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To cite this version:
Jérôme Sgard. Bankruptcy Laws: Part of a Global History. 2009. hal-00972713

HAL Id: hal-00972713
https://sciencespo.hal.science/hal-00972713
Preprint submitted on 3 Apr 2014

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Bankruptcy Laws: Part of a Global History

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To be published in 2011 in:

May 2009
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1. Introduction

Economic history and the economics of development offer an almost endless collection of social mechanisms designed to support contractual exchange. They are generally analysed in the neo-institutionalist language of transaction costs, asymmetric information, commitment devices, moral hazard and so on. Among these mechanisms however some address the initial, *ex ante* structure of contracts. Negotiations then raise mostly private, decentralised problems with often limited or no publicity, although a more or less extended set of social norms or formal regulations may constrain the discretion of the parties. Others mechanisms are rather remedies, that are relied upon *ex post* after a dispute or a failure to respect commitments has occurred. Typically, they call for the intervention of a third party, which will support renegotiation, adjudicate conflicts, offer guarantees of enforcement, or sanction wayward behaviour (legal or illegal).¹

These *ex post* rules may then be characterised as informal if they are managed by individual mediators, community elders, private networks, or thugs for instance. But modern States, characterised by the rule of law and the monopoly over legitimate violence, provide most often the third party institutions of last resort, typically under the form of a court. Relying upon them is even mandatory in many instances, as when public order is considered at risk. For these reasons, the judicial intervention in, and public regulation of private disputes has been a major dimension of the long-term development of modern, liberal polities and economies, however fluid and sometimes oppressive their interaction may have been. Putting all the coercive powers of modern states beyond the security of persons and the enforcement

¹ I owe special thanks to John Haley, Timur Kuran and William Clarence Smith for insights and inputs to this article; even more gratitude goes to Vincent Bignon who contributed a lot to its maturation. This research was supported by the Institut CDC pour la Recherche (Project “Les Pauvres, le Crédit et la Faillite »).
of contracts, while expecting that the sovereign would not abuse them, is a constitutional challenge if not a gamble. Still today, at least in many Developing Countries, the resilience of the “informal sector” reflects a failure to extend the rule of law to a large, often majority part of the population. Property and contractual rights will not be efficiently protected while executive forces may actually infringe into the basic rights of citizens. In such setting, the alternative is to rely upon local private orders offered for instance by “stationary bandits” à la Hobsbawm, with obvious costs of their own in terms of social violence or limited market access.2

From this perspective, bankruptcy laws probably provide the best example of a dispute settlement institution – hence an ex post instrument – that is established at the most judicialized end of this spectrum, where the authority of the state may closely govern individual behaviours. Two defining moments within the typical procedure underline this latter point. First, cases should be opened by a judgement that suspends the normal course of contractual interaction and shifts both debtors and creditors to an alternate, collective rule, supervised by the court. Second, the judge will often have to confirm the qualified majority vote of creditors once they have settled between liquidation and some continuation arrangement. At both moments, if he fails to intervene or if the law does not give him such power, then collective action problems may overwhelm agents: competing individual action against the debtor may deliver a worst-case outcome or minority creditors may holdout collective decisions. Over centuries and across countries, majority rule and judicial confirmation explain why bankruptcy laws have always revolved around the core vertical axis whereby the sovereign enforces, protects, and regulates private rights – though by intervening into them.

A remarkable consequence of this pattern is that it is not very difficult to decide whether an institution is or not a bankruptcy. A Brazilian, Polish or American lawmaker, just out today of having discussed yet another bankruptcy reform, would have no difficulty whatsoever understanding the (translated) 1262 Siennese statute, the 1673 French Ordonnance sur le Commerce or, again, the 1898 American federal statute. What differentiates these texts is primarily how the parties interact within the institution: the rules of deliberation and decision, the constitutional guarantees they receive, the entry barriers they are confronted to, or the discretion that is left to the judge. Here is where the critical evolutions took place, as states

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2 Hobsbawm (2000).
and markets agents evolved together and progressively institutionalised competition and market sanction.

The following section of this essay proposes a short summary of the history of this institution. Section 3 then assess how economies with or without a bankruptcy rule may schematically compare; as intermediate cases we briefly compare Roman, Islamic and traditional Japanese debtor law. On this basis, the fourth section then discusses further the constitutional dilemma raised by the critical encounter between private wealth and market exchange on the one hand, and public intervention and majority rule on the other. It is then hypothesised (Section 5) that the emergence of full-fledged bankruptcy statutes was de facto conditioned by a republican (municipal) constitutional order that allowed to formalize such a complex, constitutional rule of interaction.

