

**FaR 2021****International Forum “Freedom and responsibility in pivotal times”****THE IMPACT OF ECONOMIC FACTORS ON THE LEGISLATIVE  
POLICY ON BANKRUPTCY**

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**Abstract**

The article used methodological approaches to determine the socio-economic portrait of an insolvent debtor in a bankruptcy case. The Russian law on bankruptcy was comprehensively analyzed, as well as the practice of its application. The analysis was carried out at the level of empirical research. The article presents the socio-economic characteristics of Russian debtors - legal entities and citizens. For the purposes of the study, a differentiated analysis of economic indicators was carried out in relation to legal entities and individuals. Indicators that were directly related to debtors were examined, in relation to which a bankruptcy case was opened; indicators characterizing persons who are applicants in a bankruptcy case; number of bankruptcy procedures applied; average length of bankruptcy proceedings; indicators characterizing the requirements of creditors. The main indicators of the “Resolution of insolvency” indicator, which is calculated by the World Bank when determining the Doing Business rating of countries, are considered. The article concluded that the analysis of the property status of insolvent debtors is of practical value for the purposes of subsequent legal research, as well as the justification of proposals for improving legislation. The legislative policy of the state should be based on the results of economic research.

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## 1. Introduction

Russian legal science rightly notes the fact that Russian bankruptcy legislation is currently one of the most dynamically changing systems of legislative regulation (Karelina, 2018). However, most of the changes are due to subjective reasons, which are situational or legal and technical in nature and do not solve many of the cornerstone problems of the institution of bankruptcy. It seems that the following judgment should be recognized as the initial methodological basis for substantiating legislative innovations: fundamental changes in bankruptcy legislation should be conditioned by the needs of socio-economic development and should be in demand in practice. In this regard, the doctrine correctly notes that “it is economic practice that should underlie lawmaking in the sphere of economics,” while “not so much legal practice, but economic (economic) practice should determine the directions of improving legislation in its broad understanding, its disadvantages and advantages, directions of development” (Gubin, 2018, p. 5).

Therefore, before giving recommendations on improving the current Federal Law of October 26, 2002 No. 126-FZ "On Insolvency (Bankruptcy)" (Federal Law No. 126-FZ, 2002), one should have a clear idea of what socio-economic processes are taking place in the property sphere of the participants bankruptcy relations.

## 2. Problem Statement

According to Karelina (2019) the socio-economic content of insolvency can be characterized using a system of the following indicators: insolvency of a person; special property condition of the debtor; the level of efficiency of financial resource management; the degree of balance between incoming and outgoing cash flows. In my opinion, the socio-economic portrait of a Russian debtor in bankruptcy can be made differentially for legal entities and individuals. In this case, the following groups of indicators can be used: indicators directly related to debtors in respect of whom a bankruptcy case is open; indicators characterizing persons who are applicants in a bankruptcy case; the number of bankruptcy procedures applied; the average length of a bankruptcy case; indicators characterizing the claims of creditors. An important fact is that bankruptcy relations in Russia are associated with violation of the law. Meanwhile, the criminological characteristics of economic crime in the course of bankruptcy is the subject of a separate study. In the Russian literature, relevant issues have been subjected to a comprehensive study (Astafiyev et al., 2018; Lagutin et al., 2015; Svetnik & Koryagina, 2018; Yakimova, 2019).

At first glance, the substantiated author's approach is fundamentally different from the conclusions advocated by S. A. Karelina. In fact, this is not the case. The difference is not of a conceptual nature, but is due to the fact that approaches to the socio-economic characteristics of the debtor's insolvency have different goals and levels of scientific knowledge. Karelina (2019) aims to reveal the economic essence of insolvency at the level of theoretical analysis. The purpose of this article is more modest - at the level of empirical analysis, we present the socio-economic characteristics of an insolvent debtor based on open data, which are used for statistical observation. The analysis proposed in the article is the initial stage of understanding the economic essence of insolvency, and the judgments of S. A. Karelina are its final stage.

### **3. Research Questions**

The subject area of the research is to identify the patterns of legal regulation of relations that arise, develop and stop during the implementation of bankruptcy procedures. The article deals with the issues of the influence of economic factors on the development of the legislative policy of the state in the field of bankruptcy. For these purposes, the problems of application and interpretation of the norms of Russian law are being studied. The article is a continuation of the author's research in the field of bankruptcy (Alekseeva et al., 2018; Bondareva & Pakharukov, 2019).

