

# The two uses of bankruptcy law in 19<sup>th</sup> century France: dealing with the poor and restructuring capital

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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 them, however, some mechanism address the initial structure of contracts, when negotiation raises mostly private, decentralised problems, with often limited or no publicity. Other mechanisms are rather remedies, which are relied upon after a failure or a dispute has arisen. Typically, they call for the intervention of third parties, which will help re-negotiation, adjudicate conflicts, offer new guarantees of enforcement, or sanction wayward behaviour (legal or illegal).

These *ex post* rules and institutions may then be characterised as informal, if they are managed by communities or private networks for instance. But typically, modern States, governed by the rule of law, provide the third party institutions of last resort; relying upon them is even mandatory in many cases, even purely civil ones. Legalisation and judicialisation around dispute settlement are more generally a core feature in the broader development of modern, liberal polities and market economies. Historically, they tight together State-building and bureaucratisation one the one hand, with the long term dynamic of commercialisation and economic development on the other one. This experience has been observed and researched under many angles in the Western, European past and in present-day developing countries. Here and there, market agents, sovereign powers and bureaucracies have had to bargain on mutually beneficial legal rules, which would support the operation, hence the extension and growth of markets.

Bankruptcy laws and procedures may provide the best example of such dispute settlement institutions, at the most formal and judicialised end of the spectrum. Since the early medieval Italian experiences, their history has revolved around the defining axis which links public, indeed sovereign institutions, typically the judiciary, to micro-level, private, contractual interests and conflicts. One reason at least beyond this early emergence is a very simple, almost generic character of the issue at stake. Once a debtor with multiple creditors has defaulted, rules of collective action should control the risks of a run on the remaining assets, which outcome would be both inefficient and inequitable; latter, qualified majority decisions by the creditors will often be needed in order to identify a collectively superior outcome to the procedure (liquidation vs. continuation, for instance). But in both instances, disciplining dissenting creditors will require the intervention of a judge: under a liberal constitution, he is typically the sole agent with the authority to suspend or rewrite individual rights – contractual and legal. This simple though defining character of the issue at stake and its settlement, by a sovereign

third party, goes a long way in explaining the persistence of the core features of a bankruptcy process, over centuries.

The economic literature then carries two main assumptions, or expectations, as regard the underlying logic of a bankruptcy law. First it is generally viewed as an indeed thoroughly capitalist institution: it should sanction insolvency and reallocate property rights, without mercy and without much consideration for non-market concerns. In so doing, it fits directly in a Schumpeterian view to capitalism where entrepreneurship, competition and market exit are the governing forces beyond development and growth. Hence the identification of bankruptcy laws with big business, stretching from the medieval Italian trading cities to late 19<sup>th</sup> century industrialisation, and present-day financial capitalism.

A more microeconomic view of bankruptcy then insists on its role in fostering market discipline. Rather than an instrument for settling defaults and bargaining *ex post* on residual rights, its first and main concern should be the *ex ante* signals and incentives addressed to all market agents – not only those under financial distress. When designing this instrument, lawmakers should aim primarily at controlling moral hazards among and strengthening market discipline. In this view, a straightforward, transparent, highly predictable procedure, which directly sanctions insolvency, would often come up as a preferable option; conversely, it would see with suspicion rules which support re-negotiation, leave the debtor with room for strategic behaviour, or simply support the continuation of businesses.

A corollary issue is raised by the on-going debate on the differential impact of legal traditions on economic development. Anglo-American legal history often underlines the pro-business, pro-market bias of the Common law tradition and suggests that Continental laws would have been more conservative, and possibly also more repressive as far as bankruptcies are concerned. The “legal origin” argument, recently expanded by La Porta and others (1998, 1999), defends more generally that Civil law, as well as the administrations and courts which serve it, often interact poorly or dysfunctionally with market agents and market interests.

These questions can be addressed in some details in the case of France, thanks to the data on bankruptcy procedures collected and published from 1840 onwards. The *Comptes Généraux de la Justice Civile et Commerciale*, typically included some 200 pages of statistics every year, based on a systematic collection of micro-level data produced by each court (number of cases, accumulated backlog, outcomes, value of assets and liabilities, etc). This was indeed an instrument for monitoring local jurisdictions, especially the elected, largely-self-managed commercial courts – the *Tribunaux de*

*Commerce*<sup>1</sup>. Thanks also to their consistency over time, the *Comptes Généraux* thus offer a detailed view of how the procedures worked and evolved, their performance and outcomes, how agents reacted to reforms or interacted among themselves. The present contribution is essentially based on reconstructed time-series, all based on the *Comptes Généraux*, which so far have been only partially exploited by historians and economists<sup>2</sup>.

Three main conclusions stand out.

- There are clear evidences of a sustained, long-term process of legalisation and judicialisation, whereby the settlement of private defaults became increasingly ruled by law and by courts. Especially until the 1880s, the gross number of procedures being processed each year increased more rapidly than either GDP or the total number of businesses; there are also indications of an increase in the productivity of courts; i.e. the costs of processing defaults went down.
- The gross increase in the total number of procedures was driven, first and foremost, by the expanding reach of the institution towards the lower strata of economic activity, i.e. small and very small businesses. In other words, in gross terms, this is not primarily a history of big business, industry and investment banking, i.e. Schumpeterian capitalism: it should rather be compared with the experience of informality and formalisation in present day developing countries.
- The logic of “formalisation” is however a complex one: there are clear elements of “legal supply” meeting a “demand for formalisation”, but reforms have also had unintended effects, as they were used in unintended ways. Whereas the institution seems to have worked and adapted in a rather continuous, apparently satisfactory way as regard relations between established businesses, the law and the court have clearly had difficulty addressing the case of the poorer debtors, with not or limited residual assets. How to alleviate the risk of a debt- or poverty-trap, though without creating market hazard has clearly been a major dilemma. Though the law seems to have eventually worked as an instrument for fresh-start, this seems to have been much more a matter of ex post result, than ex ante political intention.

Whereas legal and judicial rules are often perceived as something which should be “extended”, a bit like public order is enforced over an unruly population, this suggests that legalisation is also about interactions, incentives, and trade-offs – even when market sanction is at stake. This conclusion is indeed consonant with recent research on developing countries, who also insists that formality and

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<sup>1</sup> Since the 16<sup>th</sup> century, commercial courts have been locally-elected courts, staffed and managed by traders ; over the centuries, bankruptcies have been the object of a fierce contest with the civil courts, though the former eventually got the upper hand in the 1808 *Code de Commerce*. Afterwards, civil courts dealt with commercial matters only in the smaller towns, where no Tribunal de Commerce had been established. On average, there were around 210 and 220 commercial courts and 170 civil courts dealing with commercial affairs ; but the former absorbed close to 80% of total bankruptcy cases.

<sup>2</sup> Marco (1989) and Hautcoeur and Levratto (2007) also used the *Comptes Généraux*.

informality is about institutional design but also microeconomic choices (see for instance Maloney, 2004).

The rest of the paper is organised as follows. Section 2 gives a brief overview and description of the data we used. Section 3 presents the aggregated evidences showed by these data and notably the increase of the number of bankruptcies and of the efficiency of the commercial justice. Section 4 and 5 then discuss the two the main instruments introduced during the 19<sup>th</sup> century that impacted a lot on the aggregate evidence suggests by section 3.

## 2. The data

The data used were gathered from the *Comptes généraux de la justice civile et commerciale*, a periodical statistical book published by the French ministry of justice from 1820 onwards. Each volume is made of two parts, the first one consisting in a report of the minister either to the King or the President that explains the main figures of the year and a second one that includes all statistical tables. Inspection of one of this volume indicate that those data were collected by the French ministry of justice to have a periodic overview of the activity of civil and commercial conflicts in courts. Each volume then includes some statistics on the activity of commercial courts. Over the course of the century and with the increase in the stock of bankruptcies, the collection of these statistics was aimed also to monitor local – elected and largely-self-managed – commercial courts, the *Tribunaux de Commerce*<sup>3</sup>.

The first volumes, from 1820 to 1839, give few materials on the activity of these courts by only providing the number of commercial conflict. Beginning with the volume of 1840, the ministry of justice – concerned, as said in this volume, with measuring precisely the changes involved by the 1838 modifications of the bankruptcy legislation – decided to include more detailed aggregated pieces of information. We then are able to extract from these yearbooks the figures on the number of bankruptcies procedures opened each year, those still pending at the end of this year and those terminated during the course of this year. We also get information on who asked the judge to initiate a procedure, on the amount – verified and audited by a special agent, the *syndic* – of the liabilities and assets of the debtor (disaggregated into mortgaged, privileged and other junior debts, and into real

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<sup>3</sup> Since the 16<sup>th</sup> century, commercial courts have been locally-elected courts, staffed and managed by traders ; over the centuries, bankruptcies have been the object of a fierce contest with the civil courts, though the former eventually got the upper hand in the 1808 *Code de Commerce*. Afterwards, civil courts dealt with commercial matters only in the smaller towns, where no Tribunal de Commerce had been established. On average, there were around 210 and 220 commercial courts and 170 civil courts dealing with commercial affairs ; but the former absorbed close to 80% of total bankruptcy cases.

estate or real asset for the asset side). Also, for terminated procedures, those yearbooks provided numbers on the yield for each class of outcomes.

