contracting than both the pre-Napoleonic and the *Concordat* approaches favoured on the Continent³⁶. English creditors could choose only between unanimity accord under private seal and bankruptcy, which would exclusively lead to liquidation; as already stated, the only open question at that point, was whether the bankrupt would be eventually offered a discharge on her residual debt. In both 1825 and 1849, two attempts at supporting *concordats* agreements had been failures: the majority threshold was too high (9/10 in sums in the former case), and the debtor had to relinquish most of his goods, despite the arrangement's aim of avoiding undue liquidation.

The breakthrough came in 1861, when these restrictions were abandoned so that bankruptcy could be used *also* as an instrument for restructuring balance sheets.³⁷ The key policy question at that point was whether such accord should be negotiated within or outside the bankruptcy process *per se*, that is whether softer forms of judicial oversight could be envisaged. After some trial and error, agents were left in 1883 with three options:

1. a full bankruptcy procedure leading to liquidation, with the possibility of the judge granting a discharge;
2. a reorganisation or self-liquidation plan decided outside formal bankruptcy, with limited personal costs to the debtor but still under tight judicial oversight (the debtor lost the control over assets, he was publicly interrogated, the judge had substantial power to reject the voted plan, etc.);
3. a high-majority, low-oversight formula that was similar the past, unanimity *deeds of arrangements*, which appeared to be the favourite option (as became clear once registration and some publicity rules were introduced in 1887).

On the Continent, Belgium took the same year a comparable route toward a "menu" approach to renegotiation. The 1883 *Concordat préventif* allowed distressed debtors to

³⁵ A 1697 English act, allowing for qualified majority votes on arrangement was abandoned one year later as a result of apparently extensive fraud and dissimulation (for quotations see Holland 1864, pp.14-17). This implies not that private arrangements were unusual, but rather that ex post judicial confirmation seems to have raised considerable difficulties in England. Information however is scarce because these agreements explicitly aimed as avoiding publicity. For indications on 18th century practices see in Hoppit (1987); and see Lester (1995) as regard the nineteenth century. This anti-arrangement bias is also present in the United States, where the option was not introduced until the third federal bankruptcy law, in 1867. Tellingly, Coleman (1974) does not mention the terms "arrangement" or "composition" in his index. See also Mann (2003).

³⁶ On 18th century and early 19th century English law, see Davies (1744), Cullen (1800), and Cooper (1801).

³⁷ See Holland (1864) and Robson (1888).

negotiate wide-ranging plans under some judicial oversight, though without supporting the many costs of entering formal bankruptcy. The debtor would not lose control over his assets, social and symbolic costs were intended to be much smaller, and his obligations in terms of providing information were more limited. But he was put under some control by the court and the creditors, and if he failed to obtain qualified support, then he would be shifted into bankruptcy proper : the *Concordat préventif* was not a soft option to protect the debtor and/ or the manager. Finally, Germany took exactly the opposite way to that adopted by England and Belgium: after due consideration, lawmakers decided that the modern approach to bankruptcy adopted in 1877, that explicitly aimed at incurring minimal economic and civic costs to the debtor, should remain the sole entrance to any form of collective negotiation, whether they would lead to an arrangement or a liquidation. In this respect, Germany remained closer to LLSV's preference for maximal procedural guarantees against their optional relaxation.

Convergence at the end of the century thus took place around two models: by 1914, ten countries had adopted a multiple-track, Anglo-Belgian approach while the remaining five had opted for the integral, German one. A major innovation – restructuring assets and liabilities without liquidation – had thus been adopted in most countries, though without the “legal origin” issue having here a clear impact. Legal traditions were not a serious obstacle for inventive lawmakers.