The law and finance literature highlights the role of investor rights in financial development, firm corporate governance, and financing patterns. Such studies are not uncommon abroad. For example, for a panel of 35 countries, scientists examined how bankruptcy use relates to countries' creditor rights and judicial efficiency. Researchers have found that bankruptcies are higher in countries with more creditor rights, except for a "no automatic stay on assets" provision. Higher judicial efficiency is associated with more bankruptcies and appears as a substitute with more creditor rights. Creditor rights are complex, balancing prioritization of claims, ex ante risk-taking incentives, and an efficient resolution of distressed firms (Claessens & Klapper, 2005). Russian science also draws attention to the need to understand the influence of the state of the economy on the formation of the institution of economic insolvency (Chigrina, 2006).

What are the main socio-economic characteristics of persons in respect of whom a bankruptcy case is opened in the Russian Federation today? The answer to this question can be obtained by referring to the statistical information periodically published in official sources. Sources for obtaining information include the Unified Federal Register of Bankruptcy Information, the Federal Tax Service and the Judicial Department at the Supreme Court of the Russian Federation.

### **4. Purpose of the Study**

The aim of the study is to formulate and reasonably solve scientific problems of legal regulation of bankruptcy of legal entities and individuals. In particular, analyzing scientific literature, Russian legislation and law enforcement practice, an attempt was made to develop a system of recommendations aimed at further improving bankruptcy legislation. Achievement of this goal is carried out on the basis of solving the following set of research tasks:

- to analyze analytically the main socio-economic indicators of insolvent persons in relation to whom a bankruptcy case is opened; to do this, consider such issues as the socio-economic portrait of the debtor - a legal entity and the socio-economic portrait of the debtor - an individual;
- to study the socio-economic characteristics of Russian insolvent debtors - legal entities in assessing the Doing Business indicator;
- to establish the legal value of studying the issues of the socio-economic situation of the insolvent debtor to justify proposals for improving the current legislation and developing the legal policy of the state.

## 5. Research Methods

The methodological basis of the research was formed by the general (dialectical) method of cognition, general methods of formal logic (analysis and synthesis, induction and deduction, analogy, comparison), some general scientific research methods (system approach, statistical method), as well as scientific methods of jurisprudence (formal-logical method of interpretation of law, comparative legal). Consideration of these methods as an organically integral system made it possible to carry out a comprehensive analysis of the phenomenon under study, identify the shortcomings of legal regulation, and also formulate proposals for improving bankruptcy legislation.

## 6. Findings

Let us consider the socio-economic portrait of a debtor - a legal entity by analysing the dynamics of changes in these indicators. At the same time, we will take into account the most relevant statistical data for the first nine months of 2019 as an empirical basis for the analysis. In addition, let's compare them with the same period in 2018.

1. The quantitative composition of debtors is characterized by the following features. Arbitration courts in January-September 2019 declared bankrupt 9127 organizations, which is 5.7% less than in the same period in 2018. According to the Federal Tax Service, in the first nine months of 2019, 6415 organizations ceased their activities through bankruptcy (in 2018, over the same period - 7310). For reference: as of October 1, 2019, the total number of legal entities that ceased their activities due to bankruptcy for the entire period of maintaining the Unified State Register of Legal Entities (from 2002 to the present) is 232945.

2. Applicants in bankruptcy cases of organizations, as a rule, were bankruptcy creditors. In January-September 2019, they initiated 78.8% of cases, in January-September 2018 - 75.9% of cases. The number of applications from the Federal Tax Service with bankruptcy petitions decreased in relative terms from 13.9% to 11.4%, while petitions from the debtors themselves remained at the level of 9% compared to 2018.

3. The number of rehabilitation procedures (financial rehabilitation and external management) introduced by the courts in the first nine months of 2019 decreased and amounted to 169 (0.9% of all bankruptcy procedures introduced during the specified period). For comparison: in the same period of 2018, rehabilitation procedures were introduced 240 times (1.2%). The Judicial Department under the Supreme Court of the Russian Federation provides information on the number of cases in which the corresponding bankruptcy procedures were introduced in the first half of 2019: supervision - 5096, financial recovery - 8, external management - 94, bankruptcy proceedings - 6138, amicable agreement - 441. Thus, the most used bankruptcy procedure for legal entities is bankruptcy proceedings (Mastilovich, 2019).

4. The average duration of bankruptcy proceedings (excluding banks), completed in January-September 2019, increased compared to the same period in 2018. by 8.5%, and is 732 days. Thus, this indicator exceeded two years for the first time in the entire period of its calculation (since 2015). The average observation duration increased in January-September 2019 by one day and amounted to 198 days compared to the same period in 2018.

