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# THE RISE AND FALL OF ENTREPRENEURS: AN EMPIRICAL STUDY OF INDIVIDUAL BANKRUPTCY PETITIONERS IN ISRAEL

Rafael Efrat\*

ABSTRACT:

*This Article addresses two fundamental areas of inquiry in personal bankruptcy. First, it examines what conditions justify an expansive vs. stringent bankruptcy debt relief regime in a given country. Second, the article examines what contributes to the particular profile composition of individuals in bankruptcy.*

*The author hypothesizes that the scope of the fresh-start policy and the composition of the bankruptcy population in a given country is predicated on government's predisposition towards credit deregulation, the extent of the welfare state and the standards employed by financial institutions when extending credit to the private sector.*

*To test this hypothesis, the author has undertaken an empirical study of consumer bankruptcy filings in Israel examining the characteristics of the petitioners and the causes of filings. By comparing the findings of this undertaking with the results of similar empirical studies in the United States and Canada, this Article provides strong support for the suggested three-prong hypothesis.*

## A. INTRODUCTION:

This Article addresses two fundamental areas of inquiry in personal bankruptcy. First, it examines what conditions justify an expansive vs. stringent bankruptcy debt relief regime in a given country. For example, currently pending in Congress is a major reform legislation of the personal bankruptcy in the United States.<sup>1</sup> The underlying premise of much of the reform is the notion that the rather expansive debt relief regime available to

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individuals in the United States is ill conceived as it promotes widespread abuse.<sup>2</sup>

Proponents of the broad fresh-start policy of the existing bankruptcy law regime in the United States cite to evidence suggesting that the vast majority of petitioners in the United States are in dire financial need<sup>3</sup> and there is little, if any, evidence of abuse.<sup>4</sup> To add clarity to this fundamental and ongoing public debate, this study aims to provide a model that, depending on the underlying circumstances in a given country, could be used to justify an expansive or, in the alternative, a stringent fresh-start policy in bankruptcy.

Second, the Article examines what contributes to the particular profile composition of individuals in bankruptcy. Studies in the United States have demonstrated that the average bankruptcy petitioner resembles a fair cross section of the population a whole. American households who resort to bankruptcy are similar to American middle class households in terms of employment status, citizen status, ethnicity, race, gender, marital status and age.<sup>5</sup> In contrast, Canadian bankruptcy petitioners are demographically similar to the Canadian population as a whole in terms of age, gender and marital status,

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<sup>1</sup> See *House, Senate Approve Sweeping New Law; Conference Committee Next Step Forward*, AM. BANKR. INST. J., April 2001, at 1.

<sup>2</sup> See Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing* 1999 B.Y.U. L. REV. 177, 180 (advocating a more stringent debt relief bankruptcy regime in the United States as “[i]n our view, the evidence now available tends to suggest that the recent rise in personal bankruptcies has been significantly influenced by a decline in the personal shame and social stigma traditionally accompanying bankruptcy, and by changes in the law and legal practice that have facilitated filing bankruptcy.”).

<sup>3</sup> See TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 61 (2000) [Hereinafter “THE FRAGILE MIDDLE CLASS”] (“Collectively, these data reveal a group of debtors in serious financial difficulties.”).

<sup>4</sup> See Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Consumer Bankruptcy in the United States: A Study of Alleged Abuse and of Local Legal Culture*, 20 J. CONSUMER. POL. 223, 244 (1997) (“The review of the financial situation of the debtors [in the United States] does not suggest that there are substantial numbers of bankruptcy petitioners who could easily repay their debts. Although the individual circumstances might bear further scrutiny, no statistically detectable abuse appears from these data.”).

<sup>5</sup> See *THE FRAGILE MIDDLE CLASS*, *supra* note 3, at 3 (“[W]e report in this book that the bankrupts do represent a fair cross-section of the American middle class.”); *id.* at 6 (“The families in bankruptcy are a good, though not perfect, cross-section of America by age, by gender, by race, by marital status, by ethnicity, by citizenship status, by employment status.”).

but not in terms of employment status.<sup>6</sup> This study will attempt to ascertain the reasons for the demographic parallelism and disparities between bankruptcy petitioners and the general population in a given country.

In this Article the author hypothesizes that the scope of the fresh-start policy and the composition of the bankruptcy population in a given country should largely be a function of government's predisposition towards credit deregulation, the extent of the welfare state and the standards employed by financial institutions when extending credit to the private sector. A government's decision to deregulate the consumer credit in the marketplace results in increased competition in consumer lending. This heightened competition naturally creates greater access to consumer credit. In turn, this wider access may lead to increased financial vulnerability as individuals undertake excessive debt. The increased financial vulnerability results in a greater need for individual bankruptcy relief.

Second, the weaker the social safety net a particular country provides, the more likely it is that individuals will have to resort to borrowing to obtain services that otherwise would have been provided by the government (such as education, medical benefits, housing, etc). Also, government's decision to provide limited financial welfare benefits results in diminished individuals' safety net. This restricted safety net offered to individuals inevitably leads to greater financial vulnerability arising out of job layoffs, medical bills, or family dissolution. Lastly, as the source of much of the credit that is available in the private sector today, the degree of due diligence which financial institutions utilize when extending credit to individuals has a significant impact on the

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<sup>6</sup> See Iain D.C. Ramsay, *Individual Bankruptcy: Preliminary Findings of Socio-Legal Analysis*, 37 OSGOODE HALL L. J. 15, 30-32 (1999).

debtors' financial vulnerability. The greater the due diligence employed, the less there is an opportunity for individuals to become over-indebted.

This proposed model suggests that the rather liberal fresh-start policy in the United States is justified. In the United States, we have witnessed a dramatic rise in consumer credit over the last twenty years following the American government deregulation of the consumer credit industry. Empirical studies suggest that the significant increase in consumer debt in the United States over the last twenty years was an important factor in explaining the significant increase in economic distress leading to consumer bankruptcy.<sup>7</sup> Concurrently, we have witnessed politically a reduction of already limited social welfare programs in the United States. This limited social safety net afforded in the United States reduced the cushion that might otherwise would have been available to individuals who faced financial trouble. On top of the significant rise in consumer credit availability and the corresponding stingy social welfare benefits, financial institutions in the United States have purportedly engaged in limited scrutiny and relaxed standards when issuing the rising volume of consumer credit.<sup>8</sup> Therefore, the highly de-regulated consumer credit market coupled with the limited social welfare benefits offered to Americans and the relatively relaxed credit standards employed by the consumer credit industry makes the rather liberal fresh-start regime in the United States appropriately tailored to the conditions on the ground.

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<sup>7</sup> See Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate*, 98-5 BANK TRENDS 1 (1998)(this study by the Federal Deposit Insurance Corporation demonstrates the close statistical connection between the abolition of usury laws (i.e., consumer credit market deregulation), the large increase in consumer credit, and the dramatic rise in consumer bankruptcies).

<sup>8</sup> See *infra* note 212 & accompanying text.

Recent experiences in several countries in Western Europe provide further evidence to the proposed hypothesis outlined above. Traditionally, Western European countries have followed a relatively conservative approach to fresh-start in bankruptcy.<sup>9</sup> However, recently (late 1980s and early 1990s) governments there have begun deregulating the consumer credit industry.<sup>10</sup> The resulting explosion of consumer debt has been as extraordinary in Europe, as it was in the United States.<sup>11</sup> Despite its generous state welfare, the rise in consumer debt has brought about widespread consumer distress as manifested by the significant rise in consumer bankruptcy filings in those countries.<sup>12</sup> Correspondingly, many Western European states have recently adopted a much more liberalized fresh-start policy in their bankruptcy laws that is more appropriately tailored to the increased financial distress many consumers have experienced following the deregulation of the consumer credit market.<sup>13</sup>

Similarly, Canadian's fresh-start policy in bankruptcy provides further support for this three-prong hypothesis. Canada offers a stronger social safety net than is offered in the United States, but it is significantly more limited than the generous package offered in Western European countries. Also, while consumer credit in Canada has been traditionally more tightly regulated than in the United States, consumer credit in Canada has been de-regulated to a greater extent than in most European countries. Correspondingly, and appropriately so, the Canadian personal bankruptcy system provides greater financial relief for financially troubled individuals when compared to the

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<sup>9</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 257.

<sup>10</sup> See *id.* at 258.

<sup>11</sup> See *id.*

<sup>12</sup> For example, insolvency rate in the U.K. has jumped by 600 percent from 1980 to 1997. See *id.* at 259.

<sup>13</sup> See Rafael Efrat, *The Fresh-Start Policy in Bankruptcy in Modern Day Israel*, 7 AM. BANKR. L. REV. 555, 575-76 (1999).

European bankruptcy regimes, but offers less relief when compared to the American expansive fresh-start policy in bankruptcy.<sup>14</sup>

To further test the three-prong hypothesis outlined above, this study has undertaken an empirical study of consumer bankruptcy filings in Israel examining the characteristics of the petitioners and the causes of filings.<sup>15</sup> Israel provides a suitable country to further test the hypothesis as it has deregulated its consumer credit market to a lesser extent than in the United States and Canada, its financial sector employs a more stringent set of criteria for extending consumer credit than do its counterparts in the United States and Canada, but its government offers a more generous welfare state than is offered both in the United States and Canada. By comparing the findings of this undertaking with the results of similar empirical studies in the United States and Canada, this Article provides additional support for the suggested three-prong hypothesis.

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<sup>14</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 257-58.

<sup>15</sup> Prior to this study, there was very little data relating to the profile of bankruptcy petitioners and the causes of filing in Israel. See Ron Harris, *From Imprisonment to Discharge: Setting an Agenda for Reform in Debtor-Creditor Law*, 23 TEL-AVIV U. L. REV. 641, 649 (2000) (“In Israel, no empirical study relating to bankruptcy has yet been conducted by either the government or by members of the academia.”). However, one scholar had conducted an empirical study of the personal bankruptcy system in Israel. That study, however, was from the early 1970s, focused primarily on Jerusalem and was limited in scope. See Philip Shuchman, *Field Observations and Archival Data on Execution Process and Bankruptcy in Jerusalem*, 52 AM. BANKR. L.J. 341, 345 (1978). The Israeli Central Bureau of Statistics provides the only public empirical data on bankruptcy in Israel. It provides an aggregate number of bankruptcy filings in any given year. However, the figure reported by the CBS does not distinguish between personal and corporate filings and it lumps into the calculations unrelated cases involving partnership matters. See ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 2000, Figure 20.6 (2000). The Official Receiver in Israel collects more detailed data relating to bankruptcy. Its data includes the annual number of bankruptcy filings nationally and regionally, the number of bankruptcy receiving orders and the number of bankruptcy adjudication orders issued by courts in a given year. However, the figures collected by the Official Receiver are not made public. The unavailability of reliable government statistics on bankruptcy matters is also a concern in the United States and Canada. See TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 15-16 (1989) [Hereinafter “AS WE FORGIVE”] (discussing the various deficiencies of the

## B. THE BANKRUPTCY SYSTEM AND THE BANKRUPTCY SAMPLE:

Individuals commencing bankruptcy in Israel are expected to liquidate their assets and allocate a portion of their future earnings over a number of years to repay their creditors. While some petitioners settle with their creditors during bankruptcy, discharge is granted infrequently.<sup>16</sup>

To collect empirical data for this study on Israeli personal bankruptcy system, a sample of 213 bankruptcy files of individuals was selected, analyzed and coded.<sup>17</sup> The bankruptcy files included extensive information on the debtors' financial condition.<sup>18</sup> Also in the bankruptcy files, copies of the Official Receiver's detailed investigatory

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bankruptcy data collected by the U.S. Administrative Office of the Courts); Ramsay, *supra* note 6, at 82 (citing the lack of availability of reliable governmental statistics relating to bankruptcy in Canada).

<sup>16</sup> For a detailed discussion of the personal bankruptcy laws in Israel see Efrat, *supra* note 13, at 578-600.

<sup>17</sup> The data-collection technique of analyzing bankruptcy files was used primarily because of the wealth of information and the accuracy this data collection method provides. The bankruptcy files, as maintained by the Official Receiver, include debtor's bankruptcy petition, detailed investigatory reports, notes and analysis authored by officers from the Official Receiver's office, internal memoranda of the Official Receiver, transcripts of various court hearings, minutes of creditors' meetings, correspondence with the debtor and other interested parties, transcripts of periodic questioning of the debtor by the Official Receiver, and inspection reports of the debtor's assets completed by the Official Receiver. Such detailed and comprehensive information relating to the debtor's affairs could not have been obtained merely through informal interviews with the debtors. Furthermore, this form of data-gathering not only provided significant amount of information, but it also maximized accuracy as the information was provided by the debtor under penalty of perjury and closely scrutinized by the Official Receiver. For similar conclusions in the American bankruptcy context on the benefits of court files rather than interviews as the preferred method of data-collection, see AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 18 ("We decided to focus on the bankruptcy forms because more information is available in these forms than most people could explain in a half-hour interview. Moreover, the accuracy of the information is likely to be higher than it would be when people are trying to recall complex information and give immediate answers."); Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Bankruptcy and the Family*, 21 FAM. & L. 193, 195-96 (1995).