Table 1 - 1865-1885 : towards a new bankruptcy model

Official end of prison for debt	'Old-way' judicial stay	Extra-bankruptcy framework	Within-bankruptcy framework
Austria, 1866 France, 1866 England, 1869 Belgium, 1871 Germany, 1871 Ireland, 1872 Denmark, 1872 Norway, 1874 Switzerland, 1874 Sweden, 1877 Scotland, 1877 Italy, 1882 Netherlands, 1893 Greece, 1900	The Netherlands, 1814- Belgium, 1830- Portugal, 1833- France, 1848 and 1871 Prussia, 1855-1877 England, 1849-1861 Russia, 1826-1903	England, 1869-1883 Belgium, 1883 Spain, 1885-1897 France, 1889 Switzerland, 1889 Portugal 1899 Norway, 1899 Italy 1903 Russia 1903 Denmark, 1905	Austria Germany Hungary The Netherlands Sweden

7. WHY CONVERGENCE ? SOME HYPOTHESIS

What were the driving forces beyond the successive patterns of Europe-wide convergence ? Though providing a complete answer to this question is beyond the limits of this article, some indications are readily available. A first evidence is that there was a lot of communication and exchanges between lawyers of different countries, especially during the second half of the period. In particular, the French legal profession and public administration developed a consistent effort at collecting and translating foreign statutes (see the bibliography of this article). Given the centrality of French civil law, French language and the Sorbonne at the time, there is good reason to believe that this was the support for a de facto coordination between legal professions, across a substantial part of Europe³⁸.

A wholly different question is how communication and influence made the legal texts converge : which reasons induced the French 1889 lawmakers, or the 1903 Italian ones, to take a serious look at earlier English and Belgian innovations and to follow their lead ? A first, polar hypothesis is that strong market actors, increasingly engaged in cross-border exchanges, explicitly pressured national governments to reduce discrepancies between national laws and procedures. Convergence would then reflect a demand for cross-country co-ordination, as a response to the regulatory challenges of trade integration. In that case, however, one would expect these issues to have also emerged as an important field of legal expertise, then as a topic for international negotiations and eventual treaty-making. But interestingly that point is missing.

Although the subject had been approached before, legal research on cross-border bankruptcies, as a sub-field of international private law, emerged only in the latter decades under review. The founding contribution was published in Italian by Guisepppe Carle, in 1870 : it established unity and universality as the key principles that should govern cross-border proceedings, against their being fragmented between competing, territorial procedures³⁹. But what the latter legal literature then states, again and again, is that national laws remained closely aligned on a territorial doctrine : rules of co-ordination across

³⁸ Saint-Joseph (1844) was an early, quite interesting attempt at comparing commercial laws across Europe. But the *Annuaire de Législation étrangère*, published every year by the *Société de Législation Comparée* from 1871 onward, is the most consistent outcome of that investment. Goldschmidt (1875) is as well a landmark, though bankruptcy is not included as such: following upon the German tradition, it is classified as a part of civil procedure. A late though remarkable endeavour was then the project of a global encyclopaedia of trade law, launched jointly in France, Germany and the United States in 1911, but aborted in 1914 : a series of volumes, edited on a country by country basis, offered a detailed presentation of each country's trade law, both in its original language and, respectively, in French, German and English; see the collection '*Lois commerciales de l'univers*'.

³⁹ See Carle (1875) for the French translation, which adds a lot of complementary indications on i.a. French, Belgian, Italian and German case law on conflicts of law; the book was originally published in Italian in 1870.

borders remained very weak, and the attempts at improving them were limited till 1914, and indeed well after that date.⁴⁰

Basically, the norm for each country was to defend the integrity of its own procedures, though they generally offered equal rights to nationals and foreigners, domestically. Some would then state that after local creditors had been reimbursed, the balance of the proceeds of a liquidation could be transferred to a foreign bankruptcy court; but even that was conditional upon reciprocity and generally subjected to case by case, bureaucratic confirmation. Beyond, few of the steps discussed by Carle were taken. No country accepted for instance that a foreign judgement opening of a bankruptcy process could have direct legal effects domestically, on contracts and the execution of guarantees for instance, not so speak of its triggering a domestic procedure. The rule was that foreign judicial decisions should first be examined and confirmed by domestic courts, under their own terms. By the same token, the principle of a cross-border insolvency being subjected to a lead-procedure, possibly foreign, to which secondary ones would report, was not at all on the horizon. One exception was a bilateral agreement reached by France and Belgium in 1899, and a more limited accord with Switzerland in 1869. Otherwise, no multilateral treaty on bankruptcy was ever negotiated or signed, in a period famous for the number of trade-supporting agreements being agreed upon. A series of international conferences on private law, taking place in The Hague, actually put the subject on the agenda in 1894, but reached a clear stalemate in 1900 and ended up in 1909 with only a blueprint for possible bilateral conventions – without any practical consequence.⁴¹