5. Claims of creditors can be characterized as follows. In January-September 2019, the bulk of all claims (99.7%) included in the registers were attributable to third-tier creditors (99.6% in January-September 2018), of which 92.3% are creditors' claims the third priority, not secured by a pledge, the remaining 7.4% - claims secured by a pledge. The share of satisfied creditors' claims (to the total volume of all claims included in the registers) in January-September 2019 decreased to 4.7% from 6.3% in the same period in 2018. At the same time, the percentage of claims satisfaction was significantly higher for secured creditors - 32.4%, while non-tax creditors of the third priority received only 2.4%, and all third-priority creditors - 4.6%. The share of satisfied claims of second-priority creditors (as you know, these are primarily wage claims) slightly increased to 22.0% from 21.4% in the same periods.

Based on the foregoing, we can outline the following generalized image of an insolvent debtor - a legal entity. As a rule, a bankruptcy case is initiated by a bankruptcy creditor, which lasts more than two years; during the consideration of the case, it is highly probable that the organization will eventually be declared bankrupt by the court and bankruptcy proceedings will be opened, during which a significant proportion of creditors' claims were not satisfied.

Socio-economic characteristics of Russian insolvent debtors are legal entities in the assessment of the Doing Business indicator. The described indicators of the socio-economic portrait of an insolvent debtor are a legal entity correspond to the corresponding indicators of the "Resolving Insolvency" indicator, which is calculated by the World Bank when determining Doing Business. In relation to the Russian Federation, the main indicators of the Resolving Insolvency indicator remained practically unchanged compared to last year. Only the debt recovery ratio increased slightly - from 42.1 to 43 points. All other indicators remained at the same level. Thus, the experts of the World Bank estimated the term of bankruptcy procedures at two years, the costs of bankruptcy procedures amounted to 9% of the value of the debtor's property, the efficiency index of the regulatory framework is 11.5 points. For several years now, the Russian Federation has received zero points on the "Outcome" indicator, since the assets of the debtor in the bankruptcy case are sold in parts. Those countries whose legislation provides for a real opportunity for the enterprise to continue functioning receive one point.

Despite a slight increase in the Resolving Insolvency indicator (59.1 points in 2019 against 58.4 points in 2018), the Russian Federation dropped from 55th to 57th place in the corresponding ranking of countries, leaving behind Kenya and India, in which bankruptcy legislation acquired a rehabilitation rather than liquidation orientation.

The socio-economic portrait of a debtor - a citizen can be presented by analysing the dynamics of changes in similar indicators used in relation to legal entities.

1. The quantitative composition of debtors is characterized by the following features. Arbitration courts declared 46,734 citizens (including individual entrepreneurs) bankrupt in January-September 2019, which is 53.9% more than in the same period in 2018. For reference: the total number of citizens declared bankrupt by courts for the entire period of application of consumer bankruptcy legislation is 140,989 people. Thus, for every 100 thousand people of the population in Russia there are 96 bankrupts. In addition, a distinctive feature of insolvent debtors - individuals is the lack of property. So, the share of cases in which the debtor did not have property to be sold in January-September 2018 and 2019 amounted to 74% and

77%, respectively. At the same time, the share of those whose creditors received nothing as a result of the sale of assets reached 66% and 65%, respectively.

2. Applicants in bankruptcy cases of citizens, as a rule, are the debtors themselves. In January-September 2019, they initiated 90.3% of cases, and in January-September 2018, 85.5% of cases. The share of bankruptcy creditors as applicants decreased from 13.2% to 7.8%, while the share of the Federal Tax Service increased from 1.3% to 1.8%.

3. Characteristics of the applied bankruptcy procedures. The restructuring of a citizen's debt in the first nine months of 2019 was introduced somewhat less frequently than in the same period in 2018 - 18.0% and 18.5% of bankruptcy cases, respectively. The Judicial Department under the Supreme Court of the Russian Federation provides information on the number of cases in which the corresponding bankruptcy procedures were introduced in the first half of 2019. Restructuring of a citizen's debts - 6018, sale of a citizen's property - 29085, amicable agreement - 208.

4. The average duration of the procedure for the sale of a citizen's property, completed in January-September 2019, increased by 4.7% to 274 days compared to the data for the same period in 2018. The duration of the restructuring of a citizen's debts in January-September 2019 averaged 194 days, which indicates a 3.3% decrease over the same period in 2018.