One of the most interesting thing with these data is their reliability all along the 19<sup>th</sup> century as the rules and treatment of the procedure were defined clearly (and not change thereafter) by the 1807 *Code de commerce*. Over the course of the century, some law did change part of this legislation but the administrative procedure was kept intact. Typically, a bankruptcy was initiated by a judge on request of a debtor, of an unpaid creditor or by the judge itself. If necessary, the judge decided to open a bankruptcy procedure and in so doing he also decided on the day the procedure should have been open. A *syndic* was then named to audit the professional and personal assets of the bankrupt, to verify the debts and organise the deliberations of the verified debt holders. Typically, those creditors can either agree on a liquidation or a composition (*concordat*). At this point the judge can validate or not the solution proposed by the creditors. Once the creditors and the judge had decided on the fraudulent nature of the bankrupt, the procedure ended with the payment of the dividend to the creditors in case of liquidation or on an agreement on the (future) dividend the composition will give.

### 3. Aggregate evidences

#### *Gross Performances*

The first evidence that comes out from the time series built from the *Comptes Généraux* is the rapid increase in the total number of procedures, whatever their outcomes, their initiator, or the stock of debt at stake. This dynamic is specifically observed during the first half of the period under review, from the 1840s till the 1880s. Afterwards, although the economy kept expanding at a rapid pace, the series shows a clear brake (see graph 1). This two-sided evolution is reflected econometrically when the number of procedures is regressed against GDP levels: they increase by a ratio of 4,6 as long as GDP per head remained in the [1000-2200 \$] bracket (in 1990 terms), and then shifted to a polynomial pattern, with no clear growth trend. Using the Hodrik and Prescott filter to extract the trends of each series does not change the figure with again a strong positive correlation between the number of bankruptcies procedures opened during a year and the GDP per capita and a peak around 9000 bankrupts in 1898.

It then seems that the economic development of France was – over 70 years – correlated with an increase in the number of bankruptcies. Of course, part of this increase in the number of bankruptcies

can be explained by the growth of the number of firms<sup>4</sup>. We do know the number of firms from 1859 to 1910, thanks to a business tax (the *patente*) that quite all agents running an independent business – whatever its legal status – had to pay. This measure is considered as a good proxy for the number of firms because very few people could avoid paying it (mainly notaries or bailiffs). Hence, only very few economic activities were exempted while the government's agents collected it directly by visiting shops, industries, banks. Graph 2b shows that the increase in the number of firms explained at most 20% of the increase in the number of bankruptcies from the 1880's to 1910 and between 20 and 30% in the 1870's.

As we only have a truncated series for the number of firms, we repeat this exercise using GDP growth as a proxy for the growth in the number of firms. We then construct graph 2c by computing the number of bankruptcies France would have experienced if the number of bankruptcies would have grown at the rate of the GDP per capita. We make this exercise assuming that the base year is 1820 and the mean of the number of bankrupt of 1820-25. Graph 2c exhibits the same features as graph 2b as at most one third of the increase in the number of bankruptcies can be explained by GDP growth.

Moreover, computing a bankruptcy rate using the data on the number of bankruptcies and firms (graph 2d), did not change the basic features. Again, as for other graphs, the bankruptcy rate increases from 1859 to reach a peak at the end of the 1880's. Although we still have to work more on this, and especially to extend our series for the bankruptcy rate, the striking correlation between bankruptcies and French economic take-off seems robust to variations in the way we measure the importance of bankruptcies.

One natural explanation of such an increase could have been either changes in the legislation that make easier going bankrupt or an increasing efficiency of the commercial courts dealing with bankruptcies. Graph 2a and 2e plotted the number of bankruptcies and the dates of major changes of these laws. These graphs indicates no systematic evidence of an immediate increase of the number of bankrupt following the advent of some changes. Moreover, the most liberal evolution, the one of 1889 that introduces the judicial liquidation, coincides with the end of the age-old increase in the number of bankruptcies and with the peak in the bankruptcy rate<sup>5</sup>.

To account for the evolution of the judicial efficiency, we construct two series that reflect the time cost associated with the bankrupt procedure, i.e. the duration of the process and the gross productivity of a

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<sup>4</sup> Data on the number of firms come from the “*annuaire statistique rétrospectif*” published by INSEE in 1946.

<sup>5</sup> See Sgard (2006) for a presentation of the evolution of French bankruptcy law in the line of the modern literature.

representative commercial judge<sup>6</sup>. Graph 3 indicate that the duration of the process fell from an average of 36 months in the 1840s to 22 months during the last two decades. Correspondingly, the gross productivity of the representative commercial judge increased 4 times between the first half of the 1840's and the beginning of the 20<sup>th</sup> century, from 2,6 bankruptcy cases per year to 8,2 over the last two decades under review<sup>7</sup>. This derives from the very slow growth of their jurisdiction : the number of courts remained almost stable, and the total number of commercial judges increased only by 18,6% over the 73 years under review.

A parallel evolution, which also suggests a reduction in transactions costs, or risks, is the performance of the *syndic* in appraising the residual value of failed businesses. This private, professional agent took the actual control of the business, when the procedure was opened and managed it in the best interest of creditors ; he also had to audit the firm and reconstruct the whole balance sheet, on the basis of authenticated debt titles and an estimate of the market value for assets based of his own judgement and experience. The parties would then deliberate and make their decision on this basis. Interestingly, the capacity of syndics to make a viable valuation of failed business increased over time : starting from a clear upwards bias in the early periods, pre-sales estimates have then converged roughly with ex post market values (graf5).

### *The weight of informational asymmetries*

The same data also underlines the huge asymmetries of information which weighted on credit markets. Theoretically, a firm should go bankrupt on the day its debt becomes larger than assets; no investor should lend to it anymore, granted he knows the true state of its balance sheets. The ratio of assets to liabilities may thus be considered as a rough but strong proxy for the overall level of informational asymmetries (moral hazard and adverse selection included). Graph 4 then provides a clear indication that the representative lender was operating in a massively adverse environment, which apparently became increasingly so over the period under review: on the basis of audited accounts, the average assets-to-liabilities ratio started from an average of 32% during the 1850s and reached 21% on average in the last ten years of our data-base. Either asymmetries of information increased as a whole, or some markets segments with more comparatively more acute informational problems grew more rapidly.

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<sup>6</sup> See Hautcoeur and Levratto (2007, p. 15-6) for two other measures of the increase efficiency of commercial courts.

<sup>7</sup> Providing a cost-measure of the efficiency of courts is not easy because commercial jurisdictions in France operated free of charge, though some taxes were levied and private actors in the procedure had to be paid by the creditors (notably the *syndic*).



## *Financial structure*

Within assets, the share of real estate (*actifs immobiliers*) fluctuated in the [35-40%] bracket during the earlier decade and then experienced a slow downward trend till the early 1880s, by a total of about ten percentage points (see graph 4b). Wide fluctuations are then observed, before the ratio stabilised in the lower 20s, before the war. The ratio of real estate to mortgaged debt (*créance hypothécaire*) is extremely stable until the latter 1890s, with a coefficient of correlation of 0,92<sup>8</sup>; this suggests that debtors tended to mortgage all their property before going bankrupt. Later, the data fluctuates widely, reaching from time to time levels which are clearly inconsistent with the previous reliability of the *conservation des hypothèques*. Apparently, the problem seems to have been more one of adjusting the production of statistics to changing market and legal environment.

As regard the liability side of the average balance sheet, the brake-down between the main, usual classes of creditors is remarkably stable (see graph 5). On the basis of *syndic*-audited accounts, and before the parties had decided on liquidation or continuation, senior (i.e. mortgaged) claims represented only 8,7% of average of total liabilities, against 87,1% for junior creditors. Privileged claims fluctuate at a low average of 3,5% of the total until the 1890s, and then shift to an average of 6,5% in the last eight years before the war; a survey of the underlying regulation would identify which non-contractual stake-holders (i.e. tax authorities or workers) were then been able to increase their relative share, in anticipation of the much larger evolution observed latter in the 20<sup>th</sup> century. As a whole, however, these data reflect very simple balance sheets and a legal framework that actually did what it is was expected to do – protect junior creditors rights. This is a simple, early capitalist, and very liberal institution.

### 4. Small and big debtors

The *Comptes Généraux* then highlight a striking contrast in the distribution of procedures, whether one considers the number of cases or the volume of debts at stake (grafs 6 & 7). On the basis of the main, standard outcomes of the *faillite* – liquidations and *concordat* – the number of cases with *ex ante* debt under 10 000 Francs, an indeed *very* small sum, is striking. Though they show large fluctuations over time, they represent on average 27% of cases during the 1840s', and 35% during the last decade under review. Conversely, the 'true capitalist', Schumpeterian failures, approximated by firm with debts over 100KF, represent just 12% of the total, with a few picks over 15%, mainly at time of crisis, as in 1885-89 when a major reform was voted; small bankruptcies were at a rather low ebb, at this time.

When volumes of debts are considered, rather than the number of cases, the overall picture is thrown upside down. The 12% of bankruptcies with more than 100 000 francs of debt actually represented 33% of the financial value at risk. And small bankruptcies, which represented 31% of the total cases, absorbed only 4% of the debt, never rising over 6%. In other words, this population, which increasingly crowded the courts, was not negligible (several thousands per year, by end-century), but the gross financial value at risk was. This should be considered the consequence of two secular trends.

