

Original Research Article

On the issue of “ excessive consumption “ in the conditions for personal bankruptcy

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Abstract: The rapid rise of Chinese family’s debt has attracted wide attention, financial risk prevention issue has become the focus of the society. The Personal Insolvency Law system is helpful to solve this problem. However, during the progress of establishing Personal Insolvency Law system, preventing this system abuse has become a key topic for all concerned parties. This article focus on the “excessive consumption” concept in personal insolvency apply procedure, using the way of comparative research, citing the practice data of Taiwan and the United States, reference to the world bank’s report on personal insolvency and combined with the specific situation of our country, suggested that the “excessive consumption” must be restrictive interpenetrated and applied, as well as the examination period and specific amount should be set scientifically.

Keywords: Personal bankruptcy; Excessive consumption; Comparative study

1. Introduction

With the changes in China’s economic structure and social consumption concepts, there has been a rapid rise in the indebtedness of residents, which has aroused widespread concern. According to the data released by the central bank, in 2020, China’s residents’ debt ratio was 72.5%^[1]. Despite China’s continuous regulation under the influence of the epidemic, as of the fourth quarter of 2021, the residents’ indebtedness rate is still as high as 62.2%^[2]. Despite China's continuous regulation under the influence of the epidemic, as of the fourth quarter of 2021, the residents' indebtedness rate is still as high as 62.2%^[3]. In view of the important role of personal bankruptcy system in the maintenance of modern financial order and the resolution of financial risks, there is a growing call from all walks of life for the establishment of a personal bankruptcy system as soon as possible, while at the same time, the concern that the personal bankruptcy system may be abused is also prevalent, and therefore it is necessary to make an in-depth discussion of the legal issues involved.

2. Formulation of the issue

Personal insolvency, the official definition of which was first described by the drafters of the British Bankruptcy Act 1883, refers to the state of insolvency of a natural person, and the personal insolvency system is the system used to allow a natural person in that state to obtain debt forgiveness at an appropriate cost and on reasonable terms^[4]. The personal bankruptcy system is the last link in the debt chain, and it has an indispensable role in the whole modern economy and social and financial order, which can regulate the improper lending behaviors of financial institutions, guarantee the systematic stability of housing loans, and it is a firewall of the financial and economic system, which can restrain the volume of "shadow banking", partially replace the function of social welfare system, and stimulate the risky investment and the spirit of innovation. The accumulation of various marginal effects after the implementation of the personal bankruptcy system can have a greater impact on the social system. Personal bankruptcy actually protects the end demand of the market

economy, because if the demand side does not improve, the supply side will be affected ^[5].

China's personal bankruptcy law has not yet been legislated and has long been in a state of "half bankruptcy law", but due to the urgent economic and social needs, personal bankruptcy systems have begun to be implemented on a trial basis in different forms in different parts of the country. The Shenzhen Special Economic Zone Personal Bankruptcy Regulations were adopted on August 26, 2020, and on March 1, 2021, they began to be implemented. Zhejiang Province and Shandong Province have also implemented centralized personal debt clearance systems to varying degrees. The local legislatures and judiciaries have made it clear that the personal bankruptcy system is to protect "honest but unfortunate people". However, the details of the system vary slightly from place to place, with different provisions on whether or not to restrict the application of the personal bankruptcy system to "over-spenders". Article 2 of the Regulations on Personal Bankruptcy of the Shenzhen Special Economic Zone makes it clear that only those who have lost the ability to settle debts or whose assets are insufficient to settle all debts as a result of their production, operation and consumption may apply the Regulations. The President of the Bankruptcy Court of Shenzhen Intermediate People's Court pointed out that bankruptcy due to "excessive consumption" does not meet the conditions for applying for personal bankruptcy^[6]. The centralized personal debt liquidation systems of courts in other jurisdictions refer to a review of "profligate consumption". In the current practice of personal insolvency regimes around the world, especially in the practice of personal insolvency liquidation, different countries and regions also have divergent views on the choice of this concept and the criteria for its application.

3. Reference to the determination of "excessive consumption" in China's current judicial practice

In the context of bankruptcy law, the dichotomy between "living consumption" and "excessive consumption" has been recognized in two ways in our judicial practice.

The first approach stems from the definition of "daily life consumption" in the Law on the Protection of Consumer Rights and Interests. In Supreme People's Court Guiding Case No. 17, the court pointed out that the plaintiff Zhang Li purchased the car for her daily needs, and the defendant failed to prove that the car was used for business purposes, so her actions were recognized as daily consumption. This case emphasized the defendant's burden of proof, which is useful for the allocation of the burden of proof in the personal bankruptcy system. However, the direct application of this concept to personal bankruptcy may result in luxury goods consumption being regarded as living consumption, reducing the effectiveness of preventing abuse of the system.