5. Claims of creditors can be characterized as follows. The bulk (99.8%) of claims included in the registers falls on third priority creditors. Including 89.3% of the total amount are claims of third-priority creditors not secured by a pledge, and the remaining 10.4% are claims secured by a pledge. The percentage of claims satisfaction is higher for secured creditors and is 17.3%. Non-tax creditors of the third priority received 1.8%, and all third-priority creditors - 3.4%. The total percentage of settled claims of creditors in January-September 2019 increased to 3.5% from 2.8% in the same period in 2018.

Based on the foregoing, it is possible to outline the following generalized image of an insolvent debtor - a citizen. As a rule, the bankruptcy case is initiated by the debtor himself, the bankruptcy case lasts more than six months. The citizen is declared bankrupt by the court and a procedure for the sale of the citizen's property is opened, during which the overwhelming majority of creditors' claims are not paid at all at the expense of the debtor's property.

The legal value of researching the issues of the social and economic situation of the insolvent debtor. What practical significance for the purposes of legal regulation is the characteristic of the socio-economic portrait of an insolvent debtor in modern Russian conditions? It seems that the most immediate. First of all, a complete and comprehensive understanding of the social and economic situation of an insolvent debtor actualizes the main directions of improving the current bankruptcy legislation.

First, restorative (rehabilitation) bankruptcy procedures in Russia, as follows from the analysis, are not actually applied. Here we are talking about financial recovery, external management and settlement agreement. It would not be an exaggeration to say that regulations on financial recovery, for example, are not applicable. In connection with this remark, it is natural to raise the question of the need to modernize the restoration mechanism of the institution of bankruptcy of legal entities. The Russian economic system needs new, but more effective and efficient means of restoring the solvency of insolvent debtors. This primarily concerns those spheres of activity in which there is a state interest (city-forming organizations, strategic enterprises, subjects of natural monopolies). In particular, of interest for the Russian legal system

is the institution of “sale of a debtor as a legal entity together with its property and property rights”, used in Serbian legislation since 1989, in bankruptcy, in which there is a change of founders (participants) of the debtor - a legal entity (Mastilovich, 2019, p. 42).

Secondly, it should be borne in mind that bankruptcy cases, as a rule, are initiated against citizens who do not have any property. Therefore, the lack of property does not allow at least partially satisfying the claims of creditors. The issue of legislative design of a simplified bankruptcy procedure for such a category of debtors - individuals - is relevant.

Compiling a Doing Business rating is also not an end in itself. Based on the analysis of the Resolving Insolvency indicator, World Bank experts made an attempt to identify the patterns of government influence on insolvency relations and to substantiate recommendations for developing legal policy in the relevant area of public relations. In particular, the World Bank report prepared this year, in particular, notes that the current model of bankruptcy legislation should shift the emphasis to the application of "reorganization procedures" for enterprises that are economically viable, but faced temporary financial difficulties ... On the contrary, in relation to non-viable enterprises, mechanisms should be provided to enable them to be liquidated quickly (World Bank, 2019, p. 54). These recommendations are substantiated by the revealed empirical patterns between the reforms of bankruptcy legislation and economic relations: (1) the highest rates of satisfaction of creditors' claims are recorded in those countries where "reorganization procedures" are most in demand; (2) in countries where the use of “reorganization procedures” is not practiced, domestic investment falls or remains unchanged in all regions except East Asia and the Pacific (World Bank, 2019, p. 55).

## **7. Conclusion**

In the course of modernization of Russian legislation, the achievements of foreign researchers should be taken into account. A personal bankruptcy law that allows for a "fresh start" not only reduces the individual risk involved in entrepreneurship, but may also lead to higher interest rates charged by creditors. Both effects are less relevant for wealthy potential entrepreneurs. The results indicate that the insurance effect of a more forgiving personal bankruptcy law exceeds the interest effect and encourages less wealthy individuals to enter into entrepreneurship (Fossen, 2014).

Based on the analysis, it was concluded that it is necessary to activate the rehabilitation and health-improving mechanisms of the institution of bankruptcy in Russia. This requires amending the Russian bankruptcy legislation. On this issue, one should agree with the opinion of the Deputy Chairman of the Supreme Court of Russia Sviridenko (2016). He believes that “the most important function of the institution of insolvency is the social function, since in modern conditions the goal of the institution of insolvency (bankruptcy) is not only to satisfy the claims of creditors, to protect the rights of the debtor, but also to stability the market, market relations” (Sviridenko, 2016, p. 100). In addition, the development of a simplified bankruptcy procedure for individuals is required. This procedure should be applied to those persons who do not have any valuable property. Achievement of this goal also requires amending the Bankruptcy Law. It seems that taking into account socio-economic indicators in the course of legislative changes will increase the effectiveness of the application of legislation.

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