<sup>18</sup> The data from the debtor's bankruptcy schedules included debtor's gender; debtor's date of birth; debtor's current and former address; debtor's place of work; names of creditors; type of creditor; amount of each debt; reason for each debt; number and amount of outstanding debtor's guarantees; number of creditors; number and status of pending collection activities against the debtor; number of prior bankruptcy filings by debtor; name and employment status of debtor's spouse; age and marital status of debtor's children; debtor's monthly expenses; a list of outstanding judgments against and in favor of the debtor; gross and net monthly income of the debtor, the debtor's spouse, and the debtor's children; occupation of the debtor and the debtor's spouse; unearned income of the debtor and the debtor's spouse (including rent, social security benefits, dividends, etc); a list of real estate owned by the debtor and the amount of any related lien; debtor's stocks and negotiable instruments; debtor's business inventory; debtor's automobiles; debtor's household goods; debtor's bank accounts; list of debtor's credit cards; and insurance policies held by debtor.



reports and related documents provided valuable corroboration of the debtor's financial condition as well as other important financial and non-financial data about the debtor and the bankruptcy process.<sup>19</sup>

The sample is composed exclusively of individuals<sup>20</sup> who voluntarily filed for bankruptcy between September 1996 and July 1998.<sup>21</sup> The files were randomly collected<sup>22</sup> from all four judicial districts in Israel<sup>23</sup> in rough proportion to each district's percentage of total individual filings over that time period.<sup>24</sup> The sample of 213 files

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<sup>19</sup> The information in the investigatory reports of the Official Receiver was not uniform but it included some of the following data about the debtor and his family: place of birth; religion; the reason/s for the bankruptcy filing; any existing mental or physical disability of the debtor or her spouse; debtor's pre-petition efforts to repay the debts; creditors' pre-petition collection activities, including arrests, garnishments and repossessions against the debtor; financial analysis of the debtor's failing business; description of the debtor's post-petition efforts to maximize repayment to creditors; and a detailed description of the debtor's household goods. The files also included a detailed record of the formal bankruptcy proceedings including the debtor's applications for a stay order, a receiving order, an adjudication order and a discharge order, if any; the Official Receiver's response to the debtor's applications, if any; and transcripts of court hearings and rulings on these applications, if any. Lastly, the files also included minutes of the creditors' meeting.

<sup>20</sup> All filings were non-joint filings as the judicial system considers the bankruptcy petition of the debtor and her spouse as two separate bankruptcy filings. Thus, both spouses have to file separate petitions, pay separate filing fees, and go through a parallel process. At times, courts consolidate the hearings on the two separate bankruptcy petitions. The sample in this study contains thirty-eight bankruptcy petitions that were filed by spouses.

<sup>21</sup> The start date of the sample was selected to be September 1996 to coincide with the significant reform of personal bankruptcy in Israel that took effect at that time. The data were collected in July 1998, while almost all of the cases were still active. More than 90% of the sampled cases had been active between six and twenty-four months at the time of data collection. Less than 8% had been active for less than six months at the time of data collection.

<sup>22</sup> The bankruptcy files were randomly hand picked from the shelves at the four regional Official Receiver's offices in Israel. The Official Receiver generally maintains in chronological order all active personal bankruptcy files in its storage shelves. Since most of the bankruptcy files generally remain active for years, at the time of data collection the shelves at the Official Receiver's offices contained almost all the bankruptcy files of cases filed after September 1996. On any given data gathering day, a number of active files may have been used by the staff at the regional Official Receiver's office, and hence would not have been selected for the sample of this study. However, as the number of such files was small the impact, if any, on the representativeness of the sample was not significant. Also, due to limited access to the Official Receiver's office in Tel-Aviv, additional bankruptcy files were retrieved from the central courthouse in Tel-Aviv, where similar data collection methodology was used. However, while the files at the courthouse included similar data to data found in the Official Receiver's files, some informal investigatory reports of the Official Receiver were generally not part of the court files.

<sup>23</sup> The four judicial districts are: Jerusalem District, Central District (including Tel-Aviv), Southern District (including Ber-Sheva) & Northern District (including Haifa).

<sup>24</sup> The average distribution of the actual number of petitions filed by individuals during 1996 and 1997 was: Jerusalem District: 10%; Central District: 59%; Northern District: 19%; Southern District: 12%. The distribution of the sample files collected in this study was: Jerusalem District: 19%; Central District: 51%;

constitutes thirty-eight percent of the average annualized number of actual filings during the sample period.<sup>25</sup> From each of these 213 files, approximately 179 quantitative pieces of information were coded to build the database for this study.<sup>26</sup>

C. REASONS FOR FILING BANKRUPTCY:

The bankruptcy files reveal the causes of the bankruptcy for the sample.<sup>27</sup> By far the most prominent cause of personal bankruptcy in the sample was the failure of a small business. An overwhelming seventy-six percent of the sample filed for bankruptcy due to the collapse of a heavily indebted small business owned by the debtor, the debtor's spouse or someone whose debts the debtor or the debtor's spouse had guaranteed.<sup>28</sup> Other reasons for filing were of significantly less importance. Failing medical condition was

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Northern District: 11%; Southern District: 19%. These distributions also roughly approximate the overall population distribution in Israel: Jerusalem district: 12%; Central District: 42%; Northern District: 30%; Southern District: 14%. *See* ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1997, 3 &57 (1998); Computerized Printouts from the Official Receiver of the Central, Jerusalem and Southern districts (July-Sept. 1998) (on file with author).

<sup>25</sup> According to data supplied by the Official Receiver's office, the total number of bankruptcy petitions by individuals was as follows: 1996: 450; 1997: 587; 1998: 650 (estimated annualized). *See* Computerized Printouts from the Official Receiver of the Central, Jerusalem and Southern districts (July-Sept. 1998) (on file with author).

<sup>26</sup> In drawing comparisons with other personal bankruptcy systems, references are made to various empirical studies in other countries. The various empirical studies used distinct methodologies to gather data and hence some of the differences in the findings between the various studies may be attributed to methodology variations. For a description of the methodologies used by the works compared with this study see AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 17-20; THE FRAGILE MIDDLE CLASS, *supra* note 3, at 263-87; VISA U.S.A. INC., BANKRUPTCY PETITION STUDY: VISA CONSUMER BANKRUPTCY REPORTS 9-10 (1997); Ramsay, *supra* note 6, at 18-19; Saul Schwartz, *The Empirical Dimensions of Consumer Bankruptcy: Results from a Survey of Canadian Bankrupts*, 37 OSGOODE HALL L. J. 83, 88-90 (1999); Philip Shuchman & Thomas L. Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM BANKR. L.J. 1, 26-27 (1982).

<sup>27</sup> To systematically ascertain the reasons for the bankruptcy filing, content codes were developed for commonly identified reasons which were grouped into five main categories. The five categories are: business failure, family breakup, adverse medical condition, unemployment, and excessive consumer debt. To the extent that several causes may have reportedly led to the bankruptcy filings, multiple causes were tabulated.

<sup>28</sup> While 63% of the sample were self-employed prior to filing bankruptcy, 76.7% reported business failure as a reason for the filing. Some non-entrepreneurs also identified business failure as the cause of their financial distress. These individuals were driven into bankruptcy due to failure of a business owned by someone whose debts they had guaranteed. In the alternative, the 14% difference may be due to a number of debtors who became employees immediately before the bankruptcy filing but were entrepreneurs beforehand.

named by almost twelve percent of the sample, excessive consumer debt contributed to nine percent of the filings and employment problems were listed as the cause of only five percent of the bankruptcies. Lastly, a little over four percent of the sample reported family troubles as a leading cause of their bankruptcy.

These findings on the causes of bankruptcy contrast sharply with recent findings in the United States and Canada. While more than two thirds of the sampled bankruptcies in Israel were due to entrepreneurship failure and only a distinct minority to job problems, a recent study of United States personal bankruptcies indicated that over two-thirds of the filings were due to employment problems and less than twenty percent to entrepreneurial failure.<sup>29</sup> A Canadian study also identifies employment problems as the most frequent cause of bankruptcy filings, with business failure as a much less frequent factor.<sup>30</sup>

#### D. THE DEMOGRAPHY OF THE ISRAELI BANKRUPT:

Comparative empirical studies in the United States and Canada generally suggest that the demographic background of bankrupts there resemble a fair cross section of the population as a whole.<sup>31</sup> Similarly, the demographic background of bankrupts in the Israeli sample resembles the population as a whole in terms of age and marital status. The

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<sup>29</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 16 (“[E]mployment problems are at the heart of nearly two-thirds of bankruptcy filings”); *id.* at 58 (“[W]e estimate that in 1991 about 20 percent of the nonbusiness consumer bankruptcy cases might be ... casualties of an entrepreneurial failure.”). This disparity is due to the substantial number of entrepreneurs in the Israeli bankruptcy sample as compared to the number of self-employed petitioners in the American bankruptcy sample. See *infra* notes 123 & 124 and accompanying text.

<sup>30</sup> See Ramsay, *supra* note 6, at 61 (reporting 24% of all bankruptcy filings due to adverse employment changes and 14% due to business failure); Schwartz, *supra* note 26, at 92 (reporting job loss as the most prevalent cause of bankruptcy and business failure as a cause for merely 4% of the total sample).

<sup>31</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 3 (“[W]e report in this book that the bankrupts do represent a fair cross-section of the American middle class.”); *id.* at 6 (“The families in bankruptcy are a good, though not perfect, cross-section of America by age, by gender, by race, by marital status, by ethnicity, by citizenship status, by employment status.”); see also Ramsay, *supra* note 6, at 30-32 (reporting

average age of the Israeli bankruptcy petitioner in the sample was forty-three, which roughly approximates the average age of the adult population in Israel of forty-eight.<sup>32</sup> Lastly, seventy-eight percent of both the sampled adults in the general population as well as the sampled bankruptcy petitioners in Israel were married.<sup>33</sup> Lastly, both the majority of the adult Israeli Jews and the sampled bankruptcy petitioners were foreign-born.<sup>34</sup>

However, significant demographic differences exist between the Israeli bankrupt and the general population. While the general population in Israel splits evenly between male and female,<sup>35</sup> males constitute approximately seventy percent of the bankruptcy sample. Also, Jews constitute only eighty percent of the general population,<sup>36</sup> but make up over ninety-four percent of the bankruptcy petitioners. Further, foreign-born Israeli

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demographic similarities in terms of age, gender and marital status between the Canadian bankruptcy sample and the general population).

<sup>32</sup> See Noah Lewin-Epstein et al., *Ethnic Inequality in Home Ownership and the Value of Housing: The Case of Immigrants in Israel*, 75 SOC. FORCES 1439, 1448 (1997) (The average age of the adult population in Israel was derived by adding the weighted average of the average ages of the three ethnic groups sampled in that study. Data for that study were derived from the Family Expenditure Survey, conducted by the Israel Bureau of the Census in 1986-87. The survey covered 5,000 households sampled from 152 urban localities. While the sample was representative of approximately 90% of all families in Israel, it excluded Jews living in rural localities as well as all Arabs living in Israel.) Since minors do not file for bankruptcy protection, as they have limited access to credit, it was important to compare average age of the bankruptcy population with the average age of the *adult* population in Israel. The figure of the average age of the general population described above excluded minors. *Id.* at 1446.

<sup>33</sup> See *Id.* at 1448 (The average percentage of married individuals in the adult population in Israel was derived by adding the weighted average of the average percentages of married couples in the three ethnic groups sampled in that study.) Since minors do not file for bankruptcy protection, as they have limited access to credit, it was important to compare average percentages of marital statuses in the bankruptcy population with the average percentages of marital statuses in the *adult* population in Israel. The figure of the average percentage of married couples in the general population described above excluded minors. *Id.* at 1446.

<sup>34</sup> See *Id.* at 1448 (The average percentage of foreign born Jews in the adult population in Israel of 68 was derived by adding the weighted average of the average percentages of immigrants in the three ethnic groups sampled in that study.) Since minors do not file for bankruptcy protection, as they have limited access to credit, it was important to compare average percentages of foreign born in the bankruptcy population with the average percentages of foreign born in the *adult* population in Israel. The figure of the average percentage of foreign born in the general population described above excluded minors. *Id.* at 1446. Similarly, 52% of the bankrupt population were reportedly foreign-born and 48% were native-born.

<sup>35</sup> See *id.* at 82 (reporting that male constitute 49.5 % of the population).

<sup>36</sup> See ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1996, 3 (1997) (reporting that of the general population Jews make up 80.5%, Moslems 14.6%, Christians 3.2% and Druze 1.7%).

Jews are underrepresented in the bankruptcy population.<sup>37</sup> Lastly, while the majority of the foreign-born Israeli Jews were ethnically Ashkenazik,<sup>38</sup> the foreign-born Jews in the bankruptcy sample evenly split along ethnic lines.<sup>39</sup>

The apparent reason for these disparities between the general population and the bankruptcy sample in Israel is that most of the bankruptcy petitioners are former entrepreneurs. Over sixty three percent of the petitioners in the sample were former entrepreneurs.<sup>40</sup> It is not surprising, therefore, that the demographic characteristics of the Israeli bankruptcy sample reflect those of Israeli entrepreneurs. For example, the average age in the sample was forty-three, which coincides with the average age of Israeli entrepreneurs of forty-five.<sup>41</sup> The gender distribution of the bankruptcy sample also resembles that of Israeli entrepreneurs with the significant majority of them being men.<sup>42</sup> As women tend to stay away from the entrepreneurial sector in Israel, as wives of self-employed husbands in Israel do not automatically become indebted to the business debts

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<sup>37</sup> See Lewin-Epstein, *supra* note 32, at 1448 (The average percentage of foreign born Jews in the adult population in Israel of 68 was derived by adding the weighted average of the average percentages of immigrants in the three ethnic groups sampled in that study.) Since minors do not file for bankruptcy protection, as they have limited access to credit, it was important to compare average percentages of foreign born in the bankruptcy population with the average percentages of foreign born in the *adult* population in Israel. The figure of the average percentage of foreign born in the general population described above excluded minors. *Id.* at 1446. In contrast, 52% of the bankrupt population were reportedly foreign-born and 48% were native-born.

<sup>38</sup> Fifty-four percent of the adult Jewish population were ethnically Ashkenazik and 45% were ethnically Sephardic. See *Id.* at 1448. Since minors do not file for bankruptcy protection, as they have limited access to credit, it was important to compare average percentages of ethnic make up in the bankruptcy population with the average percentages of ethnic makeup marital in the *adult* population in Israel. The figure of the average percentage of ethnic makeup in the general population described above excluded minors. *Id.* at 1446.

<sup>39</sup> Specifically, 51% of Jews in the bankruptcy sample were Sephardic and 42% were Ashkenazik with the rest being from an unknown origin.