At the end of the *Ancien Régime*, the commercial courts were still institutions designed for, and operated by established traders, who operated with a volume of capital and reputation which clearly put them aside from the populace – they were *bourgeois* or, say, part of the élite of the revolutionary *Tiers-Etats*. The procedure of *faillite* was as well tailored on their needs and resources. Both institutions then came under strains, over the 19<sup>th</sup> century, due to the ever growing proportion of bankrupts who ended up with very limited or no residual assets – typically, small-size local retail-traders and craftsmen. And this of course reflected the increasing openness of the economy to trade, monetary transactions and credit.

Why these agents actually turned *en masse* to the courts, when encountered trouble, is a key question – though one which is hard to address on the basis of our aggregated time series. One issue, at this point, would be to draw the line between micro-level needs (collect debt, renegotiate, get out of prison, etc), and the change in the institutional environment. As economic activity became more regulated, and normalised, and taxed, exiting markets also became an increasingly legal affair. In other words, relying on courts, and specifically on bankruptcy law, would also be endogenous to the broader process of legalisation.

### *L'insuffisance d'actifs*

How the law addressed the fate of poor debtors is illustrated by the 1838 reform of bankruptcy law. Before that, indeed since the Italian founding era, and at least on the Continent, creditors could choose between two options, when dealing with a failed debtor: either they liquidated, or they negotiated with him a continuation arrangement; this choice, as well as the actual content of the accord, was most clearly up to them to decide, and the judge would only confirm qualified majority voting, so as to bind minority dissenters. In 1838, however, the law allowed the judge to decide *ex officio* the closure, or suspension, of the process if he concluded that existing assets could not even cover the costs of the procedure – in other words, there was nothing to bargain about and no return to expect for the creditors; their agreement was even not requested, though they could prompt the judge to take this

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<sup>8</sup> 1840-1886 period; 0,84 for the 1840-1913 period.

direction. The microeconomics of this reform was however complex and its consequences rapidly diverged from initial expectations.

One motive of the reform was expediency: 38% of the procedures opened between 1817 and 1826 became actually stalled because of the lack of assets<sup>9</sup> – tax stamps could not be paid, the syndic was not remunerated and apparently, in many cases, creditors did not care much with the meetings and proceedings. Disposing of these doomed cases was thus a matter of bureaucratic diligence. But moral hazard was also at stake: failed debtors apparently used to enter the *faillite* once they had spent all their wealth, with the expectation that they would stay there, without suffering much consequences, neither the threat of imprisonment by individual creditors (*contrainte par corps*). Hence the key counterpart of the *clôture pour insuffisance d'actifs*: creditors recovered all their pre-bankruptcy rights to initiate individual proceedings against both the debtor's person and his goods. And of course there was no debt-relief to be expected, and the debtor would not recover the civic and professional rights lost when bankruptcy was declared. The government even gave his hand to this enterprise, as he could advance the first costs of the procedure on behalf of the creditors, so as to make sure that bankruptcy would indeed be declared, with all its benefits (individual sanction, publicity, etc).<sup>10</sup> In other words, this reform was about closing a legal loophole, straightening market discipline, and putting the debtor in the hand of the collectively sovereign creditors – where bargaining and compassion could have their way. But this was definitely not a reform which aim was to support fresh start and fight debt and poverty traps<sup>11</sup>.

The interesting point however is that, under all appearances, this is exactly what the *Insuffisance* soon became. Although all materials to fully support the proposition have not yet been collected, case law seem to have borne heavily here. Initially, the intent of lawmakers was indeed for individual creditors to take the initiative, as they would appropriate whatever asset, or financial resource, they would have

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<sup>9</sup> This figure was published by the Minister of Justice as the main motive beyond introducing this clause.

<sup>10</sup> The repressive, anti-moral hazard dimension of the 1838 reform was further extended by the abolition of the *cession d'actifs* for traders. This old, indeed Roman, institution had remained since the Ancien Régime the main instrument for relieving (primarily) non-traders of their debt: they would offer them all their belongings, and provided creditors collectively agreed, they would not be threatened with prison anymore. But the 1807 Code de commerce did not close that option for traders, though it was part of the civil procedure, and was thus adjudicated by civil courts - whereas the *faillite* of course were processed by commercial courts. Beyond the settlement of this conflict of jurisdiction, the end of *cession* for traders actually closed an option for debt-relief which was indeed adequate to small debtors, and very economical in procedural terms. The *Concordat par abandon d'actifs* was then introduced as a substitute to the *cession*: it added some benefits for the debtors and brought the whole decision in the hands of the creditors. But the innovation was only partly successful, probably because many potential beneficiaries just had not the resources to go through the *faillite* and obtain the concordat; so they ended up with the (apparently) much more drastic option of the *Clôture pour insuffisance d'actifs*.

<sup>11</sup> A proposal, discussed in Parliament, aimed at including the possibility *l'excusabilité* after such a *Clôture*, so as to limit the consequences for benevolent debtors, and i.a. to support “le petit commerce”; but it was rejected. (Renouard, 1857, II - p119).

been able to collect<sup>12</sup>. On the other hand the *faillite* was only suspended: its operations could be restarted without any new opening judgement, the debtor remained legally qualified as *un failli*, and the transfer of the debtor's business to the syndic (*déssaisissement*) was as well maintained – the syndic could act. The ground was thus left open for the courts to adjudicate between the two competing principles, which actually co-existed in the law – individual and collective. By a decision of 1856<sup>13</sup> the principle of collective action was fully confirmed: assets or money collected by individual creditor should be shared equally; it was even within the mandate of the syndic to actually protect the common good against separate payments<sup>14</sup>.

The main consequence was thus to devoid the 1838 innovation of a large part of its intended threats. This effect was further reinforced after 1866, when prison for debt, initiated by creditors was abolished, after it had been limited to debt over 100 francs, in 1838. On the other hand, though the debtor could start a new business, future revenue or benefits could be seized by his old creditors, provided of course they were informed. In other terms, in the absence of a debt discharge, which could only be obtained via a Concordat, he would still work under the shadow of further expropriation. How deep this shadow actually was, on an ex ante and ex post basis is however difficult to assess at this point.

The actual success of the *Insuffisance d'actif* is however beyond doubt, as far as economic agents were concerned. By the 1850s, it represented 20% of total procedures and it then reached an average of 50% during the last ten years under review (see graph 8). An important methodological consequence is that the earlier account of a strong bias of bankruptcy development towards the lower strata of economic activity was in fact *under-stated*. As mentioned, the statistical evidences provided by the *Comptes Généraux* were based on liability data, which are available only for fully-fledged *faillites*, ending up

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<sup>12</sup> In a comment of the law a few years later, Bédarride (1844) insists that this clause is a serious threat for the debtor: "La clôture de la faillite [pour insuffisance d'actifs] est donc une véritable peine infligée au failli" (II, 147). He also expect individual incentives and actions to have the prime role: "Il est certain, en effet, que si chaque créancier ne pouvait, après le jugement de clôture, poursuivre que dans l'intérêt de la masse, le failli n'aurait guère à craindre l'exercice de cette faculté; il en est bien peu qui voudraient exposer des frais souvent considérables, pour un résultat qui ne leur profiterait pas exclusivement. La certitude du contraire excitera la vigilance des intéressés, les encouragera à poursuivre même par la voie de la contrainte par corps" (II, 150-151). Renouard, one of the architect of the 1838 reform, takes the same position: « C'est là une dérogation à la règle fondamentale d'égalité entre les créanciers (...) ; faire dégénérer l'action en un simple mandat d'agir individuellement au nom de la masse, c'est en décourager l'exercice, c'est énerver la loi en la dépouillant de sa vraie sanction et exonérer imprudemment la masse des justes suites de sa négligence » (*ibid*, II-p.121-122).

<sup>13</sup> Tribunal de commerce de Paris, March 8, 1856; Tribunal de commerce de Paris, 2 août et 27 septembre 1871 ; Tribunal de Dijon, September 25, 1900. Apparently this issue did not even reached the *Cour de Cassation*, or Supreme court. More generally the *Insuffisance d'actif* has been the cause of remarkably little case law and of no further statutory intervention after 1838, beyond its replication in the 1889 judicial liquidation (*liquidation judiciaire*).

<sup>14</sup> « Si, en cas de clôture pour insuffisance d'actif, la loi restitue à chaque créancier son droit de poursuite individuelle, c'est seulement afin qu'il puisse, dans l'intérêt de tous, suppléer l'inaction du syndic (...) ; la faillite persiste et, avec elle, doit subsister aussi l'idée d'égalité qui en est la base essentielle » (Percerou 1914, II-p. 982, 1935 2d edition).

either in liquidation or arrangement. In the case of the *Insuffisance*, individual files do not provide any information on this side of balance sheets: they only offer, at individual level, the unchecked balance sheet provided by the debtor (of course of poor value) – hence no micro, and no aggregate information on the losses incurred by debtors, that is the level of debts of agents who benefited from the *Insuffisance*. Of course, theoretically, a rather well-off trader, with substantial debt, could end up with no asset at all; but recorded individual files, which are available in the archives, do not suggest that this was a common profile. In the absence of any detailed inquiry, the very strong suggestion is indeed that this rule worked, first and foremost, as an instrument for discharging the poorer debtors.<sup>15</sup>

If all cases of *Insuffisance* are then considered to have incurred less than 10 000 Francs of debts, they can be added to the liability-based series discussed the previous paragraph. Under this upper-bound hypothesis, the share of the poorer debtors in the total amount of procedures raises from 36% to 66% (years 1903-1913). Symmetrically, the relative share of “Schumpeterian” failures, with more than 100 000 francs debts, falls from 11 to 4,8%.