2- An historical sketch

To the best of our knowledge, in their fully-fledged, classical version, bankruptcy laws are a Western European, medieval invention. This institution emerged during the 13th and 14th centuries in the Northern Italian trading cities and was typically managed by semi-independent traders’ courts. From there on it extended to the rest of the continent, or at least to its main trading hubs. Later, from the 17th century onwards, this legacy was confirmed, absorbed and rewritten by the legal and judicial institutions of emerging modern states. In particular, the French commercial codes of 1673 and 1807 carried forward the core Italian patterns, first in Continental Europe, then Latin America, African colonies, Japan, Turkey, or Republican China. In a parallel manner, the specific English tradition was exported to

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3 See Santarelli (1964) for the early Italian experiences, then Fortunati (2001), Pirenne (1922), Hilaire (1985).
4 In its classical history of bankruptcy law, Kohler (1892) considers that its emergence in Northern Europe reflected Italian influence, rather than a parallel, home-grown experiment. The network of late medieval international fairs may have been a conduit for their extension. However, the logic of collective retaliation between cities, when traders ceased payment, would rather point to bankruptcies being relied upon indirectly, as a local institution, rather than being established directly as a cross-jurisdiction institution (Greif, 2004)
5 The most reliable references on the history of French bankruptcy laws are Renouard (1857), Guillou (1904), Dupouy (1960) and Hilaire (1986). See also Hirsch (1991).
6 The German and Spanish traditions as regard bankruptcy took specific characters at an early hour that proved quite resilient though they remain well inside the Italian legacy. For 19th century comparative law, see Saint-Joseph (1844), Thaller (1887); also Sgard (2006). For post World War II perspectives, Dalhuisen (1968), Pajardi (1988).
7 See the Annuaire de Législation étrangère (1871-1935), and Les lois commerciales de l’univers (1911-1914). Also Anderson and Steele (2003) for Japan, Young (1906) for the late Ottoman Empire, Théry (1935) for Republican China.
Scotland and Ireland, then to colonies across the world. In other terms, bankruptcy was not only one of the first modern market institutions to emerge. It then became a typical, European legal transplant, with the actual planter being either English, French, Dutch, Portuguese, Spanish or even German.

In all those cases, Western and non-Western, there were of course a significant difference between the law-in-the-book and the actual practice of agents. Bankruptcy works only as part of the infrastructure of local credit markets, where variety across countries and centuries is immense, as historians know. In some cases, therefore, an imported statute may respond quite directly to the needs of local trading communities, as apparently illustrated by the Indo-British law in early 20th century Zanzibar. Or it may have been progressively adjusted and even improved, following the Belgian and Piemontese experiences vis-à-vis the French 1807 Commercial Code. Alternatively, transplanting may fail as in the relatively shallow networks of colonial trading outposts, where a fractured sovereignty apparently opposed limits to political and economic re-ordering. In other words, a given bankruptcy statute may or may not affect behaviours, and it may sanction failure more or less strongly. But in turn, because it may bear so powerfully on property rights and market discipline, hence on access to economic exchange, its very presence or absence is doomed to tell a lot on how contracts are structured, and how much of them are exchanged in an economy. This is ultimately why bankruptcy laws are part of a global history.

Whether in Europe or farther afield this institution is indeed a remarkable marker of the extension of open markets, specifically open debt markets. It reflects the degree to which the adjudicative and enforcement guarantees of the state support exchanges in an impersonal, predictable way, across a more or less extended jurisdiction. Bankruptcy for this reason typically belongs to what Max Weber called modern “calculable rights” without which the potential for means-end rationalisation, that is proper to capitalist economies, is severely impaired. For centuries however those rights applied to only a tiny sub-set of the populations

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8 Bankruptcy law in England developed along very specific lines that apparently reflect the original patterns of its judicial history. Most significantly, until the late 19th century judges could not confirm majority votes. Continuation arrangements, therefore, were only private affairs, i.e. voluntary and non-coercive accords. Note also that English bankruptcy law has always been statute-based: there is not concept of bankruptcy under Common law. See Treiman (1938), Johns (1979), Duffy (1985), Lester (1995).

9 Oonk (2006), Stephens (1913).

10 Newbury (1972) quotes the English Chief Magistrate in Lagos advising in 1874 against the introduction of English bankruptcy law: « The Lagos merchants entrust their Capital to factors, usually native traders, who may or may not have property of their own, but who in their relations with Lagos, act as agents with the tribes up the country. From this state of things it follows that the Court could not possibly exercise any effective control over discharged debtors.”
– merchants, bankers, later manufacturers. This was typically reflected in their falling under the specific jurisdiction of traders’ courts, wherefrom the uniquely hard, individualistic rule of bankruptcy law emerged. In societies that otherwise remained very much patrimonialistic and averse to marketisation, the large mass of the populations would just not be exposed directly to the tough rule of market interactions and solvency constraints, then to the ultimate risk of expropriation. Here is the cultural and institutional environment where the imagery emerged of bankruptcy as a most ignominious form of personal downfall – think to Balzac, Dickens or Flaubert.