<sup>40</sup> See *supra* note 28 and accompanying text.

<sup>41</sup> See Miriam Erez & Ronit Edelding, *The Profile of the Industrial Entrepreneur in Israel: Biographical, Motivational & Cognitive Factors* 16 (Discussion Paper Number 50 of the Golda Meir Institute for Labour Research, 1991).

<sup>42</sup> See Dalia Gordon & Ester Tolido, *The Small Business Enterprise-Self-Employed in the Social Security Administration*, 13 (Discussion Paper of the Research & Planning unit of the Social Security Administration, 1996) (reporting that 20% of the entrepreneurs in Israel registered with the Social Security

of their husbands, and as financially troubled entrepreneurs must file bankruptcy petitions separately and not jointly with their wives, women are dramatically underrepresented in the bankruptcy population in Israel.<sup>43</sup>

Also, the marital status of the bankruptcy sample corresponds with the marital status of the entrepreneurs in the general population, with the vast majority of them being married.<sup>44</sup> Similarly, Jews are over represented in the Israeli self-employed population<sup>45</sup> just as they are vastly over represented in the Israeli bankruptcy sample.<sup>46</sup> Lastly, the evenly divided ethnic composition of the Israeli bankruptcy sample highly resembles the ethnic orientation of Israeli entrepreneurs.<sup>47</sup>

#### E. THE FINANCIAL CONDITION OF PEOPLE IN BANKRUPTCY

The bankruptcy petitioners in Israel do not share either the demographic or

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Administration were women). In the bankruptcy sample used for this study, women comprised 30% of the population.

<sup>43</sup> None of the bankruptcy filings in Israel are joint filings as the judicial system considers the bankruptcy petition of the debtor and her spouse as two separate filings. Thus, both spouses have to file separate petitions, pay separate filing fees, and go through a parallel process.

<sup>44</sup> See Erez & Edelding, *supra* note 41, at 16 (reporting that 89% of the entrepreneurs in Israel were married). In contrast 78% of the Israeli bankruptcy sample were married.

<sup>45</sup> See DAN CHAMNESKI & RASAM HAMAESI, EDUD HAYAZAMUT BE'YISHUVIM HA'ARAVIM BE'YISRAEL [ENCOURAGEMENT OF ENTREPRENEURSHIP IN THE ARAB SECTOR IN ISRAEL] 9 (1993) (“[T]he entrepreneurship level among Arabs is far behind the Jewish entrepreneurship level.”); NOAH LEWIN-EPSTEIN & MOSHE SEMYONOV, THE ARAB MINORITY IN ISRAEL’S ECONOMY 51 (1993) (“One aspect of particular relevance to understanding the economic transformation which has taken place in the Arab sector over the years is the decline in self-employment and entrepreneurship.”). Studies indicate that the entrepreneurship level among the Arab population is approximately 10%, whereas it is approximately 17% in the Jewish population. See NASEEM JERYIS, SMALL-SCALE ENTERPRISES IN ARAB VILLAGES: A CASE STUDY FROM THE GALILEE REGION IN ISRAEL 87 (1990); Efraim Ya’ar, *Yazamut Pratit KeMaslol LeNiot Socio-Kalkalit: Hebeit Nosaf Al Harivod HaAdati BeYisrael [Private Entrepreneurship As a Socio-Economic Mobility Force: Another Look on Social Stratification in Israel]*, 29 MEGAMOT 393, 398 (1986) (reporting an aggregate self-employment rate in the Jewish population of 16.99%).

<sup>46</sup> In the bankruptcy sample Jews constitute 94%.

<sup>47</sup> In the bankruptcy sample, Sephardic Jews constitute 51% of the foreign born Jewish petitioners. Similarly, one study suggests that Sephardic and Ashkenazik Jews are evenly represented among the self-employed in Israel. See CALVIN GOLDSCHIEDER, ISRAEL’S CHANGING SOCIETY: POPULATION, ETHNICITY, AND DEVELOPMENT 143 (1997) (“[T]he percentage of self-employed among men age 25 and over in 1983 was about the same for European-American Jews, [and] Asian-African Jews ....”).

financial attributes of the population as a whole. Instead, as a group, the bankruptcy petitioners are middle aged, Jewish male entrepreneurs, deeply in debt, with significantly less disposable income and substantially fewer assets than their fellow citizens.

1. *Income:*

The average total gross income<sup>48</sup> of the individual debtor in the sample is significantly lower than the average monthly income of individuals in the general Israeli population. The average monthly gross income per household in Israel was approximately \$3,118 in 1997,<sup>49</sup> but the average monthly gross income for the sample bankrupt's household was only \$1,675.<sup>50</sup> These earnings position the bankrupt's household income approximately in the thirtieth percentile of the average monthly gross income of the general population in Israel.<sup>51</sup>

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<sup>48</sup> Total gross income is defined in this research project as it is calculated by State of Israel Central Bureau of Statistics to include wages earned, profits from self-employment, rental income, government benefits, and other income.

<sup>49</sup> See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS 43 (1999) (showing an average monthly total gross income per household of 10,915 New Israeli Shekels). All figures reported in the text of this article have been roughly converted from the Israeli currency into American dollar based on the dollar exchange rate existing in Israel at the second quarter of 1997 of 3.5 New Israeli Shekels (NIS) for one United States dollar. See ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1997, *supra* note 24, at Table 9.12.

<sup>50</sup> The bankrupt's household average monthly gross income of 5,862 NIS, includes debtor's earnings from work, debtor's spouse earnings from work, government welfare receipts, rental income and other income. Figures for average income, expenses, assets and debts were calculated in this study after cases with extreme values were removed from the sample to avoid distortions. Total household average monthly gross income before outliers were removed was 6,238 NIS, or \$1,753. The outliers were cases with average household income greater than 17,069 NIS. The median income for the bankrupt's household was 5,708 NIS, with standard deviation of 4,175 NIS. The lowest quartile of debtor sample reported only 3,002 NIS in total household income, but the highest quartile of debtor sample reported a total household income of 8,364 NIS. While some have suggested that debtor's have an incentive to understate their income in the bankruptcy petitions, the figures reported here are the numbers that have been thoroughly verified by the governmental agency of the Official Receiver. See John M. Barron & Michael E. Staten, Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay, 9 (Oct. 6, 1997) (unpublished manuscript, on file with author) ("We are well aware that Chapter 7 petitioners have an incentive in some jurisdictions to overstate expenses or understate income."); Tom Neubig et al, *Ernst & Young: Chapter 7 Bankruptcy Petitioners' Repayment Ability Under H.R. 833: The National Perspective*, 7 AM. BANKR. L.R. 79, 96 (1999) ("Some have suggested that chapter 7 filers may have an incentive to exaggerate their financial distress by overstating expenses and understating income.").

<sup>51</sup> See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 49, at 43.

A significant portion, thirty-seven percent, of the bankruptcy sample had household incomes below the poverty line at the time of bankruptcy.<sup>52</sup> Thus, poverty rate in the Israeli bankruptcy sample is almost three times greater than the poverty rate among similar size families in the general population.<sup>53</sup> The experience of debtors in the Israeli bankruptcy sample, of being poverty stricken and earning almost half of the average earnings of the general population, is similarly shared by their counterparts in the United States and Canada.<sup>54</sup>

The financial stress of the low-income Israeli families that file for bankruptcy is compounded by the families' higher average household size. While the average number of persons per household in Israel in 1997 was 3.3, the average was 3.8 among the petitioners in the bankruptcy sample.<sup>55</sup>

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<sup>52</sup> According to a study published by the National Insurance Institute of Israel, the household poverty line in 1999 for a family of four was 4,069 NIS. In the bankruptcy sample, 36.8% of the debtors with similar household size had total earnings below that poverty line. See National Insurance Institute of Israel, *Income Support in Israel and in the World*, 58 J. WELFARE & SOC. SEC. STUD. 1, 6 (2000) <[http://www.btl.gov.il/English/Whats\\_new/journal-11-00.htm](http://www.btl.gov.il/English/Whats_new/journal-11-00.htm)> (last visited Dec. 27, 2000).

<sup>53</sup> See *id.* at 11 (reporting a poverty rate of 14.5% among Israeli households with one to three children).

<sup>54</sup> In Canada "the sample of those seeking bankruptcy protection was much poorer than the general population. Median household income in the sample was about \$24,000- well below the median income of \$37,130 for all Canadian families and unattached individuals." Schwartz, *supra*, note 26, at 97. In the United States several studies have demonstrated an inferior income position of the typical bankrupt as compared to the general population. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 61 ("Median family income for the five-district group of debtors was \$17,964, compared with the national median family income in 1991 of \$36,404."); AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 65 ("[B]oth the mean and the median incomes of the bankrupt debtors were less than two-thirds of the national figures."); Elizabeth Warren, *The Bankruptcy Crisis*, 73 INDIANA L. J. 1079, 1087 (1998) ("[T]he typical family filed for bankruptcy [in the United States] with an annual combined income of about \$21,200 compared with a median family income of about \$42,400 for those not in bankruptcy.").

Poverty rates in the bankruptcy samples of the three countries are also similar. While about 37% of the Israeli bankruptcy sample were poverty stricken, 32.4% of the debtors in the U.S. fell below the poverty rate, as did approximately 40% in Canada. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 63; Ramsay, *supra* note 6, at 34.

<sup>55</sup> See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 49, at 14. The average number of persons per household in the Israeli bankruptcy sample seems to have decline since the early 1970s. See Shuchman, *supra* note 15, at 354 (finding that in the early 1970s most of the Israeli bankrupts had three or more dependent children whereas in this study the average number of dependent children per bankrupt was approximately 2). Relatively higher household size in the bankruptcy sample has also been detected in the United States. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 65-66 ("In the United States in 1981, mean household size was



The income vulnerability of the bankruptcy sample is also manifested in their higher rate of dependency on government welfare. While government welfare constitutes eleven percent of the general population's total income,<sup>56</sup> it amounts to twenty-three percent of total income of the bankruptcy sample.<sup>57</sup> As almost two-thirds of the bankruptcy sample received welfare benefits,<sup>58</sup> it seems that in the absence of the relatively generous government welfare benefits, their income would have been dramatically less.

The reasons for the bankruptcy petitioners' lower earnings are threefold. First, the lower income figures may be the result of the over-representation in the bankruptcy population of unemployed individuals. Individuals in bankruptcy are almost six times more likely to be unemployed as compared to individuals in the general population.<sup>59</sup> As unemployed individuals tend to primarily rely on government welfare, their limited

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2.7. Mean family size among debtor in our sample was about 3.4, or nearly one person more.”); Sylvia Lane, *Petitioners Under Chapter XIII of the Bankruptcy Act*, 3 J. CONSUMER AFF. 26 (1969) (finding that petitioners in Los Angeles were significantly more likely to have children and to have more children); Philip Shuchman, *New Jersey Debtors 1982-1983: An Empirical Study*, 15 SETON HALL L. REV. 541, 552 (1985) (finding that the overall average family size of the bankrupt household was 3.36).

<sup>56</sup> See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS *supra* note 49, at 13 (average total monthly governmental benefits received by an individual in the general population was 1,180 NIS in 1997 compared to total average monthly gross income of 10,915 NIS); See also STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1997, *supra* note 24, at 72.

<sup>57</sup> The average monthly governmental welfare benefit given to the bankruptcy sample was 1,379 NIS. The average monthly total gross income of the sample was 5,862 NIS.

<sup>58</sup> Sixty-five percent of the sampled population received some form of financial welfare benefits. The most frequent form of welfare benefit was children allowance (53%), followed by unemployment benefits and supplemental income benefits (13% each), and then disability benefits (12%). Receipt of government welfare benefits was also a characteristic of bankrupts in Israel during the early 1970s, but has become even more pervasive. See Shuchman, *supra* note 15, at 344 (“[S]o many bankrupts are receiving aid from the various welfare agencies of the State and municipalities. In about a half of all the bankruptcies in Jerusalem and about one-fifth in Tel-Aviv, a substantial portion of the total family income is from such sources.”). Significant government welfare benefits seem to be part of the Canadian bankruptcy sample as well. See Ramsay, *supra* note 6, at 35 (“The percentages of bankrupts receiving some form of public support or insurance at the time of bankruptcy appears to be much higher than in the general population.”). See also Schwartz, *supra* note 26, at 101 (reporting that 57 percent of the sampled bankrupt population had received some form of government transfer in the two years prior to filing for bankruptcy protection).

<sup>59</sup> See *infra* notes 230 & 231 and accompanying text.

income must have contributed to a significant deflation in the average earnings of the bankruptcy population.

Second, the average income of the bankruptcy petitioners may be lower than the average earnings in the general population because many of the bankruptcy debtors have had shorter job tenure. While the majority of the bankruptcy petitioners were former entrepreneurs, many of them have become wage earners following their business failure right around the time of bankruptcy.<sup>60</sup> As a result, at or around the time of their bankruptcy filing, those former entrepreneurs, who have recently become wage earners, tended to report less earnings than the typical wage earner in the general population, who on average have had a much longer job tenure.<sup>61</sup>

Lastly, the relatively lower earnings of the bankruptcy debtors may be due to the over-representation of blue collar workers in the bankruptcy sample. Specifically, while only sixty-eight percent of the general population were blue-collar workers in Israel in 1996, almost seventy eight percent of the bankruptcy sample was classified as blue-collar laborer.<sup>62</sup> Since the sampled bankruptcy population seems to have significantly more

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<sup>60</sup> While 63% of the bankruptcy petitioners in this study were reportedly self-employed prior to their bankruptcy filing, 59.5% of the sampled petitioners were wage earners at or soon after the bankruptcy filing.

<sup>61</sup> A similar observation relating to the link between job tenure and bankruptcy petitioners' earnings was made as part of an empirical study of bankruptcy debtors in the United States. *See AS WE FORGIVE OUR DEBTORS*, *supra* note 15, at 96-97.