These elements suggest that the patterns of convergence observed between European bankruptcy laws did not reflect primarily a demand for cross-border, trade-driven co-ordination. Nor can they be interpreted as the effect of underlying “legal origins”, shared by sub-groups of countries. Most probably, then, convergence was the ex post effect of two factors : pure intellectual influence working across national legal professions; and the pragmatic decisions of national lawmakers within a “territorial” game-set. Practically, they would have reached comparable legal solutions to comparable problems, arising from comparable, parallel processes of economic and social development. And in this case, copying each others or copying a lead-innovator is rational. “Why re-inventing the wheel, if the Belgians already did it? ”. The intuition is that things indeed happened this way.

Specifically, three main institutional innovations have been mentioned, that may account for the mid-period, joint-change in bankruptcy paradigm. First is the possible reduction in informational problems, due to the rationalisation of i.a accounting rules, property titles, collateral and mortgage registrars, payments flows and so forth; these standardised tools were then mobilised by a new class of intermediaries (universal banks, credit bureaux,

⁴⁰ The difficulty of present-day European countries to achieve a reasonable degree of co-ordination between national procedures can also illustrate the point; see Béghin (1994).

⁴¹ See Conférence de la Haye chargée de régler diverses matières de droit international privé (1894, 1900, 1904, 1909)

specialised journals, etc.). Second is the emergence of large publicly-traded firms that raised new issues of going concern and governance (the extension of limited liability and the differentiation between managers and shareholders). Finally, the better regulation of the money and capital markets would have increased the quality of the signal for entering bankruptcy, while making easier the disposal of assets and the restructuring of liabilities.

Though hypothetical, this broad interpretation of convergence patterns is consistent with the propositions of Rajan and Zingales (2003) who underline the impact of domestic, political economic factors in the long-term evolution of institutions, over the 20th century. During that century, the main trend as regard the regulation of insolvencies was of course, after the 1930s', the declining relative strength of creditors against non-contractual stakeholders (specifically workers and tax administrations). This is clearly the background of LLSV approach to bankruptcy, as of the large differentiation across countries reflected by their database. As important, however, is probably the long term decline of capital markets as an instrument to sanction capitalist failure and reallocate assets, with parallel evolutions observed on the labour markets. There is actually no point enforcing a strong bankruptcy law in a corporatist regime, that is explicitly built on the premise that market forces should not have the upper hand in the (re-) allocation of factors. Conversely, the renewed interest in bankruptcy reforms since the 1980s should be seen as a reflection of the reverse trends: the conflicting reinstatement of creditors rights against non-contractual claims⁴², and the evolution toward more competitive economies and much freer markets for factors (flexible labour markets and liquid capital markets). The present success and influence of the U.S. Chapter 11 would then reflect the emergence of the Anglo-Belgian liberal solution to re-contracting, in the early 1880s. And of course, today as one century ago, some countries innovate, some other adjust rapidly, and other lag.

8. CONCLUSION

A dataset of 51 European laws and statutes has documented the evolution of bankruptcy procedures between 1808 and 1914. A first conclusion is that, throughout the period, the protection of creditors' rights was a core feature of all statutes, whatever the legal tradition they belonged to; only England may be considered a partial exception. The claim that "legal origins" have a permanent, country-specific impact on creditors' rights, as defended in LLSV (1998) and elsewhere, is thus not warranted⁴³. This certainly does not imply that all countries were equally efficient in actually protecting stated rights; but as far as the structure of the law is concerned, there is not much room for doubt.

Beyond, the main lesson is that broad, continent-wide evolutions, arguably linked to the process of capitalist development, are much more important than country-specific features. Two bankruptcy models were identified across the Continent. A first one, best represented

⁴² See Baird (1987), Bebchuk and Fried (1996), Jackson (1982), Warren (1987).