Still, the Italian and French early bankruptcy laws were already framed as altogether a repressive institution and as a civil dispute resolution mechanism. That is, they would not necessarily cause *la mort civile*: they were also designed to regulate the inevitable flow of commercial failures that surface in any market economy. For centuries, judges and lawmakers were indeed haunted by the fate of the legendary “honest but unlucky debtor”: that is, the merchant who had committed neither a fault nor a sin, and whose civic status and access to market should be protected, or conditionally reinstated. Beyond fairness, economic efficiency was clearly the issue: in an expanding open market economy, an exclusively penal, exclusionary approach to debt defaults would inevitably impair risk-taking and entrepreneurship. Eventually, the standard answer was debt relief, either as a collective decision of the creditors or as a judicial one. Provided the bankrupt had dutifully ceded all his remaining assets, this would open him the prospect of a fresh start. As Blackstone famously commented: “Thus the bankrupt becomes a clear man again; and […] may become a useful member of the commonwealth” (1811, p. 488).

Over the course of the 19th century, as the European and American societies fully entered market exchanges, problems of over-indebtedness and insolvency extended to retail traders, then to farmers, later households. Both the law and the judiciary then had to address the needs of this new, much larger clientele, with its specific needs and resources. This would raise considerable challenges to institutions that had been established, sometimes centuries ago, to serve only a limited number of cases, arising from a rather homogenous population. Take the case of France, where the total number of bankruptcies cases grew by about 240% between the 1840’s and World War I: far from reflecting a mostly “Schumpeterian story” where masses of entrepreneurs would face success or fiasco, the largest contribution in this increase

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11 Seventeenth-century England is the only early-modern country where this civil dimension is absent. The introduction of court-based debt discharge, in 1705, would bring it into the fold, though within a procedural framework far distant from that observed on the Continent. (Sgard, 2009)
came from the lower strata of small, local businesses.\textsuperscript{12} Part of the answer to this increased demand came from rationalization and standardization in the courts, but that was not enough: in a growing proportion of cases, the limited value of residual assets did even not cover the costs of running the procedure. A mass of insolvent retail-traders and craftsmen then clogged courts, until judges were allowed in 1838 to close or suspend cases \textit{ex officio}; creditors’ agreement was even not requested. In other words, the old, honourable \textit{Tribunaux de Commerce} simply excluded small debtors and their creditors and therefore refused to enforce market sanction at the lower end of the economic population. By the 1850s, 20\% of cases did not proceed till the end; during the last ten years before 1914, this ratio averaged 50\% of the total. In other words, these agents were de facto left to the “informal sector”, an experience that is indeed very comparable to that observed today in many developing countries: the law and the institutions of open market economies may be in place, although they only reach a part of the populations, often a minority one.\textsuperscript{13}

\textbf{3- A world without a bankruptcy?}

This account still carries much weight today, even in countries with well-established judiciaries: informal debt markets and private ordering should not be considered a mere residual, or a testimony of past practices and institutions. Consumer credit or micro-credit institutions for instance never rely upon judicial enforcement in case of default: they explicitly state that the cost of drawing debtors to the courts is not worth the return. Hence, they rely on reputation-based mechanism – like credit bureaux – or on private enforcement. And from there on, of course, undue pressure and extortion may rapidly arise, especially in the most vulnerable, least educated parts of the populations. Racketeering by loan-sharks regularly come back to the front pages of the newspapers and keep remembering the ever present potential for debt contracts to become the vector of highly asymmetric, exploitative social interactions.\textsuperscript{14} In such conditions bankruptcy comes out again, just as in the early-modern period, as an obviously harsh answer, though one that is ultimately predicated on a principle

\textsuperscript{12} Between 1840 and 1914, the number of bankruptcy cases with \textit{ex ante} debt under 10 000 Francs, an indeed \textit{very} small sum, fluctuates upwards between 25\% and 35\% of the total, while absorbing only 4\% on average of the total debt at risk. The equivalent numbers for large firms, with debts over 100 000 Francs, were 12\% and 33\%.

\textsuperscript{13} See De Sotto (2002) and Maloney (2004).

\textsuperscript{14} See Nugent (1941) on the progress in the regulation of US loan-shark lending between 1900 and 1940; McMullan (1980) for a sociological study of the micro-level promiscuity between officials and racketeers in the case of poor consumer debtors in Montreal; Rezendes and Latour (2006) for a remarkable, four-part survey on the same subject published in the \textit{Boston Globe}. See also Leahy and Chopra (2008) on suicide for debt in contemporary India.
of social and economic inclusion. Where mechanisms of socialization have run their course – think to Social Security – access to a court-based, debt relief procedure is the last saving rope before social exclusion. This is why, in the United States, since the 1980s, the debt threshold that conditions personal bankruptcy and debt relief has become such a major policy issue. It is one of the ultimate backstop rules whereby lawmakers decide that the logic of private contract and market discipline should be suspended in the name of a broader notion of common good – or public decency.  