#### *Rates of return on bankruptcy procedures*

Together with the number of cases, the volumes of debts, and the outcomes of the procedures, the *Comptes Généraux* then offer information on the return obtained by junior, non-guaranteed creditors – mortgaged creditors were by definition protected by the law (graph 9). Of course, at this point, the huge number of *Insuffisances d’actifs* wears heavily. When the *faillites* ending up with no dividend for junior creditors are added to them, the proportion of cases where they did not recover anything is indeed staggering : from a [25-30%] bracket in the latter 1840s’, this ratio increases steadily until the late 1880s and then stabilise in the [50-55%] bracket. A corollary is that the average return of bankruptcies, whatever their outcome and size, sees a strong downward trend: from 18% during the 1840s’ it reached 10% during the last ten years under review. When cases with zero return are excluded, the average rate over the whole period is 23%, with surprisingly limited fluctuations.

In absolute terms, total debts compromised in bankruptcies represented 1,25% of GDP on average during the whole period under review, and eventual capital losses 0,85% of GDP (after 1846). Debts at stake increase trendwise from the 1840s’ and reach a maximum between 1889 and 1896 with an average of 2,3% of GDP being processed by the courts each year (see graph 10). An element of liquidity shocks seems however to have played at that time, as eventual, ex post capital losses did not increase proportionally; the same observation can be made at the time of the 1848 revolution and the 1906 crisis.

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<sup>15</sup> We expect to provide empirical support to this hypothesis in a latter version of this paper, using individual archival files.

## 5. Bargaining on bankruptcy

### *Concordats*

However, graph 7 – that shows the volume of debts induced by large bankruptcies – remember that bankruptcy policy is also about the restructuring and the loss of substantial amounts of capital, by firms endowed with financial structures substantially larger and more complex than that of bartenders and tailors. The most striking feature in this respect is the large though declining role given to privately negotiated, judicially enforced arrangements – the *Concordat*. From an average of 50% of cases in the 1840s', its proportion fell to 11% during the 1880s, then 7% during the remaining years (graph 8). The *Liquidation Judiciaire*, introduced in 1889, offered a more open, less constraining procedural menu, which included a new formula for arrangements, which brought their total share to around 17%.

Together with the unexpected life of the *Insuffisance d'actif* as a pro-poor policy instrument, the success and demise of the *Concordat* is the most remarkable and intriguing feature of the history of bankruptcies in 19<sup>th</sup> century France. There are actually good reasons to believe that its success was not a one-off bubble, which surfaced just at the beginning of the surveyed period: between 1817 and 1826, 59% of completed procedures ended in a concordat, which was already a most popular feature of commercial law under the *Ancien Régime*. Interestingly, this approach contrasts strongly with that observed in England, where arrangements were totally banned since the early 17<sup>th</sup> century and only reintroduced in the 1880s' (Sgard, 2007). A 17% share for arrangements by the end of the century in France may thus reflect a striking convergence with the English experience, after two centuries and half marked by a major divergence.

An underlying suggestion is that early and late periods *Concordats* did not serve the same needs and interests. Whereas a modern, present-day view of arrangement would expect it to operate as an instrument for reshuffling assets and liabilities, in a financially-developed environment, the earlier version probably had more to do with illiquid markets for capital goods. Traders' books indeed indicate fire-sale liquidation was something to be avoided if there was still some trust and assets to trade on.

### *Initiating bankruptcy*

If bankruptcy is about bargaining, then incentives and strategies should play a role. Typically, for instance, if the lawmaker aimed at supporting an early initiative by distressed debtors, so as the restructure before it is too late, then threats should be minimised and incentives maximised – unless

one also cares with the risk of moral hazard caused by an easy exit out of distress. By the same token, if the law supports arrangements, it should also encourage voluntary openings, i.e. procedures being declared at the initiative of the debtor. Conversely, liquidation is the only prospect, even with debt discharge, then the propensity of the debtor to reach to the courts should be attenuated. This is why, in the English model, where the room for bargaining was minimal, the initiative traditionally came from creditors only – bankruptcy was long involuntary only.

The evolving trade-off faced by distressed debtors is reflected in graph 11, which represent the relative share of voluntary bankruptcies<sup>16</sup>. The link between their slow demise and that of arrangements indeed suggest a more substantiated relationship between the two variables, which full exploration would require more disaggregated data than those provided by the *Comptes Généraux*. The interaction between the law and the actors is finally illustrated by the already-mentioned *Liquidation Judiciaire* : that is, the enlarged menu offered to the parties after 1889, which reduced substantially the loss of civic and professional rights still incurred by debtors. Though it remains difficult to identify the exact microeconomic demand to which this reform answered, at least one point comes out very strongly: from year one (1889) the proportion of new procedures opened by the debtors reached 97% and never fell beyond. Apparently, economic agents perceived that the new supply of procedures better answered their long-standing problem, or helped them addressing forgotten ones.

## 6. Conclusion

19<sup>th</sup> century French bankruptcy comes out as a remarkably Weberian institution. It is a paradigmatic, rational-legal bureaucracy, operated by officials and professionals; and it is also an instrument of economic rationalisation, which actually links optimising behaviour to accounting rules.

When dealing with bankruptcies, the *Tribunaux de Commerce* apparently functioned as a rather efficient bureaucracy, at least one which worked smoothly: rationalisation, standardisation and division of labour are indeed the underlying social force beyond both the *Comptes Généraux* and individual files. Cases were dispatched regularly and predictably, agents and officials contributed their parts under the expected form, and even the archives were generally kept in the exact, (reverse) chronological order. This was as well an institution which survived political and economic shocks without much apparent stress: revolutions (1848, 1871) and crisis (1880s, 1906) have a visible, often sharp impact on time-series, for instance in terms of backlog of cases, but they are absorbed fairly rapidly.

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<sup>16</sup> Hautcoeur and Levratto (2007) noted that the share of voluntary bankruptcies was greater in Paris than in other part of France (p. 13)

Hence the image of an institution which is indeed a force of formalisation, hence judicialisation; an institution which also restores social order when de-coordination and violence threatens, and imposes equality in front of the law. And this sense of social power, and order, in a very silent, discrete and anonymous way. The reports being written by the syndic on the state of affairs of the debtor, and the reasons for his failure, are often short stories in their own rights, though they are also obviously sad and very often tragic. But then, '*la justice passe*': cases are dispatched without much apparent protest or resistance, whether debtors are big traders, substantial bankers or small shop-keepers. Maybe this is how Weber's Iron Cage looks like. In a society which became increasingly commercialised and monetised, it regulated the expanding sphere of contractual exchange and it also ruled on its borders, i.e. on its relation with the civil society and the polity.

What also comes out of these data is the account of a less fatalistic, less irresistible process of legalisation and judicialisation. Obviously the entry of masses of small traders and shopkeepers, with very low levels of revenue and wealth, put the old process of *faillite*, which had only been codified in 1808, under serious stress. Remarkably, its rather liberal, pro-market feature progressively appeared as an obstacle to the speedy relief of small debtors and the alleviations of serious risks of debt-traps. Debt write-offs and the notion of a fresh-start were strongly principles of the Ancien Régime and the 1808. But they were to be obtained at the end of a now rather cumbersome process, which was designed to support and protect the deliberation of the parties, but which could simply not address the case of debtor with almost no residual assets. Hence the experience of the *Clôture pour insuffisance d'actif*, which was designed as an instrument to limit moral hazard and entice debtors to do everything possible et proceed to the end of the *faillite*. But that was apparently not a viable way, and as the law lost most of teeth, thanks to the judges, it actually became an instrument for debt discharge, though in a fully in-intended, oblique way.

Beyond, whether one considers small debtors or "Schumpeterian" businesses, the main lesson, or suggestion, provided by the *Comptes Généraux* is that legalisation is an issue of "supply" and "demand", of policies and interests, though agents also bargain on debt and assets, within tight rules of interaction, and under the shadow of a law-enforcing sovereign. They interact within the institution, use it differently, abandon some legal feature or seize innovations. Here the process of legalisation and judicialisation takes a more microeconomic, and arguably more complex dimension, where the aggregate data we have used show their clearer limits.