⁴³ Comparable conclusions are reached i.a. by Lamoreaux and Rosenthal (2005) and by Musacchio (2005).

by the 1808 Napoleonic Code, was characterised by heavy threats and repression vis-à-vis the debtors and by limited contractual autonomy; at the time, the rationale put forwards was the need to control moral hazard and opportunism. After a transition period between the late 1860s and the late 1880s, an alternate and more liberal model emerged: prison for debt was abandoned, rehabilitation became easier, and the parties were given much more room to re-contract on property rights. If the explanation for the first model is correct then, transaction risks should have declined sharply in the latter part of the century.

The empirical evidence does not contradict the observation of covariance within legal traditions. Instead it underlines the extent of joint changes across countries as well as the pattern along which traditions may evolve: they can endure for centuries, but they can also adjust rapidly to a changing environment. The shift of English statutory law toward court-based debt discharge and multiple-entry procedures is a remarkable example. Yet, it is not possible to point out any occasion when “legal origins” might have been at work, against or in support of creditors’ rights. No essential or a-historical hard core of legal institutions could be observed that would predict how real-world institutions are designed and how they bear on economic outcomes. “Legal origins” are a proxy for a social entity whose shape, structure, and quality remain elusive.

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Box 1 – The bankrupt’s status, an index

- Is prison for debt a standard feature, or is it limited to open misconduct, bad faith behaviour, etc?
- Can the debtor be freed, once he has transferred all his wealth to his creditors?
- Is rehabilitation a normal outcome of bankruptcy closure?
- Do traders and non-traders follow the same basic procedure?

Box 2 – Contractual autonomy, an index

- Are there pre-conditions to the confirmation of an arrangement, in terms of i.a. minimal return?
- Does the law include an out-of-bankruptcy, judicial moratorium (or stay) for solvent but illiquid debtors?
- Does the law allow broader, out-of-bankruptcy arrangements, with judicial oversight and confirmation ?
- Does such arrangement require pre-conditions, in terms i.a. of minimal return?
- Are there legal guarantees to extra-judicial arrangements?
- Does the law allow the receivers to engage into active trading on behalf of the creditors?

ANNEX 1

MAJOR BANKRUPTCY LAWS ADOPTED BETWEEN 1814 AND 1914 IN EUROPE

Austria

1859, law on bankruptcy
1865, end of prison for debt
1869, reform of the law on bankruptcy
1885, new bankruptcy law

Belgium

1830, inherits the French 1808 Code
1851, reform of the bankruptcy law
1871, end of prison for debt
1883, introduction of the non-bankruptcy composition

Denmark

1842, law on bankruptcy
1872, law on bankruptcy,
end of prison for debt
1887, reform of the law
1905, non-bankruptcy composition

England,

1814, reform of the bankruptcy law
1826, reform of the bankruptcy law
1831, reform of the bankruptcy law
1843, reform of the bankruptcy law
1849, reform of the bankruptcy law
1861, reform of the bankruptcy law
1869, reform of the bankruptcy law,
end of prison for debt
1883, reform of the bankruptcy law

France

1808, Code de commerce
1838, new bankruptcy law
1866, end of prison for debt
1889, non-bankruptcy composition
1905, reform of the bankruptcy law

Finland

1868, law on bankruptcy

Germany/ Prussia

1855, Prussian bankruptcy law
1877, law on bankruptcy, end of prison for debt
1898, partial reform of the bankruptcy law

Hungary

1842, law on bankruptcy
1881, law on bankruptcy

Italy

1842, commercial code (Kingdom of
Piedmont & Sardinia)
1882, new commercial code,
end of prison for debt
1903, non-bankruptcy composition

The Netherlands

1814, inherits the 1808 Code de commerce
1838, reform of the commercial code
1893, reform of the commercial code,
end of prison for debt

Norway

1863, law on bankruptcy
1874, end of prison for debt
1899, non-bankruptcy composition

Portugal

1833, new commercial code
1888, new code of commerce,
1899, non-bankruptcy composition

Russia

1826, *Digest* of commercial law
1903, non-bankruptcy composition

Sweden

1830, ordinance on bankruptcy
1862, new bankruptcy law

Switzerland

1874, end of prison for debt
1889, first federal law on bankruptcy

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