The second way is through the review of the existing personal bankruptcy system. For example, the Shenzhen Special Economic Zone Individual Bankruptcy Regulations require debtors to declare one-time expenditures of more than 50,000 yuan in the two years prior to the acceptance of the application and require the administrator to review consumption during that period. In addition, relevant guidelines in Zhejiang Province similarly require debtors to declare similarly large expenditures and review profligate spending. These provisions reflect the identification and regulation of "excessive consumption". The main issues to be discussed include the fixed amount standard and the review period. If the fixed amount criteria are not properly formulated, it may lead to a mismatch between applications and social needs; while an excessively long review period may result in an inverse relationship between social costs and benefits. These factors need to be fully considered in the design of the system to ensure a fair and effective insolvency regime.

4. Application of the concept of “excessive consumption” in extraterritorial judicial practice

In view of the fact that personal bankruptcy is closely related to the cultural environment, this paper selects the Consumer Debt Settlement Regulations and its implementation in Taiwan as a reference. Meanwhile, considering the economic situation and geographical imbalance in China, this paper selects the implementation of the personal bankruptcy system in the United States, especially the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, as a reference.

4.1. Practical setbacks due to ambiguous definitions: the Taiwan region

Taiwan’s Consumer Debt Settlement Ordinance (CDSO), the country’s first law addressing personal bankruptcy, was published in 2007, implemented in 2008, and improved twice in 2012 and 2018. The background to this legislation stems from the rapid rise in credit card liabilities. In the 1990s, there were only 400,000 credit cards in Taiwan with a total transaction value of NT\$12.5 billion, but by 2014, there were more than 37 billion credit cards in circulation and the transaction value had soared to NT\$195 billion. The market for credit card debt began to experience problems in 2005, when 700,000 borrowers were at risk of not being able to repay their debts^[7]. Article 135 of the initial version of the ordinance provided that debts resulting from “wasteful, gambling, or other speculative behavior” that resulted in a significant diminution of property would not be forgiven. However, the vagueness of the standard of “wastefulness” posed a potential problem for judicial practice. Due to the concern about abuse of the system and the Chinese cultural concept of “repayment of debts”, the courts have expanded the interpretation of “waste”, resulting in a very high percentage of non-exempt cases, with 88.73%^[8] of non-exempt cases applying this provision between 2008 and 2011^[9]. 88.73%^[8]. In the 2012 amendment to the law, Taiwan recognized this problem and amended the provision to include “consumption of luxury goods or services” as a reason for non-exemption, and set a dynamic standard. This change concretized “waste” by requiring the fulfillment of the two conditions of “exceeding the needs of daily life” and “consumption disproportionate to income”. Data show that the number of bankruptcy exemption cases increased rapidly after the amendment, and the overall exemption ratio reached 67.46% in 2021^[9], and there was no public pressure of malicious debt evasion. This empirical experience suggests that overly vague and strict criteria may be further interpreted by the judiciary in the context of Chinese culture, thus affecting the implementation effect of the personal bankruptcy system^[9], and there was no public pressure of malicious debt evasion. This empirical experience suggests that overly vague and strict criteria may be further interpreted by the judiciary in the context of Chinese culture, thus affecting the implementation effect of the personal bankruptcy system.

4.2. Unexpected failure of tough standards: United States of America

The U.S. Bankruptcy Reform Act of 1978 was notable for its liberal bankruptcy standards, which led to a significant increase in the number of bankruptcy cases between 1979 and 1980, from 196,976 to 314,886^[7]. When the law was amended in 1984, in order to prevent fraudulent behavior, the legislature added restrictions on “luxury goods and services” to make it clear that these goods and services were not necessary for the maintenance of the debtor and his dependents. The legislature added a limitation on “luxury goods and services” to prevent fraud by making it clear that these goods and services are not necessary for the maintenance of the debtor and his or her dependents. As a result, the definition of “luxury goods and services”

has been strictly interpreted in practice and is actually closer to “waste”. As a result of continued calls from financial institutions, particularly credit card institutions, for strict protection against bankruptcy abuse, the Bankruptcy Abuse Prevention and Consumer Protection Act was introduced in the United States in 2005. The Act adjusted the luxury spending limit in Section 523(2)(C) of the Federal Bankruptcy Code from one thousand dollars to five hundred dollars and extended the review period from sixty to ninety days, however, empirical studies by scholars show that these measures are of little help to creditors^[8]. Many scholars believe that the 2005 reform failed to effectively prevent bankruptcy abuse and instead increased bankruptcy costs. The number of Chapter 13 bankruptcy reorganization filings did not rise, while the number of liquidation proceedings did not fall, and the number of bankruptcy filings continued to decline. After the reform, the number of filings in federal Chapter 7 liquidation proceedings fell to 58.37% in 2006, and the number of bankruptcy reorganization filings was cut in half^[9]. The cumbersome nature of the bankruptcy process requires ordinary debtors to spend more time on financial counseling and filing, among other things, and it seems that only financial institutions ultimately benefit. The legislative changes in the United States are closely related to the neo-liberal economic model it promotes, suggesting that the traditional stringent standards such as the extended “excessive spending” review did not achieve the desired results, but instead led to higher social costs.