<sup>62</sup> The Central Bureau of Statistics in Israel uses the following categories in reporting on occupational distribution in Israel: unskilled workers; industry construction and other skilled workers, skilled agriculture workers, agents, sales and service workers, clerical workers, managers, associate professionals, academic professionals. ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1996, *supra* note 36, at 316-17. The author classified managers, associate professionals and academic professional under the category of white-collar workers. All other occupations were classified as blue-collar workers. In 1996, the general population had the following occupational distribution: unskilled workers: 9.4%; industry construction and other skilled workers: 23.8%; skilled agriculture workers: 1%; agents, sales, service workers: 15.2%; clerical workers: 18.7%; Managers: 5%; associate professionals: 14.5%; academic professionals: 12.5%. In contrast, the sampled bankruptcy population had the following occupational distribution: unskilled workers:12.4%; industry construction and other skilled workers:17.1%; skilled agriculture workers:2.1%; agents, sales, service workers:36.8%; clerical workers:9.3 %; Managers:5.7%; associate professionals:13.5%; academic professionals:2.1%. Although only a minority of the bankruptcy

blue-collar workers, who tend to earn less than white-collar workers do, the average income of the sampled bankruptcy petitioners was substantially lower than the average earnings of workers in the general population.<sup>63</sup>

2. *Expenses:*

Household expenses further strain the financial viability of the bankruptcy sample. The average monthly household expenses of the sample population was \$1,580, which left the average household with less than \$100 to pay debts and save for the future.<sup>64</sup> The bankrupt petitioner had only a tenth as much left after expenses when compared with the general population.<sup>65</sup> Further, as discussed below, the debt burden of the bankruptcy sample was significantly greater than that of the general population.<sup>66</sup>

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petitioners in the sample of this study were white-collar workers, there seems to have been a dramatic increase in their bankruptcy population composition over the past twenty years. *See* Shuchman, *supra* note 15, at 355 (reporting no white collar workers in the Israeli bankruptcy sample between 1975-1976).

<sup>63</sup> Under-representation of white collar workers in the bankruptcy sample was also detected in the United States and Canada. *See* AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 87 (reporting that 23.1% of the bankruptcy sample in the United States in the early 1980s were white collar workers (Professional-Technical & Manager-Administrator categories) compared with 35.3% of the general population); Ramsay, *supra* note 6, at 39 (“The top three classes (self-employed professionals, employed professionals, and high-level management) and middle management are significantly under-represented among bankrupts [in Canada], while those in the skilled clerical/sales/service category are over-represented.”); *See also* Schwartz, *supra* note 26, at 101 (“In our [Canadian bankruptcy] sample, 33 per cent were in unskilled categories, as opposed to 21 per cent of the *General Social Survey* sample.”).

<sup>64</sup> After outliers were removed, the average total monthly expenditure in the bankruptcy sample was 5,533 NIS. Outliers were cases with household monthly expenditures greater than 11,950 NIS and lower than 1,830 NIS. The average monthly household expenditure before outliers were removed was 5,682 NIS. The average total monthly income in the Israeli bankruptcy sample was 5,862 NIS. The median total monthly expenditure in the bankruptcy-sampled population was 5,100 NIS. The median total household monthly income in the bankruptcy population was 5,708 NIS. While the majority of the sampled bankrupt population in Israel had greater income than expenses, in Canada “more than half of the potential bankrupts had monthly expenses that were equal to, or greater than, their monthly income.” Schwartz, *supra* note 26, at 96. While debtors have an incentive to overstate their expenses in order to reduce their payment obligations under an adjudication order, the expense figures reported here are generally reliable as the Official Receiver closely scrutinizes that data

<sup>65</sup> The left over disposable income of the average household in the bankruptcy sample was 329 NIS, whereas the disposable income of the average household in the general population was 2,782 NIS in 1997. *See* STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 24, at 13-14 (reporting average monthly household income of 10,915 NIS and average monthly household expenditure of 8,133 NIS).

<sup>66</sup> *See infra* note 119 and accompanying text.

Hence, the debtors in bankruptcy not only have less income, but also less disposable income to pay a greater amount of debts.

One obvious question is whether the debtors have less disposable income due to an extravagant lifestyle or wasteful spending. The data indicate, however, exactly the opposite. While the average debtor in bankruptcy has more dependents than the average individual in the general population,<sup>67</sup> the debtor spent two thirds per month of what her counterpart in the general society spent per month in 1997.<sup>68</sup> In fact, the average expenses incurred by the petitioners' households at the time of bankruptcy were lower than the lowest twentieth percentile of monthly expenditures in the general population.<sup>69</sup>

### 3. *Assets:*

To have a more complete understanding of the debtors' financial condition, it is important not only to examine the debtor's income and expenses, but also to inquire whether the debtor has any assets of value. The data suggest that the average value of the sampled bankrupt's assets is significantly lower than that of the general population. At the time of filing, the debtors owned assets with an average value of \$69,017, and a median value of approximately \$6,900.<sup>70</sup> In contrast, individuals in the general

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<sup>67</sup> See *supra* note 55 and accompanying text.

<sup>68</sup> In 1997, the average total monthly expenditure in the general Israeli population was 8,133 NIS, whereas the average total monthly expenditure in the sampled bankruptcy population was 5,533 NIS.

<sup>69</sup> See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 49, at 32 (the monthly expenses incurred by the twentieth percentile in 1997 were 5,011 NIS, whereas the average monthly expenses incurred by the sampled bankrupt population was 5,682 NIS).

<sup>70</sup> The total value of the debtor's assets was based on the figures provided in the debtor's bankruptcy petition. As others have indicated, there are accuracy limitations when the valuation is based on the debtor's own reporting. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 66 (describing the debtor's incentives to underreport their assets, debtor's difficulty to assign accurate value to certain assets and debtor's tendencies to provide incomplete data). However, in Israel there is less likelihood of understatement because the government agency of the Official Receiver frequently verifies values. The total asset valuation figure is composed of the value of funds in bank accounts, the fair market value of the debtor's house, if any, and the value of the debtors' personal assets, including household goods and automobiles. After outliers were removed, the average value of the total assets owned by the debtors at the

population owned assets with an average value of \$132,865.<sup>71</sup> Hence, the data suggest that the average bankruptcy petitioner in Israel again falls financially below the average Israeli, with her assets worth only half of those held by individuals in the general population.<sup>72</sup>

The average Israeli bankrupt not only has less asset value than the general population, but also had significantly fewer assets than the population as a whole. For example, home ownership among the sampled bankrupts is only half as frequent as it is in the general population.<sup>73</sup> Similarly, car ownership among the bankrupt petitioners is less than half that of the general population.<sup>74</sup>

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time of bankruptcy filing was 241,559 NIS and the median was 24,129 NIS. The outliers were cases with average value of assets greater than 1,575,000 NIS. Before outliers were removed from the sample, the average value of total assets owned by the debtors at the time of petition was 296,551 NIS, or \$84,728. The standard deviation was 443,467 NIS. The highest quartile of debtor sample reported assets valued at 562,474 NIS. The significant disparity between the mean and the median figures and the high standard deviation suggest that few debtors, who have extremely high asset holdings and hence are outside the normal distribution, significantly pull up the mean for the whole sample. This phenomenon was also apparent in a previous empirical study on personal bankruptcy in the U.S. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 65 (noting that disparity between mean and median was a reoccurring phenomenon throughout the study).

<sup>71</sup> Since there was no readily available data relating to the average value of assets held by individuals in Israel, the figure presented here was deduced by dividing the total assets held by the private sector in Israel in 1998 by the number of individuals living in Israel and 20 years old or older at the end of 1997. Based on these calculations, the average value of assets held by individuals in Israel was 465,026 NIS. See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 2000, *supra* note 15, at Figure 2.19 (reporting that the total population in Israel in 1997 of individuals 20 years old or older was 3,617,000); Doron Wisebrod et al., *Magamot Be'Hitpatchut Tik Ha'Nechasim Ve'Hahitchaivoyut Shel Ha'Zibur Be'Yisrael [Trends in the Israeli public Asset holdings and Liabilities]*, 32 EXECUTIVE 62, 62 (1999) (reporting that the total physical and financial assets held by the Israeli private sector at the end of 1998 was 1,682,000,000,000 NIS).

<sup>72</sup> A similar disparity was detected in the United States where Americans in bankruptcy held assets valued at one-third than those reported by the general population. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 68; See also AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 68.

<sup>73</sup> The overall homeownership rate in Israel was 71% in 1997. See Yona Rubenstein, *Mechirei HaDirok Be'Yisrael BeShanim 1974-1996: Bua Financit? [The Prices of Houses in Israel Between 1974-1996: A Financial Buble?]*, 44 ECONOMICS QUARTERLY 492 (1997) (suggesting that home ownership rate in Israel during 1992-1993 was higher than seventy percent); See also Doron Wisebrod et al., *BeMoked HaKalkala: Mashkantaot LeDiyur [In the Center of the Economy: Home Mortgages]*, 28 EXECUTIVE 67, 70 (1999). In contrast, homeownership rate among the bankrupts was 42%. A similar disparity of homeownership rate between the general population and the bankrupt population was detected in the United States and Canada as well. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 204 ("The proportion of homeowners in bankruptcy is lower than in the population generally. As mentioned above, 64.2 percent of all Americans were homeowners in 1991, which means that about a third more Americans in the general population own

While the median value of the Israeli debtors' assets was roughly similar to the median value of assets owned by American bankrupts,<sup>75</sup> the average value of total assets in Israel was significantly higher. The average value of total assets among Israeli bankrupts was \$69,017 in 1997, but the mean of similarly situated individuals in the United States was only \$45,344 in 1991.<sup>76</sup> The disparity may be traced in large part to the value of family homes in Israel. In both the United States and Israel, the value of family homes constitutes the bulk of the assets of the bankrupts.<sup>77</sup> However, the significantly higher value of homes owned by Israeli bankrupts as compared to their American counterparts left the Israeli bankrupts with a significantly higher overall average asset value.<sup>78</sup> The disparity in average values of the bankrupts' homes in Israel and the United States reflects a similar disparity in home values in the general populations of the two nations.<sup>79</sup>

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homes than in the bankruptcy sample.”); Ramsay, *supra* note 6, at 42 (“Twenty-five per cent of debtors listed a house (real property) as an asset on their Statement of Affairs. . . . These data indicate a much smaller percentage of homeowners in the sample than the general population of Ontario (65 per cent owners), Canada (65 per cent). . . .”).

<sup>74</sup> The car ownership rate in Israel was 54% in 1997. See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 49, at 18. In contrast, the car ownership rate among the sampled population was approximately 21%. A similar disparity of car ownership rate between the general population and the bankruptcy sampled population was identified in Canada. See Ramsay, *supra* note 6, at 47 (“Forty-seven per cent of bankrupts owned at least one automobile. This is significantly less than the general population in which 77 per cent of Ontario households owned one or more automobiles in 1994.”).

<sup>75</sup> While the median asset value for the Israeli bankrupts was \$6,900 in 1997, the median asset value for the U.S. bankrupts was \$12,655 in 1991. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 68; See also electronic mail from Iain D.C. Ramsay, York University, to the author (Feb. 19, 2001) (on file with author) (reporting a median asset value for the Canadian bankrupts of \$3,000).

<sup>76</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 66.

<sup>77</sup> In Israel, home values constitute on average as much as 90% of the total sampled bankrupt's assets, whereas in the U.S. the family homes represent 64% of the total bankrupt's assets. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 67.

<sup>78</sup> In Israel, the average value of a family home for bankrupts that owned one was \$182,484 (638,695 NIS), with a median of \$164,571 (576,000 NIS). In contrast, the median value of the American bankrupt's home was \$53,750 in 1991. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 353 fn.75.

<sup>79</sup> The median price of a home in the United States was \$118,200 in 1996. See U.S. CENSUS BUREAU: STATISTICAL ABSTRACT OF THE UNITED STATES 720 (1997). In contrast, the average price (no median data was available) of a home in Israel was approximately \$179,000 in 1997 (626,500 NIS). See Wisebrod et al.,

#### 4. *Debts:*

While the petitioners' gross and net income and asset holdings are significantly lower than those of their fellow Israelis, the debts of the bankrupts indicate an even more dire financial condition. The average outstanding debt owed by the sample was an exceedingly high \$277,782, with a median of approximately \$200,000.<sup>80</sup> Not only is the average debtor burdened by an enormous debt in absolute terms, but also the debt level was very high relative to the average debt level in the general population. In 1998, the average Israeli citizen had debts only twelve percent as high as those held by the sampled bankrupts.<sup>81</sup> The debt burden of the Israeli petitioner is so heavy that it would take the average Israeli bankrupt over fifteen years to repay the entire amount, even if all earnings could be devoted to debt repayment.<sup>82</sup> In contrast, in 1991 it would have taken the average American debtor almost three years to fully repay her bankruptcy debts,<sup>83</sup> and six

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*supra* note 73, at 70 (reporting that the average price of a family home in Israel during 1997 was approximately 100 times gross monthly wages).

<sup>80</sup> After outliers were removed from the sample, the average total debt of the Israeli bankruptcy sample was 972,241NIS and the median was 702,634 NIS. The outliers were cases with total debts greater than 4,684,857 NIS and lower than 70,000 NIS. Before outliers were removed, the average total debts owed by petitioners in the sample was 1,120,942 NIS, or \$320,270. While some scholars have suggested that debtors frequently understate total debts in their filings, it is not likely to be the case here. Since the data used in this study is primarily based on the debtor's figures as confirmed, in most instances, by the Official Receiver, the understatement bias may be minimal in this study, if at all. *See AS WE FORGIVE OUR DEBTORS*, *supra* note 15, at 68 (outlining the persistent understatement bias the debtor's bankruptcy reports of debts tend to have).