What this tells, from a global historical perspective, is that the working of a bankruptcy law, considered as an ex post relief mechanism, should always be considered in parallel with two other types of institutions: first, those that allow for a degree of ex post socialization; second the ex ante rules that govern and possibly prevent access to debt markets. In the previously discussed case of 19th century France, widespread exclusion from the courts ultimately reflected the gap between a lowered doorway to market entry and an exit doorway that remained high, i.e. costly, and therefore unavailable to many new entrants. By the same token, the American policy debate on the regulation of consumer debt markets is always about balancing private responsibility, ex post relief and the ex ante regulation of credit institutions.

At the other hand of the historical spectrum, traditional or pre-modern societies often put much weight on ex ante, supply side rules that prevent agents from taking too much risk. As entrepreneurship and innovation is stymied, the probability is controlled that they would accumulate too much debt and become vulnerable to contract breach. Usury law is the classical example, but the Indian Damdupat is a functional alternative; market-based rules can also be relied upon, as in the case described by Brockman (1980) of the contingent clauses written into Taiwanese future rice contracts that split excess price fluctuations between the two parties so as to limit the risks of destabilising wealth transfers.

These risk-limiting rules are then often balanced by a harsh, exclusionary treatment of failed debtors, if they overpass safeguards: they would have not only broken their contracts, they would have also violated the rules of the social game. In modern Europe, for instance, those we would now call consumer debtors typically suffered a harder fate than failed traders, just because their debts were much less legitimate to start with. Under both the English and the French legal traditions, access to either debt discharge or arrangements typically remained curtailed until the twentieth century. Earlier, open-ended prison for debt may be seen as the

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15 Warren 2004
16 See Swamy 2007
standard counterpart to usury law,\textsuperscript{17} though public humiliation, excommunication and banishment came to the same effect. One step further are the many possible forms of debt slavery - permanent or time-limited, transmitted to children or strictly personal, allowing or not for the debtor to be sold on the market. Greek cities, and more clearly Republican Rome, are examples where the (im-)balance between ex post and ex post rules allowed the debt market to profoundly affect broader, social and political relations, as Max Weber emphasised.\textsuperscript{18} Comparable experiences have been observed in the most diverse environments - antique empires, African kingdoms or traditional India. Testart (2000) underlines that debt servitude is quite common in traditional societies, in parallel or not with the enslavement of war prisoners. It characteristically comes together with a high degree of social differentiation and the acceptance of a strong nexus between the distribution of wealth and power. Modern colonial or post-colonial societies also present many comparable examples, like coolie-labour in South-East Asia or debt peonage in Latin America\textsuperscript{19}. Here, the debtor does not formally loose his social and civic status, so that servitude, when it become enduring, is more a de facto than a de jure situation.

In a broad, comparative perspective, these oppressive or despotic institutions should be envisaged as the alternate to modern or liberal bankruptcy laws. Depending upon this primary choice –a bankruptcy rule or not -, social integration and the sanction of contractual failures will be articulated in starkly different manners. Or, hypothetically: a pure “Crime-and-Punishment” approach to debt default may be viable either in societies where access to debt is highly constrained ex ante, or when debt has become the vector of wide-scale, politically-sanctioned reliance upon unfree labour.

\textbf{4- Three intermediate cases.}

If we now look for some intermediary institutions between these two polar cases – worlds with or without bankruptcy - three historical experiences may be singled out that help identifying the uniqueness of this institution. A first, most original case is the \textit{traditional}


\textsuperscript{18} “the class struggles of early Antiquity took place between the urban patriciate as creditors and the peasants as debtors or as dispossessed debt slaves. (…) The ancient city experienced as the chief danger arising from economic differentiation (…) the emergence of a full class of citizens, descendants of families with full citizenship rights, who were economically ruined, in debt, without property, no longer capable of equipping themselves for service in the army, and who hoped for a revolution or a tyranny from which they could demand a redistribution of land, a cancellation of debts, or support out of public means…” (Weber, II pp. 1340-1341). See also Finley (1965, 1973), Frederiksen 1966.