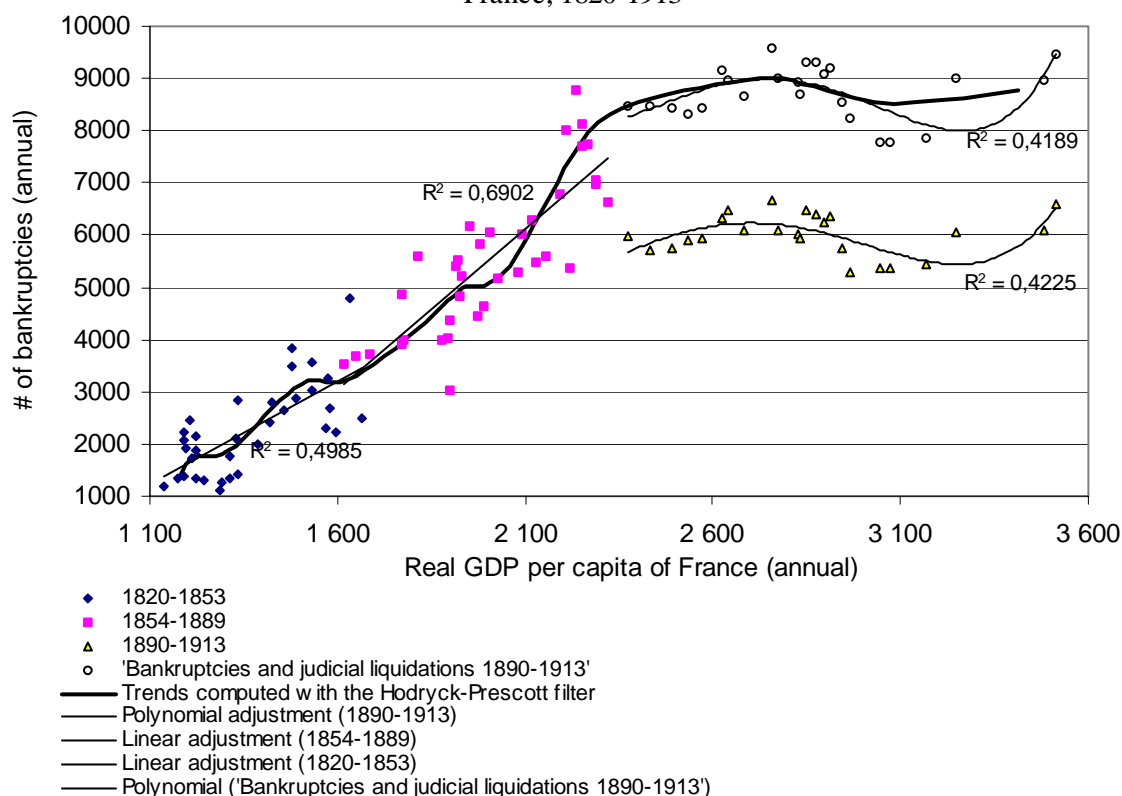
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## Appendix

Graph 1: Bankruptcies and GDP per capita

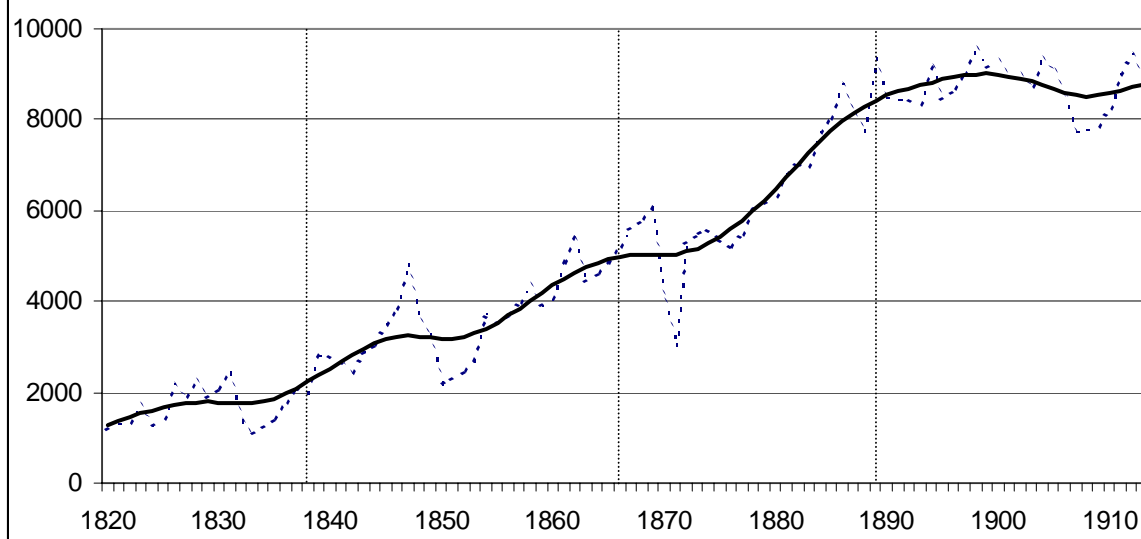
France, 1820-1913



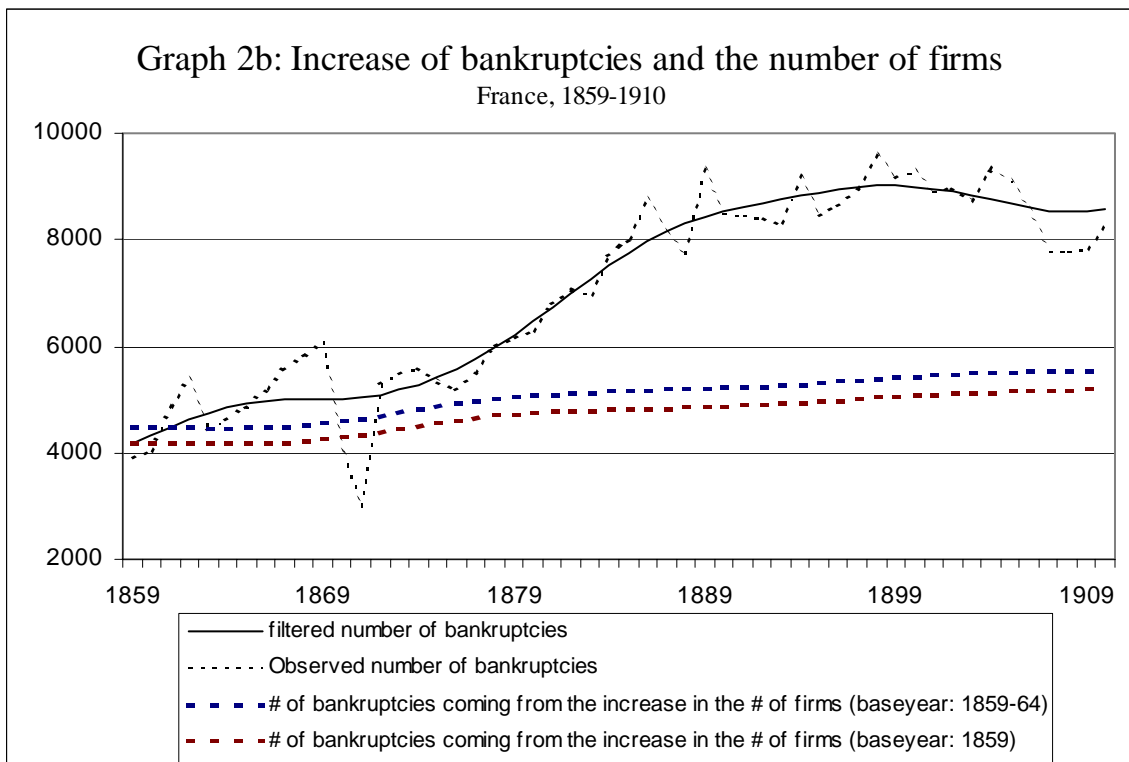
Sources: The number of bankruptcies and liquidations judiciaries are from the “Comptes généraux”. Real GDP per capita is from Madison (1995). Trended data were computed by applying the Hodrick and Prescott filter to extract the trend of each series.

Graph 2a: The number of bankruptcies and bankruptcy laws

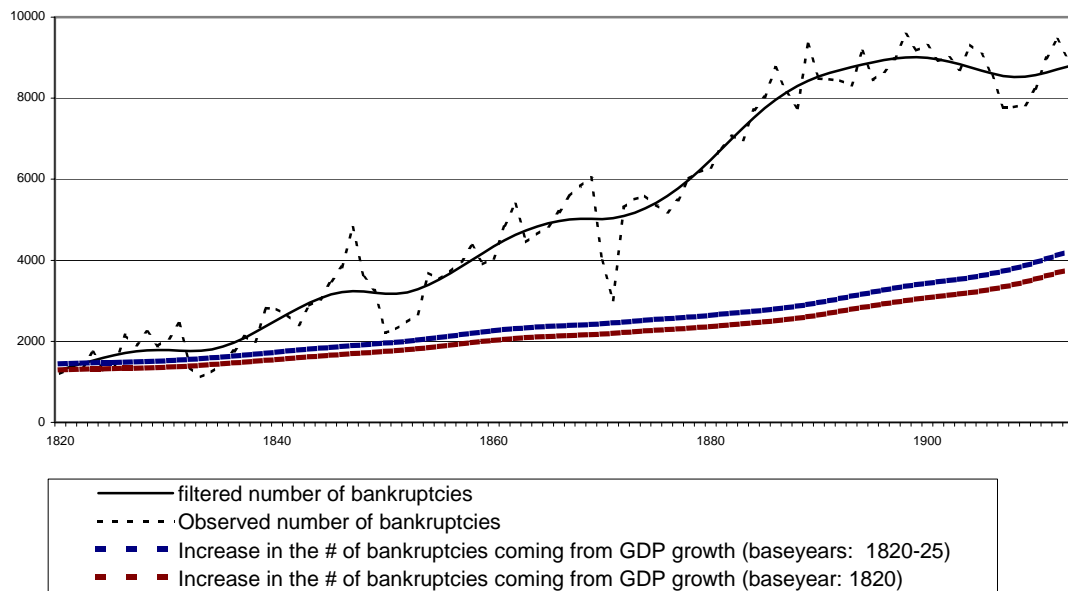
France, 1820-1913



The three prominent changes in bankruptcy law are plotted in vertical dashed lines on graph 2a. They occurred in 1838 with the introduction of the insuffisance d'actifs, in 1866 with and in 1889 with the introduction of the judicial liquidation.