<sup>81</sup> The calculated average debt held by individuals in Israel at the end of 1998 was \$33,650 (117,777 NIS). Since there was no readily available data relating to the average debt held by individuals in Israel, the figure presented here was deduced by dividing the total liabilities held by individuals in the private sector in Israel in 1998 by the number of individuals who were living in Israel and were fifteen years old or older at the end of 1997. Based on these calculations, the average amount of debt held by individuals in Israel was 117,777 NIS. *See STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 2000*, *supra* note 15, at Figure 2.19 (reporting that the total population in Israel in 1997 of individuals 20 years old or older was 3,617,000); Wisebrod et al., *supra* 71, at 62 (reporting that the total debts held by individuals in the Israeli private sector at the end of 1998 was 426,000,000,000 NIS).

<sup>82</sup> The fifteen years figure was derived by dividing total debts for each petitioner in the sample by his or her average total annualized household income and then computing the average for all the petitioners' individual debt to income ratio after the removing the outlier cases.

<sup>83</sup> *See* Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook., *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991*, 68 AM. BANKR. L.J. 121, 137 (1994)

years for the Canadian bankrupt in 1994, again assuming that all income was so used.<sup>84</sup>

That is, while the earnings of the American and Canadian debtors were slightly higher than the average earnings of their Israeli counterpart,<sup>85</sup> the Israeli petitioner had incurred almost five times as much debt as the average American debtor and twice as much as the Canadian bankrupt.<sup>86</sup>

This significant disparity in debt amount between the three countries may be partly explained by the studies' different methodology. The study in the United States did not incorporate debt figures of individuals who filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code.<sup>87</sup> As indicated in a recent empirical study of Chapter 11 petitions, "one-quarter of the Chapter 11 business bankruptcies were filed by individuals."<sup>88</sup> Since the debtors filing under Chapter 11 (some of whom are individual

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("In 1991, the mean debtor [in the U.S.] was less burdened [than in 1981], and owed two-and-half-years' income in debts, while the median debtor's debts had risen to about twenty months of income.")

<sup>84</sup> The six years figure was calculated by taking the average total debt of the Canadian bankrupt and dividing it by the mean income figure for the Canadian bankruptcy sample. See Ramsay, *supra* note 6, at 52 (the mean amount of debts outstanding by the bankrupts was \$134,067); See also electronic mail from Iain D.C. Ramsay, York University, to the author (Dec. 30, 2000) (on file with author) (reporting the mean monthly household income for the Canadian sample was \$1,845).

<sup>85</sup> The average monthly household earnings of the American bankrupt was approximately \$1,711 in 1991. In 1994, the average monthly household earnings of the Canadian bankrupt was \$1,845. In contrast, the average monthly earnings for Israeli household in bankruptcy was \$1,675. See Sullivan, Warren & Westbrook, *supra* note 83, at 128 (reporting an annual household income of \$20,535 in 1991 for a family in bankruptcy); See also electronic mail from Iain D.C. Ramsay, York University, to the author (Dec. 30, 2000) (on file with author) (reporting the mean monthly household income for the Canadian sampled bankruptcy population was \$1,845).

<sup>86</sup> While the Israeli bankrupt had sustain, on average, over \$277,782 in total debts, the American debtor in bankruptcy had an average debt amount of \$61,320 in 1997 and the Canadian debtor in bankruptcy had an average debt amount of \$134,067 in 1994. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 66; Ramsay, *supra* note 6, at 37.

<sup>87</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 283.

<sup>88</sup> Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 501 (1999). Many failed business owners have filed under Chapter 11 of the Bankruptcy Code since the Chapter 13's debt ceilings excluded them. See Brian A. Blum, *The Goals and Process of Reorganizing Small Business in Bankruptcy*, 4 J. SMALL & EMERGING BUS. L. 181, 184 (2000).



entrepreneurs) have significant total debts outstanding, it is plausible that the total debt owed by bankruptcy petitioners in the United States was understated.<sup>89</sup>

While methodology differences may partly explain the debt disparity between the two countries, differences in the samples are probably more important. Less than twenty percent of the United States bankruptcy sample were former small business owners,<sup>90</sup> and only twenty-eight percent of the Canadian bankruptcy sample,<sup>91</sup> but more than sixty-three percent of the Israeli sample were former entrepreneurs.<sup>92</sup> Several studies have demonstrated that former small business owners tend to have a significantly higher debt burden than wage earners in bankruptcy<sup>93</sup> because the financing needs of a business generally are more extensive than the borrowing needs of a consumer.<sup>94</sup> Indeed, the relative difference in the average total debt of the sampled population in the three countries approximately corresponds to the percentages of entrepreneurs in each sample. The United States sample has the fewest small business owners and the lowest average total debt. In contrast, the Israeli sample has the largest number of entrepreneurs and the highest average total debt. Canada is situated in the middle. Corresponding to its middle

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<sup>89</sup> *See id.* at 526 (reporting that the average debt outstanding of debtors filing under Chapter 11 was \$919,087).

<sup>90</sup> *See AS WE FORGIVE OUR DEBTORS*, *supra* note 15, at 111 (“[T]he entrepreneurs in our [the American] sample account for 20% of the individual debtors.”).

<sup>91</sup> *See Ramsay*, *supra* note 6, at 37 (“Twenty-eight per cent of debtors described themselves as self-employed, and 24 per cent indicated that they had been in business during the five years prior to their bankruptcy.”); *See also Schwartz*, *supra* note 26, at 111 (“Roughly one in every four debtors in our sample was either self-employed at the time of our survey, or reported on their Statement of Affairs that they had been self-employed within the past five years.”).

<sup>92</sup> *See supra* note 28.

<sup>93</sup> For example, an empirical study of personal bankruptcy in Canada found that the average liabilities of an individual business bankrupt were almost six times higher than the liabilities incurred by a consumer bankrupt. *See Ramsay*, *supra* note 6, at 52; *See also THE FRAGILE MIDDLE CLASS*, *supra* note 3, at 116 (“The typical failed entrepreneur [in the U.S.] owed four times as much unsecured debt as his or her bankrupt wage-earning counterpart...”).

<sup>94</sup> *See Schwartz*, *supra* note 26, at 108 (“The self-employed have always been heavy borrowers, since they must finance the costs of starting up and maintaining a small business.”).

range percentages of entrepreneurs in its bankruptcy sample, it had an average total debt higher than the Americans' but lower than the Israelis'.<sup>95</sup>

Another interesting comparison is the percentage of debt that is unsecured. The vast majority, or eighty-eight percent, of debts in the Israeli bankruptcy sample were unsecured.<sup>96</sup> The percentages of total debt that is unsecured were much lower in the United States and Canadian samples: fifty percent and sixty percent, respectively.<sup>97</sup> The higher percentage of unsecured debt in the Israeli bankruptcy sample may be due to significant portion of business related debts in the sample<sup>98</sup> and the greater reliance by Israeli creditors on guarantees, rather than on debtor's assets, as a form of security for business loans.<sup>99</sup> This may also reflect a reporting discrepancy in the debtors' bankruptcy petitions, whereby under-secured credit is designated as unsecured.<sup>100</sup>

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<sup>95</sup> The overall average debt outstanding of bankruptcy petitions in Israel was \$277,782. *See supra* note 80 and accompanying text. In Canada, the overall average debt outstanding was \$134,067. *See Ramsay, supra* note 6, at 52. In the U.S., the overall average debt outstanding was \$61,320. *See THE FRAGILE MIDDLE CLASS, supra* note 3, at 66.

<sup>96</sup> The average debt of an Israeli debtor at the time of bankruptcy was 1,120,942 NIS, of which 131,422 NIS was secured and 984,274 NIS was unsecured.

<sup>97</sup> *See THE FRAGILE MIDDLE CLASS, supra* note 3, at 66 (reporting average debt figures for a bankruptcy petitioner in the United States in 1997 as \$29,586 of secured debt and \$29,529 of unsecured debt). Similar percentages were reported in VISA U.S.A. INC., BANKRUPTCY PETITION STUDY: VISA CONSUMER BANKRUPTCY REPORTS, *supra* note 26, at 35; Ramsay, *supra* note 6, at 53 (reporting total secured debts held by the Canadian bankrupts of \$52,124,496 and unsecured debts of \$79,071,125).

<sup>98</sup> A significant portion of the debts in the sample is business debts since the majority of the bankruptcy petitioners in the sample were entrepreneurs. *See infra* note 123. In contrast, the majority of the bankruptcy petitioners in the United States and Canada are wage earners with naturally little, if any, unsecured business debt, but with some secured mortgage debt, which may have accounted for a significant portion of their total debts. As a result, secured debt amounts to a higher percentage of the total debts owed by the American and Canadian petitioners when compared to their Israeli counterparts. *See infra* note 198 and accompanying text.

<sup>99</sup> *See Daniel Felsenstein & Dafna Schwartz, Constraints to Small Business Development Across the Life Cycle: Some Evidence from Peripheral Areas in Israel*, 5 ENTREPRENEURSHIP & REGIONAL DEVELOP. 227, 233 (1993) (referring to the reliance by commercial banks in Israel on guarantees when extending loans to small businesses); Dalia Gordon, *Encouraging the Growth of Small Businesses in the Context of Employment and Economic Development in Israel and in the World*, 40-41 BITACHON SOCIALI [SOCIAL SECURITY] 74, 89 (1993-1994) (discussing the emphasis placed by banks in Israel on guarantees for small business loans). *See also* Electronic mail from Benjamin Shalev, Director of Investment Strategy, Bank Ha'Poalim, Isr., to the author (Feb. 12, 2001) (on file with author) (describing Israeli banks reliance on personal guarantees as a form of collateral in small business loans). Researchers have also detected a similar recent trend in the United States towards heavy lenders' reliance on personal guarantees, rather than

By far the most important creditors of bankrupt petitioners in Israel are financial institutions. More than fifty percent of the debtors' average total debts are owed to relatively sophisticated financial institutions.<sup>101</sup> Consistent with its lingering dominant role in the economy, the Israeli government is in second place, holding more than seventeen percent of the petitioners' total debts.<sup>102</sup> Extension of credit by individuals and non-incorporated trade creditors closely followed the government, holding on average seventeen percent of the petitioners' total outstanding debts.<sup>103</sup>

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collateral. See Ronald J. Mann, *The Role of Secured Credit in Small-Business Lending*, 86 GEO L.J. 1, 16-23 (1997) (describing the limited value of collateral for small business lenders, and the importance of personal guarantees to small business lenders in the United States). However, since entrepreneurs compose only 20% of the bankruptcy samples in the United States, small business loans do not constitute the bulk of the loans in the samples, and hence have a relatively limited impact on securitization of loans in the U.S. samples. See *supra* note 90.

<sup>100</sup> A similar observation was made in an empirical study of Canadian bankruptcy. See Ramsay, *supra* note 6, at 54 (“However, I soon discovered that reliance on the presentation of secured and unsecured debt in the Statement of Affairs, without further analysis, underestimates the amount of secured debt. This is because of the reporting system on the Statement of Affairs where debts are reported as secured or unsecured. ... It is not easy to provide a precise percentage of the amount of debt originally secured.”).

<sup>101</sup> The average debt owed by the bankrupt population to financial institutions was 562,642 NIS. The average total debt owed by the bankrupt population was 1,120,942 NIS. A similar findings was reported in a Canadian bankruptcy sample. See Ramsay, *supra* note 6, at 53-54 (“Debts owed to financial institutions represent over two-thirds of total debt outstanding.”).

<sup>102</sup> The average amount of debts owed by the bankrupt population to the government was 195,995 NIS. The average amount of total debts owed by the bankrupt population was 1,120,942 NIS. In Canada, where governmental role in the economy is apparently smaller than in Israel, the government is the holder of just under 10% of the bankrupts' outstanding debts. See Ramsay, *supra* note 6, at 54 (“Government debts constitute just under 10 per cent of total debts, with Revenue Canada the largest government creditors.”).

<sup>103</sup> The average debt owed by the sampled bankrupts to individuals and non-incorporated trade creditors was 191,027 NIS. The average debt owed by sampled bankrupts was 1,120,942 NIS. A much lower percentage of extension of credit amount by individuals was reported in the American and Canadian bankruptcy sampled population. See Susan D. Kovac, *Judgment-Proof Debtors in Bankruptcy*, 65 AM. BANKR. L.J. 675, 727 (1991) (while 22% of the debts owed by the American bankrupts were owed to individuals, the author reported that loans from individuals constitute a little over 4% of total unsecured debt); Ramsay, *supra* note 6, at 53-54 (reporting debts owed to individuals constitute approximately three percent of the total debts outstanding in the Canadian bankruptcy sample). The difference between the percentages in the Israeli experience as compared to the American and Canadian experiences may be attributed to a more expansive definition of “individuals” in the Israeli sample, which included non-incorporated trade creditors. See *id.* at 54 (“[The category of ‘individuals’] was sometimes difficult to code in the field work, but appears to include both private lenders and other such as friends or relatives.”).

## 5. *Net Worth:*

To further assess the bankruptcy petitioners' financial vulnerability, it is critical to ascertain the ratio of petitioners' debts to their assets and income.<sup>104</sup> Debtors' net worth is an important test used to evaluate the debtors' relative financial strength.<sup>105</sup> "Net worth is important both because it influences savings, consumption, and financial behavior and because it serves as an indicator of economic well-being."<sup>106</sup> Net worth is generally measured by subtracting the individual's total debts from his or her total assets.<sup>107</sup> The mean net worth of the Israeli bankruptcy sample was a negative \$192,531, and their median net worth was a negative \$128,554.<sup>108</sup> In stark contrast, the average net worth of Israelis generally in 1998 was a positive \$99,215,<sup>109</sup> a difference of over \$290,000. In comparison to their American and Canadian counterparts, the Israeli bankrupts are significantly weaker in terms of mean and median net worth.<sup>110</sup> An overwhelming ninety-

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<sup>104</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 70.

<sup>105</sup> *Id.*

<sup>106</sup> SURVEY OF CONSUMER FINANCES, 1983: SECOND REPORT, FEDERAL RESERVE BULLETIN, 861 (Dec. 1984).

<sup>107</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 72.