5. Recommendations on the use of the concept of “excessive consumption” in China’s legislation and judicial practice

In the author’s view, one of the important purposes of the personal bankruptcy law is to let those who should get relief to get relief as much as possible, rather than focusing on excluding the ineligible people, the two orientations seem to be the same, but the focus of the system construction is very different. With specific reference to the use of the concept of “excessive consumption”, the following suggestions are made:

First, “lavish consumption” should be used as a substitute for “squandering” and “wasting” and should be applied with caution. The World Bank’s Report on the Treatment of Natural Persons in Bankruptcy states that excessive ethical standards are not entirely beneficial, and that there is a need to balance the costs of scrutiny with the costs to society, and to avoid the pursuit of perfection at the expense of the system. When applying the “honest but unfortunate” standard, flaws in life details should be tolerated and individual differences should be taken into account. Practice in Taiwan has shown that narrowing the definition of “luxury” works well with fine-grained provisions. It is recommended that the definition of “extravagance” in national legislation be amended.

Secondly, the review period should be limited to two years prior to the acceptance of the bankruptcy application. An excessively long review period will lead to an excessive rise in judicial costs, and the longer the period of time, the more difficult it will be to investigate consumer behavior, and the actual results will often be less than expected. Practice in the United States has shown that a reasonable review period is necessary and that unlimited review will generate high costs. The establishment of a review period can help prevent unreasonable expectations on the part of creditors, especially financial institutions. Experience in the United States has shown that some financial institutions have over-issued loans within the review period, and then utilized the “excessive consumption” clause to avoid exemption from liability, plunging the debtor into bankruptcy and making it difficult to restore the value of the individual to society. Therefore, the personal bankruptcy law should effectively curb the blind granting of consumer loans. A clear review period can provide guidance for judicial practice. In the process of implementing the personal bankruptcy law, several institutions such as

courts and bankruptcy administration departments are involved. Failure to set a specific time limit may lead to different standards in different places, which in turn may lead to the problem of “selective jurisdiction”. With the development of technology, it is becoming easier to verify and trace consumer behavior, so the current two-year period should be based on the experience of Shenzhen and Taiwan, and future adjustments should be made based on a comprehensive consideration of costs and social effects.

Thirdly, dynamic cost review criteria should be adopted instead of fixed criteria. The economy of modern society is changing rapidly, and our country is vast, with large economic differences between different parts of the country and increasing mobility of the population. In this context, imitating the United States fixed fee review standard is not suitable for the actual situation in China. When designing the system, it is necessary to take into account individual income and geographical differences, and at the same time to prevent “bankruptcy planning” and other malicious debt evasion behavior. It is recommended to refer to the practice in Taiwan, i.e., “the total amount of expenses incurred exceeds half of the disposable income minus living expenses for the period”, and to judge it in conjunction with individual incomes. This dynamic standard better reflects the actual situation and prevents the risk of a fixed standard being utilized for debt evasion, as it is difficult to accurately predict the proportion of an individual’s income and expenditures over a period of two years or more.

6. Conclusions

The establishment and implementation of a personal bankruptcy system is of great social significance at the current stage of high indebtedness of our population. The World Bank, after comprehensively analyzing the situation around the world in its Report on the Treatment of Bankruptcy Problems of Natural Persons, suggests that countries should fully take into account the great systemic value of the system, citing a large number of data to show that the number of “genuine fraudulent incidents” suspected by countries is very small^[7]. Nowhere in the world has the personal insolvency system been recognized as working perfectly, and in particular the implementation and supervision of post-insolvency reorganization plans is more likely to be a mere formality in developing countries, with a stronger incentive for malicious debt evasion.

Preventing the abuse of the personal bankruptcy system is a systematic project that needs to combine the legislative, judicial and administrative forces and utilize the civil, administrative and criminal measures, and we need to extensively examine the practice of other regions within the Chinese cultural circle, and we also need to refer to the data of the judicial practice of large countries with the same economic volume and the same regional differences. Therefore, this paper selects Taiwan and the United States as reference, and the author believes that a large number of empirical studies in the aforementioned regions have already shown that if the application of the standard of “excessive consumption” is too harsh, it will weaken the value of the personal bankruptcy system and affect the realization of the purpose of the system. Therefore, the standard should be interpreted restrictively, and a clear pre-application review period and a dynamic cost review standard should be adopted with a view to maximizing the social benefits of the system and ensuring that the differentiated characteristics of individuals are taken into account. The theory of personal bankruptcy is complicated and requires a high degree of legislative refinement, and the interests involved are huge, so various interest groups will continue to play games in the process of system formulation. China’s legislative bodies will adhere to the attitude of seeking truth from facts, and on the basis of a comprehensive and scientific investigation, and rejecting the sentimental thinking that deviates from the practice of social sciences, will be able to set up a personal bankruptcy system that is most suitable for the national conditions and carries forward the traditional

virtues of the Chinese nation.

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