\textsuperscript{19} In a vast literature, see for instance Galenson 1984, McCreery 1983, Klein 1986, Breman 1989.
Japanese debtor law under the Tokugawa (1600-1867). It emerged under a well-structured political system and a rather developed economy, with substantial credit markets and differentiated financial intermediaries. Collective action in case of default was apparently most common and included the possibility of joint agreements negotiated by the creditors with their debtor, on term of payments and on write-offs. A majority vote would actually seal the common act and bind dissenters. Apparently, then, Japan was the sole country beyond Western Europe where this practice emerged endogenously. Still, one piece was missing in order to obtain a fully developed bankruptcy procedure: continuation arrangements were not confirmed by authorities so that, apparently, horizontal community relations were strong enough to support self-enforcement. This is consistent with the fragmented character of trade regulations across regions, cities and professions. It also reflects a more general, explicit pattern of strong resistance against the judicial guarantee of monetary and credit relations: their enforcing private contracts was uncommon, suing indebted noblemen was most difficult, and even access to the courts by the merchants was strongly resisted. Wigmore (1970-1985) published a 1797 position by the Council of State after which: “Disputes in money loans, however old, can, if the parties act with integrity and mutual fidelity, be privately settled without difficulty, and the aid of public officials need not be sought. Actions upon such claims must necessarily mean lack of sincerity in both the borrower and the lender. The recent increase of such suits is due to the declining morality of times.” The open, though unanswered question is whether this political and legal framework could have supported more rapid growth and more market integration, i.e. a shift towards more impersonal exchanges and probably a demand for more explicit guarantees of contracts by the sovereign.

The second experiment of interest in the present discussion is the Roman cessio that emerged in the later centuries of the Empire. Here, the debtor’s estate was transferred to an agent of the creditors and liquidated, so that the queue of creditors filing for the debtor’s assets was substituted by an orderly distribution mechanism: the former were served proportionately to their due, whether their contracts had matured or not, or whether they were present or not when the default occurred. Prospects for market recovery and social pacification were then greatly enhanced. On the other hand, the debtor typically escaped prison though his remaining, unpaid debts were not void: initial contracts remained fully enforceable even

21 Sheldon (1983) states that « merchants bringing cases had to crawl on hands and knees from the door of the court to the judgement room”.
22 Greif (2004)
though they had been partly amortized. All future wealth and revenue flows might potentially be seized. Hence, when compared with the traditional Japanese model, the cessio was clearly less sophisticated at least in the sense that it left almost no scope for deliberation and collective decision among creditors. On the other hand, the cessio was more universal, or less constrained by communitarian institutions, which explains why it remained a minimal benchmark model, widely used in Europe until the 19th century. Still today, procedures applied to over-indebted consumers de facto follow the main features of the old Roman institution, though with discharge as a standard option.

Lastly, Islamic law offers a version of the cessio so close to the Roman original, that the possibility of a direct, causal influence has been actually debated. Deliberation or decision-making between creditors is de facto absent and the judge does not confirm any decision they would make: all inputs by the parties into the procedure are individual. No debt write-off is possible within bankruptcy – discharge is a personal only, unilateral act - so that after liquidation, all creditors recover their remedies against the debtor (including individual “harassment”). Beyond these important parallel features, the Islamic and European version of the cessio differ substantially as regard the position of the judge. In the former case, the common civil law judge (the qadi) has substantial discretion for equity-based judgements: he may unilaterally offer terms of payment or free debtors from prison, if it appears that they are actually unable to pay. Hence, the risk of a debt-trap is balanced by judicial discretion, vindicated by ethical or religious principles, as opposed to explicit, formal regulation. Conversely, in the typical Italian, then Western model, the decision to write-off part of the debt is in the hands of the creditors, and the law puts considerable emphasis on the regulation and supervision of the process that leads to this critical decision. For this reason, the European versions are more formally rational, in the Weberian sense, and also more protective of property rights, in the sense that their reallocation is highly controlled.

23 See Chehata (1969), Bouvet (1913), Vogel and Hayes (1998), Ziadeh (2000). Berge (1914), a French judge in colonial Tunisia, then Morocco, tells the following story about the relative easiness of obtaining a convergence between colonial, French law and traditional Islamic law. The reference is to an ad hoc commission of Muslim lawyers who contributed to this transplant operation, in Tunisia: “When objections emerged in the Muslim Commission on the adaptation of a given legal concept, which had been drawn from some European legislations, the response was to formulate them differently so that they would be accepted. And it was in the Digest that alternate redactions were found. The surprise was that Muslim lawyers then found them perfectly orthodox and that they could even find textually identical formulation in their oldest law treatises. This happened so many times that researches were made that led to the discovery of as yet unknown historical phenomena. We understood that during their first invasion of Minor Asia, Arabs met populations that were following Late Empire Roman law”, etc. This hypothesis is defended by Thaller (1887) but Bouvet (1913) who argues against it. The Digest is the main collection of Roman law, written under Emperor Justinian (sixth century A.D.).
4- Bankruptcy law as a constitutional dilemma

Modern bankruptcy laws are indeed primarily about the procedure and the rules of the game to be followed by private parties as they bargain on residual assets and past debt contract. They formalize how agents are discretely transferred into a judicial forum where the huge transaction costs of settling multiple defaults should be lowered. Since the first Italian experiments, this one-off transition has been indeed clearly written in the books: individual judicial remedies are shut, the debtor may be put in jail, all payments are suspended, contracts are accelerated, the control over residual assets is transferred to an agent, private correspondence is opened, and all past bilateral dealings may be thrown on the public place, including possible shadowy, late-hour bargains.