<sup>108</sup> After removing outliers, the average net-worth of the debtors at the time of bankruptcy filing was a negative 673,860 NIS and the median net worth was a negative 449,939 NIS. The outliers were cases with net-worth lower than negative 3,746,856 NIS and higher than 286,637 NIS. Before outliers were removed, the average net-worth was a negative 807,644 NIS, or -\$230,531. The standard deviation was 1,107,117 NIS. The highest quartile of debtor sample reported net worth of a negative 167,332 NIS. The lowest quartile of debtor sample reported net worth of a negative 1,071,117 NIS.

<sup>109</sup> The average net worth of the general population was calculated by subtracting average debts owed by the general population of \$33,650 from the average value of assets owned by the individuals in the general population in 1998 of \$132,865. See *supra* notes 71 & 81 and accompanying text.

<sup>110</sup> One study in the U.S. of chapter 7 no-asset debtors reported an average net worth of -\$36,626 and a median net worth of -\$20,951. See Ed Flynn & Gordon Bermant, *How Fresh is the Fresh Start?*, 19 AM. BANKR. INST. J. 20 (Dec-Jan. 2001); see also, THE FRAGILE MIDDLE CLASS, *supra* note 3, at 72 ("The mean net worth of the bankrupt debtors [in the U.S. in 1991] is -\$16,819, and their median net worth is -\$10,542."). Similar findings were reported in Canada with an average negative worth of \$96,099 and a median negative worth of \$23,016. See Ramsay, *supra* note 6, at 52 (reporting an average debt outstanding for Canadian bankrupts of \$134,067); See also electronic mail from Iain D.C. Ramsay, York University, to the author (Feb. 19, 2001) (on file with author) (reporting an average value of assets for Canadian

two percent of the Israeli bankruptcy petitioners had a negative net worth at the time of filing.<sup>111</sup> Moreover, to the extent that all of the sampled petitioner's exempt and non-exempt assets were to be liquidated as the sole form of repayment to creditors, half of the creditors would be receiving six percent or less of the debts owed.<sup>112</sup>

#### 6. *Debt to Income Ratio:*

The last but probably most important measurement of financial well being is the relationship of debts to income.<sup>113</sup> The debt to income ratio is calculated by dividing the debtor's reported total debt by the debtor's household total annual reported income.<sup>114</sup> The mean total debt to income ratio in the Israeli bankruptcy sample was fifteen.<sup>115</sup> At the mean, a petitioner's family owed debts greater than fifteen years' worth of income.

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bankrupts of \$37,968); Schwartz, *supra* note 26, at 103 ("The median level of total liabilities fell slightly from \$28,249 to \$26,016. . . . [T]he median 1997 potential bankrupt had assets of \$3,000").

<sup>111</sup> Similarly, in the United States the majority of the petitioners had a negative net worth. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 72 ("Only 12.6 percent of the total United States population had a net worth of zero or negative value, compared with nearly all of the bankrupt debtors.").

<sup>112</sup> The median payout figure of the sample was calculated by dividing total assets by total liabilities of each petitioner and then computing the median for the sample. The mean payout figure of the sample was calculated by dividing total assets by total liabilities of each petitioner and then computing the mean for the sample. After removing outliers, the mean payout figure of the sample was .25. That is, in the bankruptcy sample, creditors would have received on average a quarter of debts owed. However, these payout figures are overstated as they include exempt assets which are generally not liquidated as part of the bankruptcy process.

<sup>113</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 73 ("In contemporary society, the relationship of income to debts is the most critical measure of financial condition."); Schwartz, *supra* note 26, at 87 ("[A] better measure of financial vulnerability is the ratio of aggregate personal debt to aggregate personal disposable income.")

<sup>114</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 73 ("We compute the [debt to income] ratios by dividing each debtor's reported debt by reported annual income, with both spouses' incomes combined for married couples.").

<sup>115</sup> After removing outliers, the average total debt to income ratio was calculated by dividing total debts for each petitioner in the sample by his or her average total annualized household income and then computing the average for all the petitioners' individual debt to income ratio. The outliers were cases with debt to income ratio greater than 117 and lower than .93. Before outliers were removed, the average debt to income ratio was 22. The lowest quartile in the sample had a debt to income ratio of 5, while the highest quartile had a debt-to-income ratio of 24.

At the median, a petitioner's family owed debts greater than eleven years' worth of income.<sup>116</sup>

The total debt to income ratio of the average petitioner is enormous. However, the true magnitude of the debt burden is evident only when one focuses on the average short-term debt burden. The short-term debt burden was calculated by removing the primary long-term debt obligation, the home mortgage debt.<sup>117</sup> In the Israeli sample, a debtor at the mean had a non-mortgage debt to income ratio of fourteen, indicating that the average debtor owed over fourteen years' worth of income purely in short-term debt such as business cash-flow bank financing.<sup>118</sup>

These figures demonstrate an overwhelming debt burden for bankruptcy petitioners in Israel, when compared to the Israeli general population's average debt to income ratio of less than one,<sup>119</sup> and when compared with the average debt to income

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<sup>116</sup> The median total debt to income ratio for the bankruptcy sample was calculated by dividing total debts for each petitioner in the sample by his or her average total annualized household income and then computing the median for all the petitioners' individual debt to income ratio.

<sup>117</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 71.

<sup>118</sup> Specifically, the short-term debt to income ratio was 14.05. The average short-term debt to income ratio was calculated by dividing total nonmortgage debt for each petitioner in the sample by the total annualized household income for each petitioner in the sample and then calculating the mean ratio for all petitioners in the sample. The median short-term debt to income ratio was 9.34. The median short-term debt to income ratio was calculated by dividing total nonmortgage debt for each petitioner in the sample by the total annualized household income for each petitioner in the sample and then calculating the median ratio for the all petitioners in the sample. The standard deviation was 33.33.

<sup>119</sup> The average total debt to income ratio in the general population in Israel was calculated by dividing total average debts of 117,777 NIS owed by individuals by average annualized household income of 130,980 NIS. See *supra* note 81 (calculating the average total debt of the general population in Israel in 1997); see also STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, HOUSEHOLD EXPENDITURES SURVEY, 1997, FIRST FINDINGS, *supra* note 49, at 43 (showing an average monthly total gross income per household in the general population to be 10,915 NIS). These figures indicate that the average total debt to income ratio in the bankruptcy sample was more than fifteen times higher than the level among the general population. In contrast, in Canada the disparity between the bankruptcy sample and the general population is a little over two. See Ramsay, *supra* note 6, at 36 ("The total debt debt-to-income ratio [in the Canadian bankruptcy sample] was over twice the level among the general population.").

ratio of almost three in the United States bankruptcy population,<sup>120</sup> and six in the Canadian bankruptcy population.<sup>121</sup>

In summary, based on the bankruptcy sample, debtors in Israeli bankruptcy are, by and large, in terrible financial condition. At least in theory, bankruptcy is probably their only hope to regain some financial stability. Most bankrupts are former small business owners who earned at the time of the petition about half of the average Israeli. With their lower income, the Israeli bankrupts tend to support larger families, and have only tenth as much net income as the general population. The sample debtors had assets' worth half of that owned in the general population, but they owe crushingly more, nearly fifteen times more than their average annualized income. With their net worth on average of approximately \$290,000 less than the net worth of the average Israeli, the petitioners in Israeli bankrupt are those at the tail end of the financial well being of all Israelis.

#### F. ENTREPRENEURS IN BANKRUPTCY

While entrepreneurs in Israel constituted approximately twelve percent of the general population during the mid 1990s,<sup>122</sup> they made up more than sixty-three percent of the bankruptcy sample.<sup>123</sup>

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<sup>120</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 71 (reporting an average total debt to income ratio in the U.S. of 2.76 in 1997).

<sup>121</sup> The average total debt to income ratio was calculated by taking the average total debt and dividing it by the annualized mean income figure for the sampled Canadian bankrupt. See Ramsay, *supra* note 6, at 52 (the mean amount of debts outstanding by the bankrupts was \$134,067); See electronic mail from Iain D.C. Ramsay, York University, to the author (Dec. 30, 2000) (on file with author) (reporting the mean monthly income for the Canadian sampled bankrupt population was \$1,845). The Canadian median total debt to income ratio was 2.14. See Ramsay, *supra* note 6, at 36.

<sup>122</sup> See Gordon & Tolido, *supra* note 42, at 5 (reporting that in 1995 entrepreneurs made up 12% of the working force in Israel); Dafna Schwartz & Daniel Felsenstein, Small Businesses and the Israeli Market, 12

This is in sharp contrast to the composition of the bankruptcy population in the United States and Canada, where a minority of the petitioners are entrepreneurs.<sup>124</sup>

Furthermore, the significant percentages of entrepreneurs in the contemporary Israeli bankruptcy population contrasts with the situation twenty-five years ago when only forty percent of the Israeli petitioners were former entrepreneurs.<sup>125</sup>

The significant increase in entrepreneurs in the Israeli bankruptcy population is largely due to dramatic changes in the Israeli regulatory and economic climate beginning in the late 1980s. Due primarily to goals of nation building and immigrant absorption, and secondarily, to the political and religious background of many early Israeli leaders, a socialist-oriented approach to the market traditionally prevailed in Israel.<sup>126</sup> The economic policies during the early years of the State of Israel combined a strong emphasis on government central control with a very reluctant, suspicious acceptance of private entrepreneurship.<sup>127</sup> Historically, the government's policies not only failed to support

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(Discussion Paper of the Israeli Development Study Center Jan. 1995) (reporting that 12% of the Israeli labor force were entrepreneurs in 1993).

<sup>123</sup> Specifically, 63.1% of the bankruptcy sample were self-employed at the time of bankruptcy. However, this figure may in fact understate the number of entrepreneurs in the bankruptcy population in Israel. A number of petitioners, who were classified as either wage earners or unemployed, were in fact former entrepreneurs who became employed or unemployed after their business failed and before filing for bankruptcy. Indeed, while only 63% of the Israeli bankruptcy sample identified themselves as entrepreneurs, 78% reported business failure as the cause of bankruptcy filing.

<sup>124</sup> See *supra* notes 29 & 30 and accompanying text. However, a recent empirical study in the United Kingdom reported that 65% of individuals' bankruptcy filings were related to business failure. The Insolvency Service Executive Agency of the Department of Trade and Industry, *Bankruptcy: A Fresh Start - A Consultation on Possible Reform to the Law Relating to Personal Insolvency in England and Wales 7* (2000) <found at <http://www.insolvency.gov.uk>> (last visited on June 26, 2000) ("By comparison with other English-speaking OECD countries the number of individual insolvencies is relatively small. However, at some 65%, business related failures represent a far higher proportion of the total than in other countries.").

<sup>125</sup> See Shuchman, *supra* note 15, at 355 n.28 (reporting that two fifths of the bankruptcy petitioners in Israel in 1975-1976 were self employed).

<sup>126</sup> For a general description of the reasons for the traditional pervasive socialist and anti entrepreneurship orientation of the Israeli government, see Rafael Efrat, *The Transformation of the Israeli Bankruptcy System as a Reflection of Societal Changes*, 10 J. TRANS L. & POL. (2001) (forthcoming July 2001).

<sup>127</sup> See YAKIR PLESSNER, *THE POLITICAL ECONOMY OF ISRAEL: FROM IDEOLOGY TO STAGNATION* 77 (1994) ("[During the first twenty years of the Jewish state, the Israeli government] viewed private capital



entrepreneurship<sup>128</sup> but it also affirmatively aimed, directly or indirectly, to significantly restrain and regulate private enterprise.<sup>129</sup> Some of the regulatory steps traditionally taken by the government to restrain small business enterprise have included excessive and bureaucratic business licensing regimes and other informal barriers of entry,<sup>130</sup> adverse tax policies and tax enforcement mechanisms directed at small business owners,<sup>131</sup> limited

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as relatively useless to the national effort. Yet, owing to the lack of national capital, it was necessary to invite private capital to participate, albeit reluctantly.”). See also Eran Razin, *Location of Entrepreneurship Assistance Centres in Israel*, 89 ROYAL DUTCH GEOGRAPHICAL SOC’Y 431, 433 (1998) (“The Israeli political-economic system was not very receptive towards small entrepreneurs, due to socialist bias associated with deep antagonism, or even hostility, towards small-business owners.”); Eran Razin, *Social Networks, Local Opportunities and Entrepreneurship among Immigrants- The Israeli Experience in an International Perspective*, in IMMIGRATION & ABSORPTION: ISSUES IN A MULTICULTURAL PERSPECTIVE 156 (Richard E. Isralowitz et al. eds., 1991) (“Because of a socialist bias, which has been characterized by deep antagonism, and even hostility, toward the self-employed sector, the Israeli political system has not been very receptive to small entrepreneurs.”).

<sup>128</sup> See YAACOV NAHON, [SELF-EMPLOYED WORKERS–THE ETHNIC DIMENSION] 2 (1989) (In Israel, there is no formal specific policy relating to the entrepreneur sector and there is no governmental agency in charge of addressing the particular problems faced by that sector.”); MEIR TAMARI, FIRMOT KETANOT BE’YISRAEL [SMALL BUSINESSES IN ISRAEL] 3 (1991) (“Despite the significant contribution of the small business sector of the Israeli gross domestic product, that sector is still considered an outcast; while it is not prohibited, the government clearly is not creating the conditions necessary for its growth . . . .”); Naftali Greenwood, *The Nightmares of Israeli Small Business* 29 (Discussion Paper of the Institute for Advanced Strategic and Political Studies, Division for Economic Policy Research, Jan. 1990) (“Small business in Israel is a marginal player in the country’s economic arena largely because this is what the country’s establishment prefers.”).