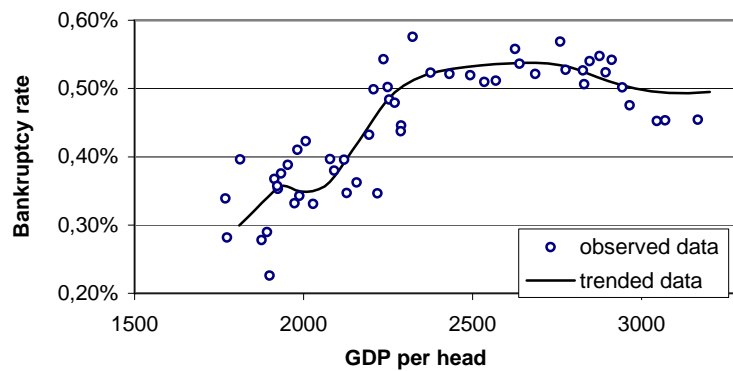


**Graph 2c: Increase of bankruptcies and GDP growth**  
France, 1820-1913

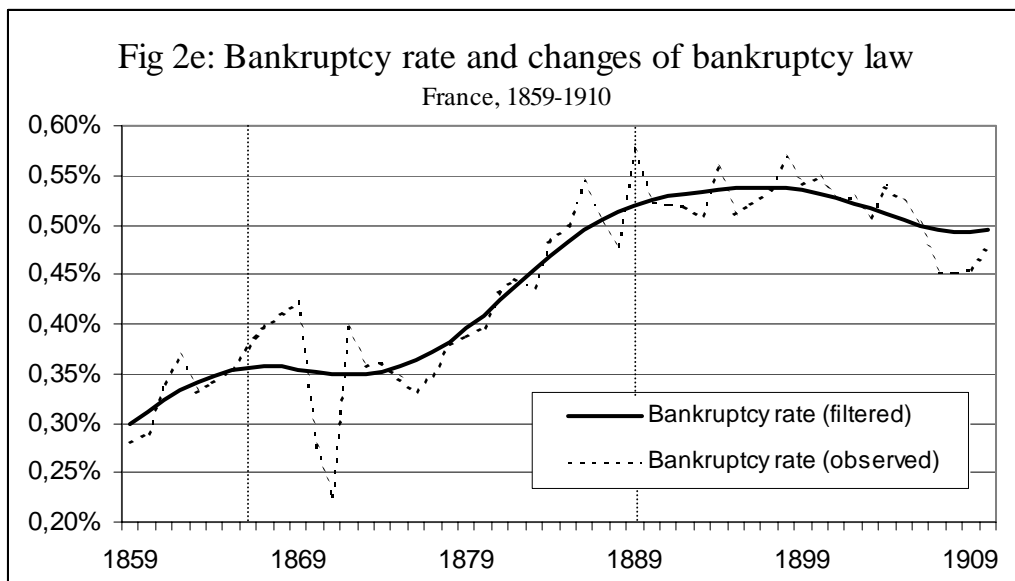


Note : Dashed lines plotted the moment of the two main changes in bankruptcy law in 1859 and 1910.

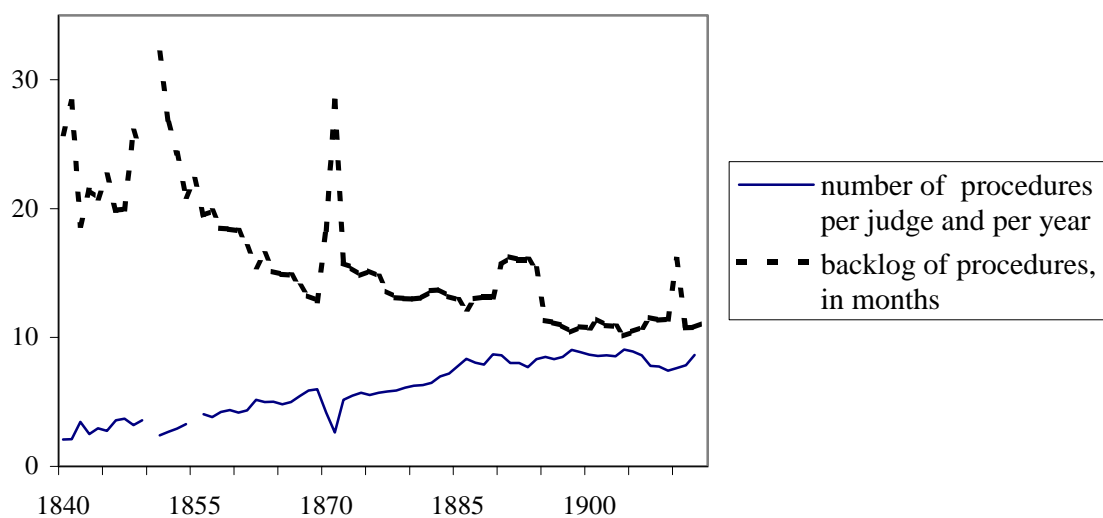
Graf 2d: Bankruptcy rate and GDP  
France, 1859-1910



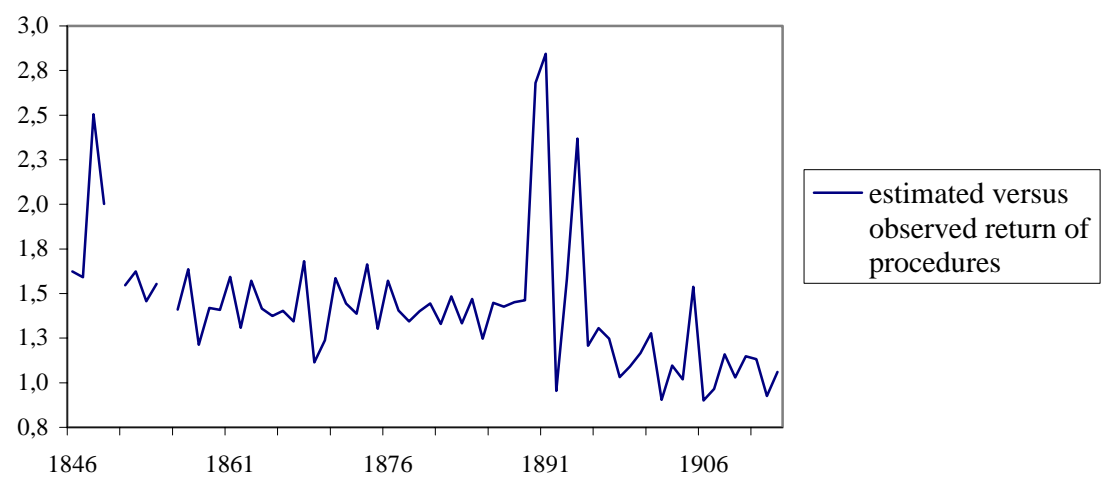
Sources graph 2: Authors computations. GDP per head is from Madison (1995) and the bankruptcy rate was computed using the data on the number of firms as shows in “annuaire statistique de la France, 1946” and the number of bankruptcies in “Comptes généraux”. Trended data were computed by applying the Hodrick and Prescott filter to extract the trend of each series.