A bankruptcy law, in other words, is very much a Hobbesian institution that protects the collective interest from a free-for-all run on the assets – that is, the equivalent of wealth-destroying civil war or a tragedy of the commons. Of course, the very figure of this peace-keeping authority - the Leviathan – immediately raises sombre prospects as well. Why should its commitment to peaceful, disinterested intervention be trusted? How may subjects guarantee themselves against the uncontrollable use of its formidable powers? The Sovereign may for instance legislate that the bankrupt estate is the legal equivalent of the remains of a shipwreck, that could be shared between himself and the first ones to have their hand on the goods. What most of them did, however, was to manipulate more or less extensively the hierarchy of creditors and protect some privileged stake-holders – doctors, inn-keepers, the Church, the fiscal administration, workers, local creditors, or real-estate property-owners.

There is more than just opportunistic rent-seeking to this post-default account of a much-threatened, open pray private wealth. The very legal definition of property rights under bankruptcy is in fact utterly problematic. The logic of the procedure is not actually to protect or reinstate those rights but, first of all, to allocate losses among creditors so that the wealth-destructing effects of insolvency will actually be absorbed in the respective balance sheets; otherwise those losses may just float around and create considerable uncertainty in market exchanges. On this basis, and as a second-order act only, new property rights will be written

24 German bankruptcy law, for instance, is traditionally part of civil procedural law, not commercial or civil. The landmark 1877 Act is for instance entirely frame as the description of the rules of the game within the institution, with no regulation that would affect or orient specific outcomes.
26 The failure to enforce bankruptcy law in Russia, during the 1990s, was the prime factor beyond demonetisation and the extension of barter. As a mass of insolvent and illiquid firms kept entering contracts, while being unable to service them, they increasingly relied upon non-monetary instruments of settlements. And
and allocated, which distribution may reflect more or less closely that of pre-bankruptcy rights, though only by design. Early bankruptcy lawmakers were actually very careful, if not Byzantine, when qualifying property over residual assets during the course of the procedure. The French 1808 Code, for instance, stated that the debtor lost the *administration* – or control – of his business. Only the eventual decision to liquidate, at a much later hour, would transfer full ownership via a *contrat d’union* to the body of creditors, or *la masse*. They would then auction off the assets and share the proceeds in cash, so that the normal regime of individual ownership and contractual exchange could be reinstated. Obviously these successive steps would not make any sense in the alternate case of a continuation arrangement or *Concordat* between the creditors and the debtor. Contracting anew on assets self-evidently supposes that the bankrupt keeps very substantial professional and property rights, even if control is temporarily lost.

What this implies is that the key constitutional issue at stake in bankruptcy is much more complex than is suggested by the traditional discourse on the “sacrosanct character” of private property – which is a myth, anyway. Bankruptcy law does not merely contribute a further variation around the well-honed principle that voracious Sovereigns should have their hands tied, when in the proximity of whatever piece of private wealth. In fact, bankruptcy helps private contracting recover, though not by restoring past rights: it formally intervenes into private contracts and reallocates wealth. The Sovereign would not simply resist the temptation to invade the collapsed market field and collect the debris of failed enterprise. It would also help traders share information, deliberate and vote, and it would then confirm and enforce the reallocation of wealth, though in principle without imposing its own preferences – like preserving local employment. Bankruptcy is as much about the public sanctuary of private rights, as about the conditions under which these protections may be suspended.

4- A Republican institution?

It is therefore quite remarkable that bankruptcy laws emerged in the specific context of the Northern-Italian municipal Republics, and then extended to the self-governed, independent trading cities of Northern Europe, specifically in Germany and Flanders. What brings these various political entities together is the more or less extended constitutional delegation they

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27 See Jackson (1985) for a modern discussion of this problem and the redistributive issue it raises.
obtained from their ultimate rulers – the Pope, the Emperor, the Count of Flanders, the King of France, etc. Against a more or less binding allegiance and a fiscal tribute, burghers and merchants could actually govern their local public affairs, administrate courts and possibly design legal institutions that best suited their interests. This is the political context where powerful innovations as regard trade law were either developed (like the commenda contract), or where they actually emerged, like bankruptcy. In Northern Italy, the relative independence of cities, as that of the corporations (arti) vis-à-vis municipal bodies, was explicitly formalised in a complex hierarchy of laws and jurisdictions. For the first generations of medieval lawyers that addressed commercial life, a defining issue was indeed the legal and jurisdictional articulation between these specific, minority, though legitimate interests, and those of the City\(^{28}\). Elected courts, the capacity to adjudicate internal conflicts, judicial confirmation, appeal, guarantees of execution, penal powers: all these were the critical points on which self-government was founded and circumscribed, even though frictions and negotiations with superior authorities were inherent to this relation\(^{29}\).