<sup>129</sup> See YAIR AHARONI, *THE ISRAELI ECONOMY: DREAMS & REALITIES* 161-62 (1991) (“In the first decade of statehood, . . . [p]rivate ownership was not assumed to be an acceptable form of pioneering activity. Since the 1960s, the government has veered sharply away from direct control, but this has not meant a free market. The Israeli economy is still highly politicized, and it is almost impossible to be successful in a business without a favorable government attitude.”); PLESSNER, *supra* note 127, at 11 (“[T]he dominating role played by the government during the first two decades created an environment hostile to private enterprise. . . .”).

<sup>130</sup> See AHARONI, *supra* note 129, at 240 (1991) (“The need to receive a license for almost any activity may have been a major curb, restraining private initiative. . . .”); *id.* at 330 (“There are very high barriers to entry into [the old-boy network] . . . and the economic system has remained highly politicized, keeping the newcomers, the small entrepreneurs and those unknown to it outside the establishment.”); Greenwood, *supra* note 128, at 19 (describing the licensing nightmare he faced, one restaurant owner was quoted as saying:” First I thought I’d get the licenses and then open up. But you can’t. You have to get one license before another, this license together with that one, and so on. . . . What you do is apply for a license and get a piece of paper affirming that it’s pending. You take that to the other bureaus and apply for the other licenses. They give you the same kind of document: license pending until you get the first license. This goes on and on until you’re a license-processor, not a restaurateur. I shut down not because I was going broke, nor because the authorities cracked down on me, but because I was just sick of it.”).

<sup>131</sup> Small business owners have identified four main problems with the Israeli revenue service and its regulatory regime. First, the corporate tax code requires businesses to prepay their tax in the beginning of every year based on the previous year’s earnings, or, in the case of a new business based on the relevant sector’s historical average profit margin. “If [a business] meets with hard times, however, it will find itself remitting taxes it does not owe, in cash, month after month, when it can least afford it. . . . Companies in

social welfare benefits offered to small business owners,<sup>132</sup> indifferent army reserve policy towards entrepreneurs,<sup>133</sup> and limited public disclosure of information relating to the business regulatory requirements.<sup>134</sup>

Israel's hostile small business regulatory environment was made even more difficult by adverse macro-economic conditions there. Particularly, high inflation and high interest rates had made transacting business unpredictable, more costly and hence less desirable.<sup>135</sup> Furthermore, the monopolistic structure of various sectors in the economy had intensified the entry barriers for many would-be entrepreneurs.<sup>136</sup>

Those who ventured into business despite these regulatory obstacles and inhospitable economic conditions, found the biggest challenge to be obtaining business credit. Until recently, the Israeli Central Bank's macroeconomic policy of containing

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these circumstances find themselves covering the advances out of capital or bank credit, hoping to survive until their tax returns are filed and the remittances refunded." Greenwood, *supra* note 128, at 16. The second main complaint relating to the tax regulations was with its unpredictability. "In the ambience of crisis that characterizes Israel's economic decision-making, legislators and senior bureaucrats introduce new taxes, invoke surtaxes, and stiffen regulations in the middle of fiscal years, irrespective of the effect this has on business." *id.* at 22-23. Next, some have complained about the overzealous enforcement mechanism used by the tax authorities towards small business owners. *See id.* at 27-28. Lastly, the relatively heavy tax burden imposed on small businesses makes it difficult for many entrepreneurs to operate and succeed. *See TAMARI, supra* note 128, at 24-25 ("Taxes have a significant component of a firm's expenses. In Israel, the problem is worse than most other countries. The marginal tax in Israel constitute 46% of the gross domestic product, compared to 37% in England and West Germany, and 30% in the U.S. and Japan.").

<sup>132</sup> *See* Greenwood, *supra* note 128, at 15 ("By venturing out of the welfare-state cocoon that protects fully employed Israelis, the small-business owner maneuvers without the wage-earner's sturdy safety net, precisely while he finances this set of safeguards for employees. Most conspicuous among the forfeited benefits is unemployment compensation, second only to reserve-duty compensation in importance for the wage earner. The entrepreneur receives neither credit nor discount from the [National Insurance Institute] for this handicap.").

<sup>133</sup> *See id.* at 14-15 (describing the difficulties faced by male small business owners when ordered once a year to take time off from running the business to serve in the army reserve).

<sup>134</sup> *See id.* at 17 (describing the difficulties faced by small business owners in Israel in locating relevant information about the regulatory requirements of operating his/her business).

<sup>135</sup> *See* Felsenstein & Schwartz, *supra* note 99, at 229 ("At the macro level, rising levels of inflation, such as those experienced throughout the 1980s, hamper the financing, pricing and exporting schedules of small firms. High interest rates discourage investment in small businesses and the upgrading of capital stock").

<sup>136</sup> *See id.* ("Furthermore, the monopolistic structure of some of the leading manufacturing and service sectors in many economies. . . , constitute an obstacle to small firm growth [in Israel]."); *See also*

inflation severely curtailed credit to the private market, including credit to small businesses, causing interest rates to rise significantly.<sup>137</sup> By virtue of its ownership of the major banks in Israel, the government tightly regulated the private sector lending industry by imposing burdensome limits on banks' lending and instituting high reserve requirements.<sup>138</sup> As a result, banks in Israel have had limited funds to lend. Under government mandate, the limited funds that banks were authorized to lend were largely used to finance government budget deficits.<sup>139</sup> The limited funds remaining for the private sector were largely extended to a list of government-approved enterprises, mostly large government-owned business entities.<sup>140</sup>

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Felsenstein & Schwartz, *supra* note 99, at 233 (describing the difficulties faced by small firms in Israeli peripheral areas due to the Israeli monopolistic economic structure).

<sup>137</sup> See AHARONI, *supra* note 129, at 233 (describing the highly restrictive monetary policy vigorously pursued by the Israeli Central Bank, the Bank of Israel, resulting in extremely high real interest rates); YISRAEL BAR-YOSEF, *BANK YISRAEL: LE'HALACHA VE'LEMAASE* [BANK OF ISRAEL: THEORY & PRACTICE] 143 (1985) (explaining that since 1950, the Israeli government has pursued monetary steps to slow down the inflation, including the control of the private credit market).

<sup>138</sup> See AHARONI, *supra* note 129, at 239 ("The major instrument of government control in Israel is its absolute control of all sources of capital. All credit flows in the capital market are regulated by the government."); BAR-YOSEF, *supra* note 137, at 136 (explaining that the high liquidity rate imposed by the governments on banks in Israel was done primarily to restrict the expansion of bank credit to the private market); Jacob A. Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in *FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION* 368, 368 (Mario I. Blejer & Marko Skreb eds., 1999) ([U]p to about 1987-88, the government was practically the sole player in the financial sector. The government determined the terms of borrowing, the financial spreads, and, as a matter of fact, the entire balance sheet of the banking sector.); Jonas Prager, *Banking Privatization in Israel, 1983-1994: A Case Study in Political Economy* 4-5 (Discussion Paper of the Institute for Advanced Strategic and Political Studies, Number 22, 1995) ("In the early years, [the Israeli Central Bank's] macroeconomic objectives, especially the containment of inflation, led the authorities to constrain bank credit, first by imposing quantitative limits on bank lending and later by using more indirect methods such as high reserve requirements.").

<sup>139</sup> See Prager, *supra* note 138, at 4-5 ("Furthermore, giving the banks free rein ran counter to sating the voracious appetite of a deficit-ridden government, which had resulted in the Treasury's stranglehold on the capital market.").

<sup>140</sup> See AHARONI, *supra* note 129, at 235 ("[The Israeli government] used the financial institutions as agents to grant loans for objectives it had defined. . . . These financial institutions may have looked autonomous, but in fact they were totally dependent on the government's directives."); Arieh Bar, *Government Policy Towards Small Businesses in Israel*, in *HETCHADSHUT VE'ZMICHIA BA'MIGZAR HA'ASAKIM HAKTANIM* [MODERNIZATION AND GROWTH IN THE SMALL BUSINESS SECTOR: LESSONS FOR PUBLIC POLICY] 105, 105-06 (Moseh Justman ed., 1994) (describing traditional governmental reliance on and preference for large scale businesses as way of providing jobs); Gordon, *supra* note 99, at 86 ("Since Israel's establishment, the economic planning was central, preferring large businesses, most of which were government owned . . ."); Meir Tamari, *Corporate Finance under Conditions of Government Intervention: The Israeli Case, 1950-*

As a result of these governmental actions, credit for entrepreneurs was generally unavailable in Israel until the late 1980s.<sup>141</sup> Moreover, the banks themselves were extremely hesitant to extend credit to small business owners, preferring instead to concentrate on the more profitable large-scale business loans.<sup>142</sup> When banks were willing to extend loans to small business owners, many of the small business applicants did not meet the bank's stringent collateral requirements.<sup>143</sup>

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1972, 112 (Discussion Paper, Bank of Israel Research Department 1979) (“[B]anks in Israel give precedence in granting credit and loan capital to large firms. . . Government policy has been to foster the establishment of large units. . . .”); *id.* at 145-46 (“It is worthwhile for the banks to cooperate with the government and the Bank of Israel, since otherwise these funds would not be available to them. It follows, therefore, that the banks do not have exclusive control over the allocation of bank credit. At the time of writing over 70 percent of total bank credit extended to the manufacturing sector consists of such directed credit.”); *id.* at 192 (“[T]he amount of bank credit which a firm received is heavily influenced by the economic policy of the government and the credit policy of the Bank of Israel.”).

<sup>141</sup> Greenwood, *supra* note 128, at 19 (“Undercapitalization is the nemesis[sic] of small businesses anywhere. In Israel, however, a set of government-created and –abetted factors make it virtually preordained.”); Naftali Greenwood, *Nightmares of Israeli Small Business- Update and Sequel 2* (Discussion Paper of the Institute for Advanced Strategic and Political Studies, Division for Economic Policy Research, July 1993) (describing how government-sanctioned monopolies and favored oligarchies in Israel have traditionally crowded out small businesses in the credit market).

<sup>142</sup> See Felsenstein & Schwartz, *supra* note 99, at 233 (“In the Israeli context, . . . small firms are perceived as high risk, and small peripherally located . . . firms are a source of even greater uncertainty. The result is a particularly conservative attitude on the part of the commercial banks to financing small business.”); TAMARI, *supra* note 128, at 16 (“In Israel today [during the late 1980s] there is only one bank that operates a special unit specializing in the credit needs of small businesses.”); Gordon, *supra* note 99, at 87 (describing the preference traditionally given by the banking industry in Israel to large business enterprises); *id.* at 89 (suggesting that it was very hard for small business owners to obtain business financing in Israel). In fact, large firms have traditionally received a disproportionate share of credit financing from banks in Israel. See Tamari, *supra* note 140, at 158 (“In Israel too the large companies receive more credit. . . . A further indication of the inequality of the distribution of bank credit may be gauged from the fact that in 1972, 10 percent of the companies received about 70 percent of the bank credit granted to manufacturing firms in that year.”); *id.* at 191 (“The large firms [in Israel] received more bank credit relative to the value of their production than did small firms.”).

Financing difficulties faced by the Israeli small firms is not unique to Israel. See generally M. Binks *Finance for Expansion in the Small Firm*, 157 LLOYDS BANK REV. 32 (1979); R.A. Licht, *Small Business Capital Formation*, in *LIVING ON THE LEADING EDGE; STATE POLICY ISSUES FOR EDUCATION AND ECONOMIC DEVELOPMENT IN A GLOBAL ECONOMY* 19 (1986); Felsenstein & Schwartz, *supra* note 99, at 233 (“First, commercial banking system is generally not equipped for dealing with small firms’ financing needs. . . . Banks will therefore prefer to deal with larger businesses. In addition, small firms are perceived as high-risk investments with low-level repayment records. This encourages conservative lending policies.”).

<sup>143</sup> See Bar, *Government Policy Towards Small Businesses in Israel*, *MODERNIZATION AND GROWTH IN THE SMALL BUSINESS SECTOR: LESSONS FOR PUBLIC POLICY*, *supra* note 140, at 113 (describing the traditional difficulties faced by small business owners in Israel seeking financing from banks who were unwilling to undertake much financial risk unless the applicant was able to provide them with collateral valued higher than the amount of the loan); Greenwood, *supra* note 128, at 16 (suggesting that banks in Israel have

Interestingly, while in the early days of the statehood, the need to provide jobs for the unemployed and newly-arrived immigrants was the main reason for the anti-entrepreneur regulatory environment,<sup>144</sup> in the late 1980s the need to provide jobs for the increasing unemployment rolls and for a new wave of immigrants led to a much more friendly regulatory environment for entrepreneurs. In the late 1980s, massive new waves of immigrants began to arrive to Israel from the former Soviet Union.<sup>145</sup> Concurrently, unemployment rates among veteran Israelis had increased at an alarming rate.<sup>146</sup> Faced with the need to provide more jobs, the government was first inclined to use public funds to finance that overwhelming task. However, due to hyperinflation in the early 1980s, which had just been curtailed,<sup>147</sup> the government was hesitant to use deficit spending to create jobs,<sup>148</sup> for that could have rekindled inflation. Instead, the government relied heavily on the then recent studies from a number of countries, which demonstrated the

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traditionally demanded that their small business loans will be fully collateralized, a demand many new small business owners were unable to fulfill especially because they were prohibited by law from mortgaging their home).

<sup>144</sup> See *supra* note 126 and accompanying text.

<sup>145</sup> See Miri Lerner & Yeoshua Hendeles, *New Entrepreneurs and Entrepreneurial Aspirations among Immigrants from the Former U.S.S.R. in Israel*, 36 J. BUS. RES. 59, 59 (1996) (reporting that almost half a million immigrants from the former Soviet Union moved to Israel between 1989 and 1993).

<sup>146</sup> See Michael Bruno & Leora R. Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel's Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH 241, 241 (Michael Bruno, et al. eds., 1991) (“In the second half of 1987 a recession developed; it deepened into a real slump in economic activity in 1988 and 1989, with GDP growth falling to around 1% per annum, unemployment gradually rising to 9.5% by the second half of 1989); Gordon, *supra* note 99, at 87 (reporting unemployment rate in Israel of 11% in 1992).