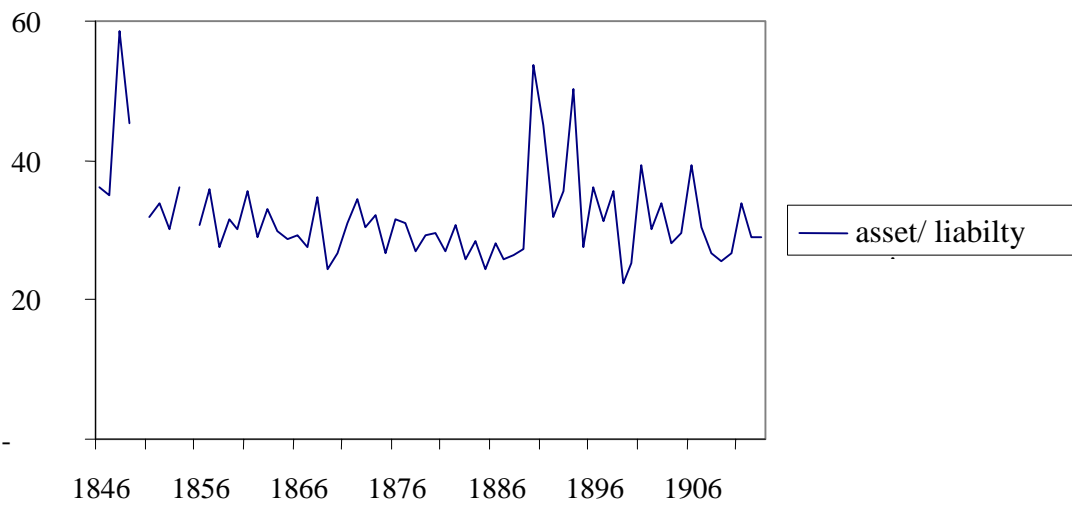
Graph 3 - The efficiency of courts



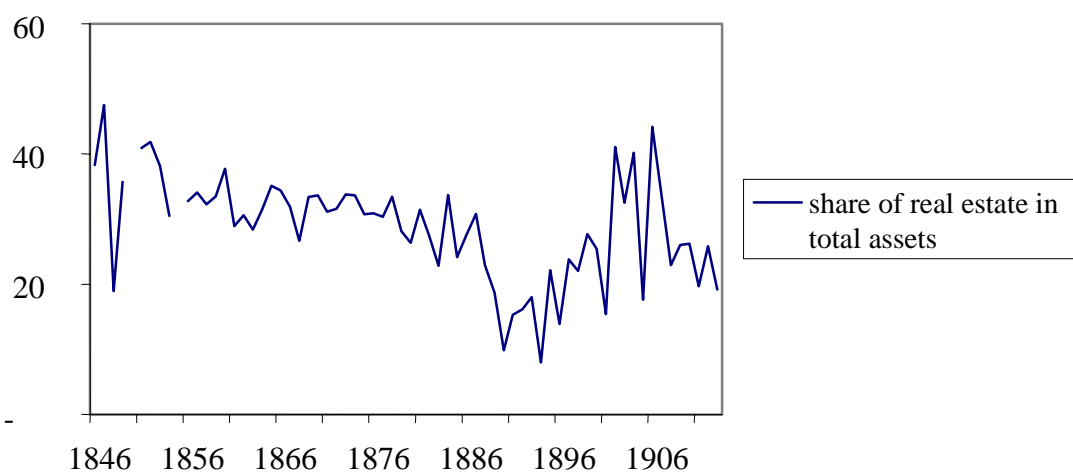
Graf 3 - Efficiency of *syndics*

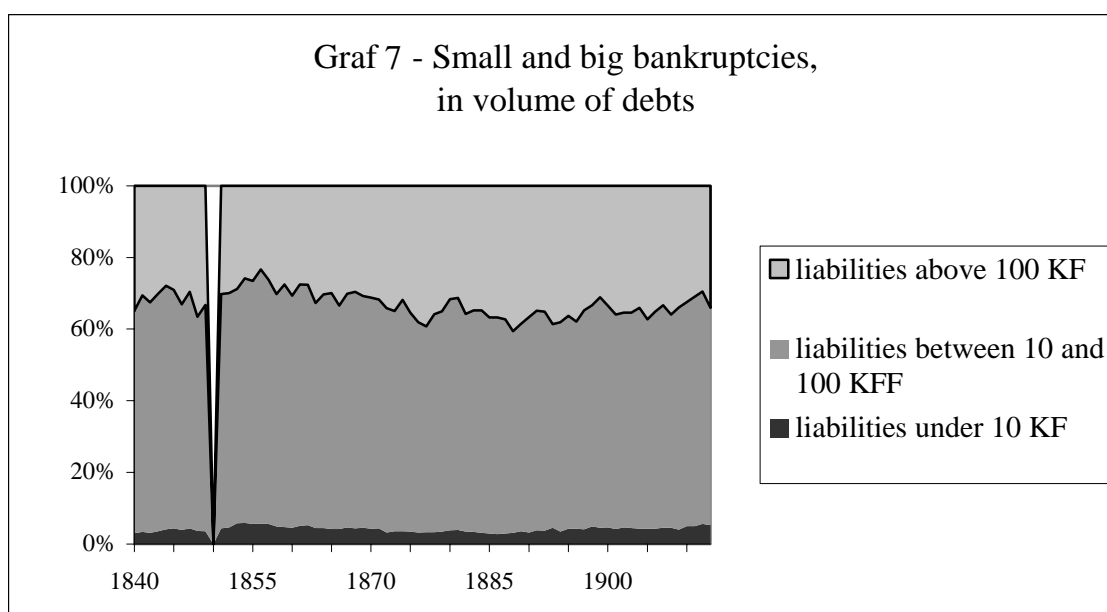
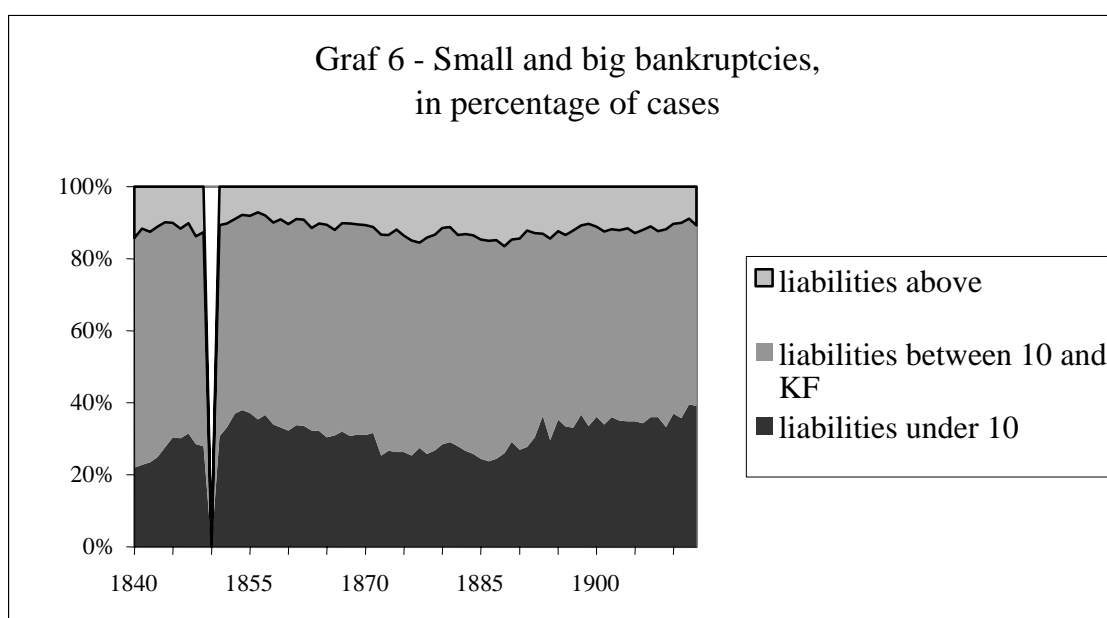
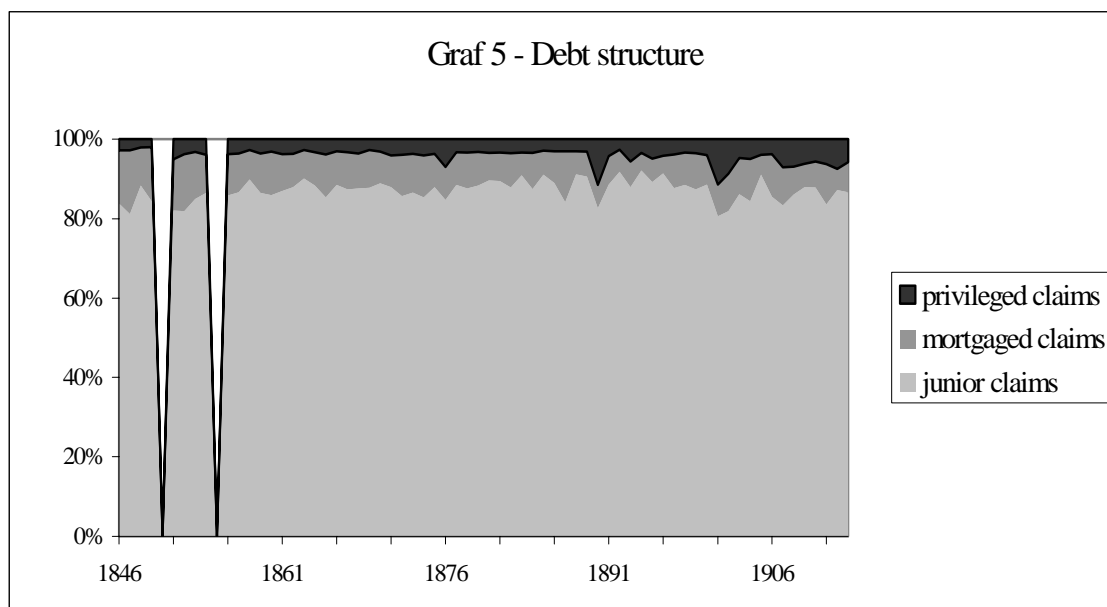