The structural affinity between bankruptcy and republican, or proto-liberal constitutions is of course reflected in their being supported by the same constituencies. Beyond their many obvious differences (bankruptcy is not a government institution) they also share a common pattern in the way they articulate private and public action, or individual interest and the common good. Both institutions are actually committed to private wealth and market exchange on the one hand, and to majority-driven, collective action by citizens on the other. They both sanction private rights and recognize the plurality of social interests, hence the possibility of conflicts between either citizens or creditors, which may eventually threaten the common good. But rather than being pre-empted by an invasive, discretionary Despot, disputes are to be governed by votes and courts, once decentralised aggregation and deliberation has failed. Municipal republics and bankruptcy procedures then explicitly addressed the classical dilemma of collective action, majority rule, and the government of the commons that are typical of modern, liberal polities. In both frameworks, collective autonomy and self-regulation are not contingent upon superior goodwill or any transcendent principle. They are to be written into constitutional rules whereby the sovereign endorses and protects the limited, local, and possibly short-lived, collective will of free agents. The legitimacy of their joint, private interest is thus fully recognised by the sovereign, potentially against his own ones or against the common interest of the City. Hypothetically, this remarkable rule of


\(^{29}\) Sbriccoli 2000.
interaction between the private and public realms – say the recognition of civil society, or civil association – may offer the critical, seminal difference with non-European or pre-modern debtor laws – like the cession and the self-sustained, Japanese “private bankruptcy”. Beyond individual property and contracts per se, other examples would be corporations, any form of perpetually lived organization\textsuperscript{30} or, by the same token, free political parties or trade unions.

Looking beyond the medieval experiences, the ulterior decline of independent cities could have been threatened this unique trading institution, at a time when patrimonialist or rent-seeking monarchies took over. Yet, bankruptcy laws and the courts that served them did not disappear. As already stated, they were progressively included by the new emerging national states into their own, vertically-integrated judicial organization. Let’s take again the case of absolutist France, which is the main link between the Italian legacy on the one hand, and modern, continental commercial law on the other. Independent, elected commercial courts were established from 1549 onwards, by the Monarchy, and then reformed and strengthened during the early reformist years of the reign of Louis XIV (1667-1673). Though these courts were thus granted, the local élites adopted and invested them so that they actually worked, as in Italy, as a commitment mechanism against political interference into the contractual disputes of traders. The main threat, however, did not come from the unchecked powers of the King, seated in Paris. It stemmed rather from the old, over-staffed, rent-seeking, local civil courts and regional supreme courts (les Parlements), which never accepted the Cours consulaires and their utterly alien rules. To start with, being elected every other year, the juges consulaires were not owners of their position and did not make a living out of rendering justice, which could thus be free of charge. Procedure was also swift, rules of proof light, oral evidences were preferred, execution was immediate and commercial customs were widely recognized\textsuperscript{31}. In this sense, they very much looked like the minimal, paradigmatic, third-party dispute settlement institution as envisaged by Shapiro (1981). This contrast obviously caused endless attempts by civil courts at getting rid of the Cours consulaires and taking control of a major pot of rent. Although the overall constitutional order was clearly not republican or liberal, limited self-regulation and effective safeguards proved actually in preserving and developing institutions designed in an earlier age. And as the commercial courts were incessantly attacked, the delegated, limited rights of traders to self-regulate contractual exchange were ultimately defended by the royal, meritocratic administration in Paris.

\textsuperscript{30} See Kuran and Roy in this volume; also Kuran 2005, North, Wallis and Weingast 2009.
A second line of defence was however established. At about the time when the traders courts were reformed, the first ever Commercial Code was written on the basis of accepted traders’ customs, or Law Merchant; that is, the diffuse body of specialised norms that had supported earlier trade integration in Europe. Against the backdrop of pervasive supply-side regulations, coming from both the state and the guilds, the *Ordonnance sur le Commerce* (1673) is primarily remarkable for its being limited to contractual exchange *per se*. This text de facto reflects a sharp, clear-cut, actually intriguing division between the regulation of access to product markets and market operations as such; say, capital raising, payment discipline and contractual disputes. The mere fact that the *Ordonnance*, specifically its chapter on bankruptcy, would apply to a segmented, status-based society can simply not be inferred from its reading. It is framed altogether as an egalitarian and a universal rule, while the courts’ intervention was not imposed on traders but proposed to them.

Although for some periods and in some places bankruptcies fell in the jurisdiction of civil courts, the *Ordonnance* then offered four procedural guarantees: the now well-established confirmation of majority vote (with protection of senior creditors); collection and circulation of information; then a series of measures that aimed at controlling moral hazard on the debtor’s side, including penal repression (*banqueroute frauduleuse*). Lastly, article 9 of the related title of the *Ordonnance* adds that notaries, escrow account receivers, judicial and police officials, and *autres personnes publiques* could never have their hands on the bankrupt’s cash, even temporarily, during the course of the procedure; if they did they could be prosecuted for corruption. It is of course difficult to know whether the threat was actually exercised, and to what effect, but the intent is clear: traders should be protected from office-holders and other patrimonialist agents. And with this view, all decisions of substance (i.e. money) were put squarely in the hands of the parties, while the *juges consulaires* and the

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32 The link has not been well explored that binds the Italian medieval trade law, that was statutory, and the Law Merchant which is often considered as purely customary and transnational. A further difficulty is that Anglo-American legal historiography is focussed on the later experience and on fair courts, though typically under their rather specific, English version (Sutherland 1934, Donahue 2004, Rogers 1995). The Italian legacy is often disposed of as just another expression of the statutory, civilian tradition. Continental historiography, on the other hand, rather suggests a continuum between Law Merchant and early mercantile law. The underlying valorisation of the former legal experiment is probably also less pronounced.

33 This first modern Commercial Code was prepared by a commission of experts, lead by Jacques Savary, a former successful Parisian trader and legal counsel. Colbert, the Minister of Finance then asked him to prepare of book of comments and explanation. Together with the *Parères* (1688), by the same author, that commented on case law, the *Parfait Negociant* (1675) was the most influential book on trade practice until the 1808 *Code de Commerce*.

34 See Gelderblom in this volume, for the case of Flanders and Holland.

35 The *Ordonnance* was the first French statute that made it mandatory, for traders, to hold proper accounting books (so-called *livres de raison*); but bankruptcy was the only occasion on which that could be checked, i.e. when commercial secret could be suspended.
officials would only offer rule-based, off-hand support to collective action. Within an otherwise despotic regime, characterised by permanent discrete executive intrusions, the institutions that enforced contractual discipline were voluntarily put off-limit and conceded to self-governed bodies.

4- Conclusion

Modern, open market economies may be thought of as a social model where agents receive uniquely large, equal, and unconditional rights to act, contract and speculate. This ex ante endowment allows them to innovate and take risk on a large scale. This is the primary reason why these societies may experience sustained, long term growth and social differentiation. One defining counterpart however is that the outcomes of investment, both individual and social, may not correspond to intentions or expectations. Financial crisis may erupt and individual firms may fail. This is the typical conjuncture where regulation or intervention by the state comes back to the fore of the public debate.

Policies may then exclusively aim at absorbing ex post the negative externalities raised by the crisis. Think to soup kitchen, debt moratoria, market interventions to support prices, and of course unemployment benefits. Governments may also conclude that future behaviour should be regulated. For instance they may restrict the capacity of financial intermediaries to lend freely to households or to highly leveraged market operators. Bankruptcy law respond to yet another logic, that should not be bend so as to reflect broader preferences, or reallocative priorities which belong to safety net policies. On the one hand, it works ex post and helps endogenising the consequences of individual failures, i.e. the risk of a tragedy of the commons. On the other hand, it enforces in a highly rule-based manner the defining norm of any developed market economy: individual solvency. How this is done then tells a lot on how expectations and behaviours will be shaped, therefore on how agents will invest and take risks. The ultimate market sanction, in other words, is not internal to market exchange – it has

36 Specifically, there was nothing comparable to the « cram-down clause » of the present US bankruptcy code, which allows the judge to impose a restructuring plan on creditors who fail to agree on their own. For the same reason, in the Italian tradition, debt discharge has never been decided by the judge, or upon his initiative, but remains exclusively a private decision, included in the arrangements.

37 The English Common law tradition is known for not having developed a specific, independent body of trade law. This echoes the possibility opened at an early hour to English noblemen and aristocrats to enter trade. Still, like its equivalent on the Continent, English bankruptcy law (which is statutory) was restricted until the 19th century to traders. Like in French or Italian lawbooks, baroque discussions can then be found that try to draw the line between this group and the rest of the population.
to be operated by a public institution which closely belongs to the long and complex history of modern state building.

As bankruptcy contributes to the institutionalization of the market, it also articulates it to this exceptionally powerful authority - only the sovereign, in a liberal polity, may legitimately reallocate private property, though under restrictive legal and judicial conditions (think also to anti-trust policy and eminent domain). Despotic forbears opposed powerful ex ante restriction to debt-taking, or they exercised, or validated oppressive ex post sanctions, like various forms of debt servitude. Early modern states then differentiated between traders and non-traders, hence in delineated a subdivision of society within which market forces would extend and be subjected to specific regulations. In contemporary societies, where indebtedness is widespread and ex ante regulations comparatively relaxed, bankruptcy still draws the line beyond which the unchecked power of contractual commitments should not extend. As modern constitutional states govern the ultimate market sanction, they also delineate the realm of market exchange and personal risk on the one hand, and civil society on the other.
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