Graf 4a - Asset/ liability ratio

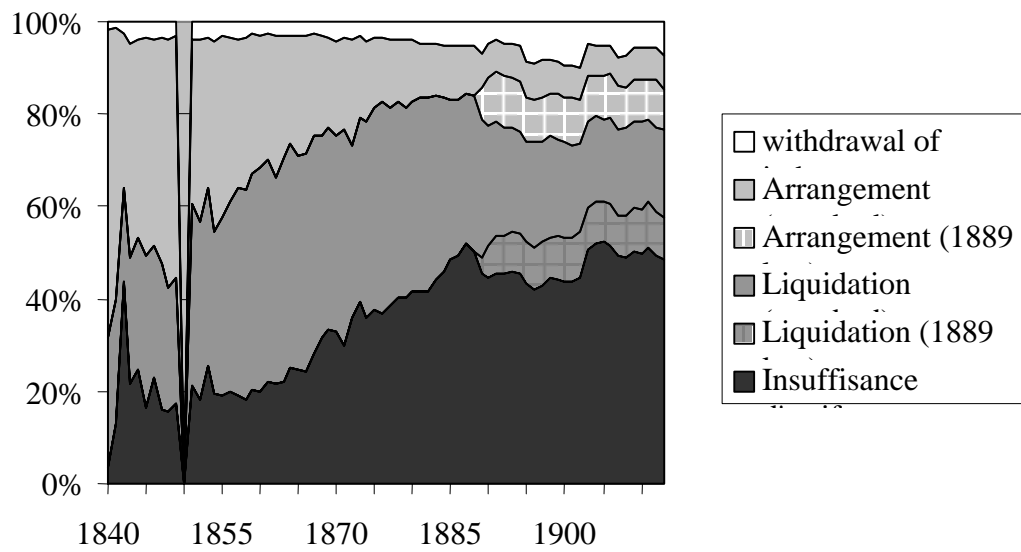


Graf 4b - Structure of assets

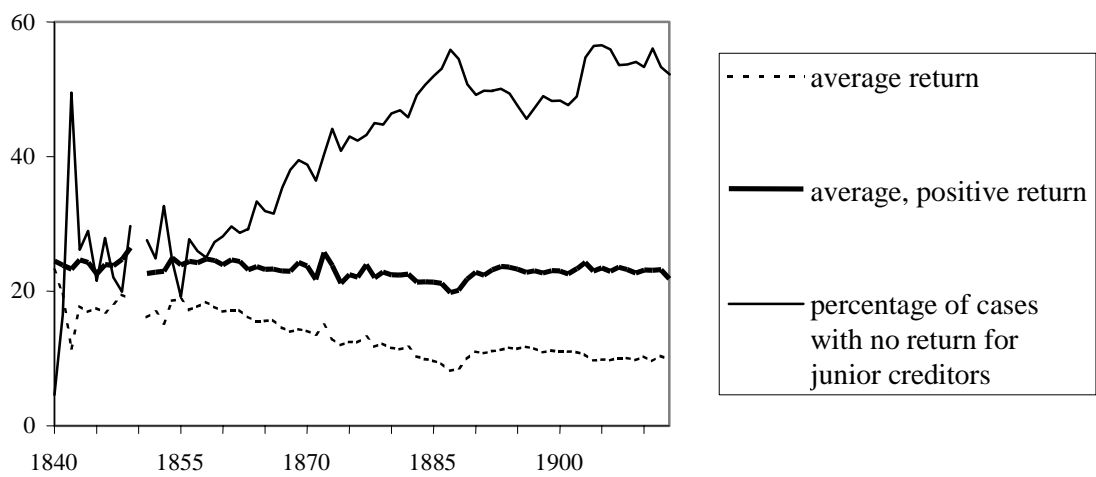




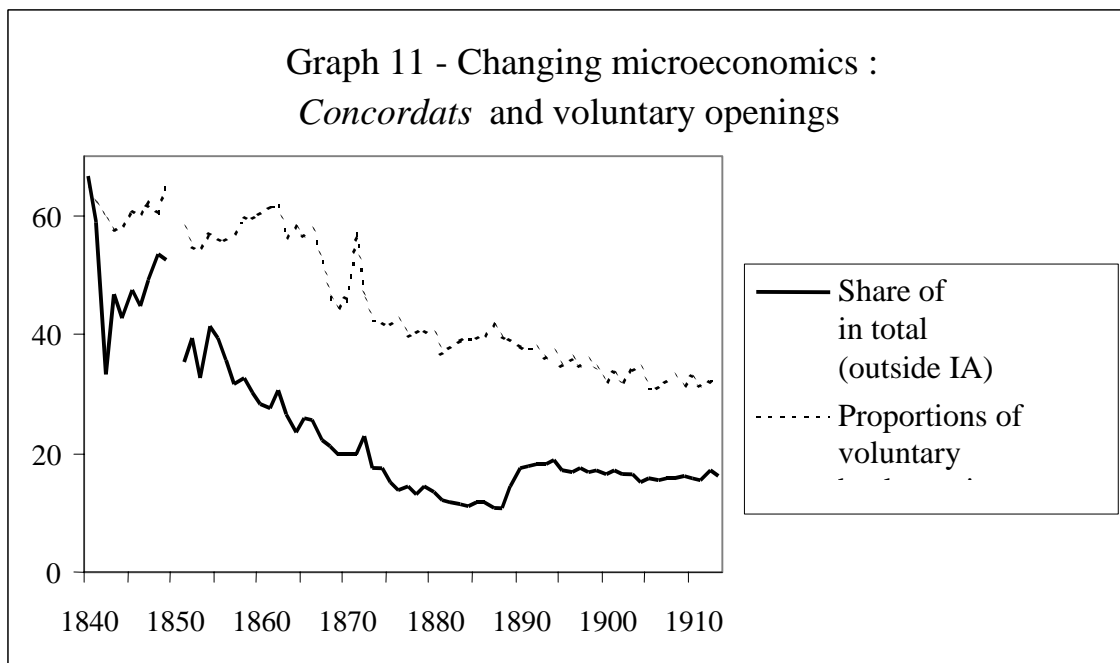
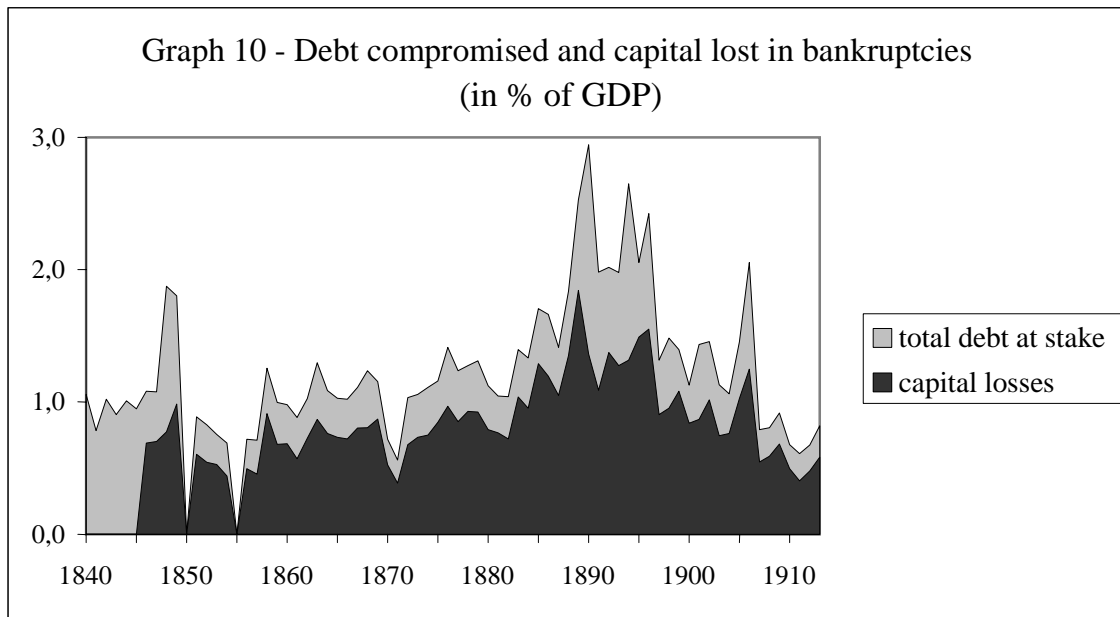
Graph 8 - Menu of procedures



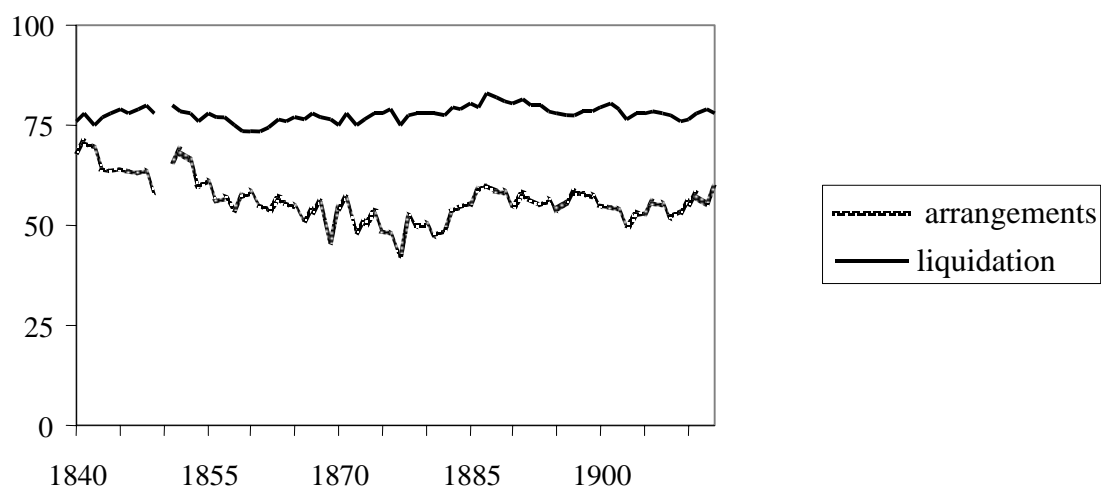
Graph 9 - Rates of return







Graf 12a - Percentage of procedures  
with a return below 25%



Graf 12b - Percentage of procedures  
with a return over 50%