<sup>147</sup> See Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION, *supra* note 138, at 368 (“[Before 1985, Israel] was experiencing an inflation rate of 450 percent that was reduced, within a year, to 18 percent.”).

<sup>148</sup> See Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel's Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 241 (describing that following the 1985 stabilization program in Israel, the “government deficit came down from an average of around 15% of GNP in the preceding decade to a complete balance and even a slight surplus in 1986 . . .”). The government’s efforts in significantly reducing the budget deficit reflected the government’s new attitude toward fiscal policy, which included a reduction in public expenditures. *Id.* at 252.

economic importance of entrepreneurship as a way of creating jobs.<sup>149</sup> As a result, in a dramatic shift of orientation, the government has begun to actively encourage and support entrepreneurship in order to provide work for the unemployed and recent immigrants.<sup>150</sup>

Beginning in the late 1980s, the government has encouraged small business growth in several ways. First, by forming agencies to encourage, educate and assist small businesses owners,<sup>151</sup> and second by reducing the regulatory obstacles associated with

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<sup>149</sup> See Bar, *Government Policy Towards Small Businesses in Israel*, in MODERNIZATION AND GROWTH IN THE SMALL BUSINESS SECTOR: LESSONS FOR PUBLIC POLICY, *supra* note 140, at 107-08 (suggesting that the government attitude towards the small business sector in Israel was prompted by studies in the U.S. and Britain demonstrating the significant job contribution of the small business sector to the economy); Daniel Felsenstein & Dafna Schwartz, *Factors that Delay the Growth of Small Businesses: Findings from Israeli Periphery*, 44-45 OFAKIM BE'GEOGRAPHIA 27, 27 (1996) (explaining how studies from various other countries shaped Israeli government disposition towards entrepreneurship); Gordon, *supra* note 99, at 86 (suggesting that it was not until the late 1980s that the Israeli government had realized the valuable contribution of small businesses to the creation of jobs, which was readily apparent in developed countries since the 1970s). Concurrently, Israeli government officials were disappointed from the recent failures of many of the government owned large-scale business entities, which were proven ineffective long-term solution in providing jobs. See Daniel Felsenstein & Dafna Schwartz, *Promoting and Financing Small Firms - What can We Learn from Experience Elsewhere?* 6 (1991)(unpublished manuscript on file with author).

<sup>150</sup> See Razin, *Social Networks, Local Opportunities and Entrepreneurship among Immigrants- The Israeli Experience in an International Perspective*, in IMMIGRATION AND ABSORPTION: ISSUES IN A MULTICULTURAL PERSPECTIVE, *supra* note 127, at 155 (“[S]ince 1989, the urgent need to accommodate and absorb the new immigration wave from the USSR, in the face of economic stagnation and limited public resources, has aroused interest in entrepreneurship as a path of absorption.”); Razin, *supra* note 127, at 433 (“The pressing need to absorb [the newly arrived immigrants] . . . in the Israeli labour market has led to the acknowledgment of entrepreneurship assistance as a cost-effective means to create jobs.”). The shift in the Israeli government orientation towards the small business sector was reflected in a government led revised school curriculum in the early 1990s whereby entrepreneurship was added to the school curriculum for the first time. See Joseph Shimron & Dani Klos, *Entrepreneurial Education Makes its Debut in Israel: New Curriculum in an Ideological Shift*, 26 CURRICULUM INQUIRY 25 (1996).

<sup>151</sup> See Bar, *Government Policy Towards Small Businesses in Israel*, in MODERNIZATION AND GROWTH IN THE SMALL BUSINESS SECTOR: LESSONS FOR PUBLIC POLICY, *supra* note 140, at 108-17 (detailing the various educational programs, incubators programs, and mentorship programs created by the government to foster the creation and success of small businesses in Israel beginning in the early 1990s); Lerner & Hendeles, *supra* note 145, at 59 (reporting that the Israeli government has established special agencies to incubate small businesses); *id.* note 124, at 59 (“In an attempt to cope with [higher unemployment, the Israeli] government policies have aimed at encouraging self-employment and small-scale entrepreneurship.”); Razin, *Social Networks, Local Opportunities and Entrepreneurship among Immigrants- The Israeli Experience in an International Perspective*, in IMMIGRATION & ABSORPTION: ISSUES IN A MULTICULTURAL PERSPECTIVE, *supra* note 127, at 156 (“[B]y 1991, numerous loan funds and incubator projects, aimed at assisting various types of entrepreneurs, have been in various phases of formation.”); Razin, *supra* note 127, at 433 (“Numerous programmes for entrepreneurship and small-business assistance have been instituted since 1990. Small-business loan funds (established by the Government and by the Jewish Agency), and educational programmes (operated by the Ministry of Industry and Trade) had a national scope in most cases.”).

running a small business in Israel.<sup>152</sup> However, the most important factor in encouraging small business growth was the significant increase in the supply and affordability of bank credit.<sup>153</sup> The supply of credit to the private market in general and to the small business sector in particular increased primarily due to the Stabilization Plan of 1985, which reduced government deficit borrowing from banks.<sup>154</sup> Also, the supply of credit increased due to banking deregulation,<sup>155</sup> which reduced banks' reserve requirements<sup>156</sup> and almost

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<sup>152</sup> See Felsenstein & Schwartz, *supra* note 149, at 27 (indicating that the Israeli government has recently adopted various plans for encouraging small businesses by reducing some of the obstacles facing them); Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION, *supra* note 138, at 369 (reporting that as part of the banking deregulation in Israel “practically all nonprudential regulations that imposed various types of constraint on transactions were eliminated.”). Nonetheless, regulatory obstacles still remain. See Greenwood, *supra* note 141, at 6-7.

<sup>153</sup> Credit affordability significantly increased once interest rates dropped in 1989 almost to international levels. See 2 MEIR HA’T, HA’BANKAOT BEYISRAEL [BANKING IN ISRAEL] 100 (1994) (indicating that in 1989-1990 the Israeli Central Bank acted to reduce the cost of bank credit); Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel’s Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 243; *id.* at 257 (“By 1989 both nominal and real [interest] rates had dropped drastically.”); Martina Copelman, *The Role of Credit in Post-Stabilization Consumption Booms*, 13 (Board of Governors of the Federal Reserve System International Finance Discussion Papers, Number 569, Oct. 1996) (indicating that real interest rate per year in Israel has declined from 26.4% in 1985 to 4.4% in 1990).

<sup>154</sup> See 1 HA’T, *supra* note 153, at 108 (reporting that beginning in 1985 there was a steep decline in government borrowing (as government deficit spending declined) and a corresponding steep increase in private sector borrowing); Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel’s Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 260 (“The drop in the government deficit also enabled a substantial increase in domestic credit expansion . . . .”); Yakir Plessner, *Monetary Policy in Israel in 1991*, 2 (Discussion Paper of the Institute for Advanced Strategic and Political Studies, Division for Economic Policy Research, Aug 1992) (“The changes which swept the financial markets from 1985 to 1990 were dramatic. . . . The government also reduced the budget deficit, lowering its borrowing requirements.”); *id.* at 2 (reporting that beginning in 1985 “[t]he government beat a substantial retreat from the credit market, causing the proportion of free credit to grow until it claimed the lion’s share of the market.”).

<sup>155</sup> See generally ASSAF RAZIN & EFRAIM SADKA, *THE ECONOMY OF MODERN ISRAEL: MALAISE AND PROMISE* (1993) (describing the process of the Israeli financial markets deregulation starting in 1985).

<sup>156</sup> See Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION, *supra* note 138, at 368 (as part of the deregulation of the banking industry in Israel “reserve requirements were reduced in a very fundamental manner. In 1987, the average reserve requirement was 63 percent. In 1995, the average reserve requirement was less than 10 percent . . .”).

eliminated banks' directed credit,<sup>157</sup> leaving banks more funds to lend to the small business sector.<sup>158</sup>

Thus, while for many years the government restricted banks' ability to lend to the entrepreneurial sector, in the late 1980s, the government began to give banks more discretion to lend to the small business sector, and to encourage banks to make such loan. That is, in addition to reducing banks' liquidity requirements, eliminating government deficit spending, and reducing the directed loan requirements, the government has also encouraged small business lending by making it easier for banks to collateralize their loans made to small business owners. In 1989, the Israeli Central Bank for the first time permitted banks to obtain a mortgage lien on the borrower's house and allow the borrower to invest the mortgage loan proceeds in his/her business.<sup>159</sup> Furthermore, in the late 1980s the government embarked on direct financing and loan guaranty programs to small business owners,<sup>160</sup> including high-risk entrepreneurs.<sup>161</sup>

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<sup>157</sup> See SHLOMI SHUV, THE ISRAELI BANKING MARKET 11 (1997)(unpublished manuscript on file with author) ("The government's attitude toward the banking system turned around in 1985 under the reforms of the National Unity Government . . . . The results of the liberalization were quite substantial: the proportion of undirected credit (i.e., credit that the banks could issue at their own discretion, not by government dictate) in the banks' credit portfolio rose from 32 percent in 1985 to 80 percent in 1995."); See Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION, *supra* note 138, at 368 (indicating that by the mid 1990s almost all credits in Israel became non-directed).

<sup>158</sup> See 2 HA'T, *supra* note 153, at 106 (describing the decline in banks' lending volume to large business entities beginning in the 1980s); Moshe Koren, *Shikulim Bebniyat Tik Ashrai Be'Bank Mischari* [*Considerations in Creating a Credit Portfolio in a Commercial Bank*], 9 SUGIYOT BE'BANKAOT 49, 49 (1989) (indicating that in contrast to traditional shortage in credit availability, most recently commercial banks have experienced oversupply of such credit); Wisebrod et al., *supra* note 71, at 67 (reporting that between 1991 and 1999 the banks' credit portfolio in Israel had substantially increased at the approximate rate of 107% in real terms). The banks' funds availability also increased in the late 1980s due to the Israeli Central Bank's increase in funds it extended to banks for lending purposes. See 2 HA'T, *supra* note 153, at 100.

<sup>159</sup> See TAMARI, *supra* note 128, at 19.

<sup>160</sup> See ISRAEL'S MINISTRY OF INDUSTRY & TRADE, ENCOURAGING SMALL & MEDIUM ENTERPRISES, 7 (1999) (describing the various loan guaranty programs offered by the government to small and medium sized businesses in Israel); Gordon, *supra* note 99, at 88-89 (generally describing various direct financing programs instituted by the government beginning in the late 1980s aimed at small business owners).



The deregulation of the banking industry in the late 1980s intensified competition among commercial banks.<sup>162</sup> The rise in competition in banking, together with the increased credit supply, resulted in a relaxation of the credit standards for small business loans.<sup>163</sup>

As the regulatory environment became more entrepreneur-friendly, credit became more available to small business owners, and interest rates and inflation decreased,<sup>164</sup> the number of *new* entrepreneurs in Israel has grown dramatically since the mid 1980s.<sup>165</sup>

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<sup>161</sup> See Daniel Felsenstein, An Evaluation of Jewish Agency Small Business Loan Funds 1993-1995, 11 (1995) (unpublished manuscript on file with author)(suggesting that much of the Jewish Agency sponsored financing to small business enterprises were directed at smaller and newer business ventures that were located in the periphery).

<sup>162</sup> Banking activity in Israel has remained highly concentrated. See Frenkel, *Liberalization & Financial Reforms: Lessons from the Israeli Experience*, in FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION, *supra* note 138, at 371 (“In Israel much of the banking activity continues to be concentrated in three major groups of banks. . .”). However, the deregulation of the financial industry has injected strong competition among the players. See Saul Bronfeld, *Capital Market Reform-Yes Indeed*, in CAPITAL MARKET REFORM IN ISRAEL (Marshall Sarnat, ed., 1991) (suggesting that the reform of the credit market in the late 1980s has resulted in “widespread courting of borrowers by financial institutions.”); Koren, *supra* note 158, at 49 (suggesting that the oversupply of credit in the commercial banking industry has intensified competition); Philip Landau, *Israel: Competition Welcome*, 142 THE BANKER 18, 18 (Jan. 1992) (“The impact of [deregulation] on the commercial banks has been varied but generally favourable. On the one hand they have to face competition with foreign banks as Israeli companies can now borrow abroad much more freely. . . . The ending of government fixing of margins and interest rates and the dramatic lowering of liquidity ratios in recent years have made almost every aspect of deposit banking and lending far more competitive.”).

<sup>163</sup> See 2 HA’T, *supra* note 153, at 102-03(describing Israeli banks’ failure to effectively monitor performance by business debtors); SHUV, *supra* note 157, at 11-12 (unpublished manuscript on file with author)(suggesting that the banks’ practices of issuing “easy credit” in the early 1990s were common); Greenwood, *supra* note 141, at 7 (“The relative contraction of the budget deficit has given the banks some latitude in lending to small businesses – even, at times, without shekel-for-shekel collateral.”); Koren, *supra* note 158, at 49 (suggesting that the recent increased supply of credit and increased competition in the credit market in Israel have lowered collateralization requirements in the business lending sector). While the increased competition in the banking industry may have led banks to reduce their credit standards when lending to small business entrepreneurs, the government’s new programs of loan guarantees may have further contributed to the reduction in the traditionally stringent credit standards used by banks in Israel.

<sup>164</sup> See Felsenstein & Schwartz, Promoting and Financing Small Firms - What can We Learn from Experience Elsewhere?, *supra* note 149, at 6 (unpublished manuscript on file with author) (suggesting that the business risk level in Israel has been significantly reduced since in the late 1980s when inflation was stabilized, and interest rates were lowered).

<sup>165</sup> See Gordon & Tolido, *supra* note 42, at 6 (reporting that between 1985 and 1995 the number of new entrepreneurs in Israel rose by 63%). In one study conducted during the late 1990s, Israel (along with Canada and the United States) was ranked as one of the most entrepreneurially active countries. See GLOBAL ENTREPRENEURSHIP MONITOR: 1999 EXECUTIVE REPORT 33 (1999).

The likelihood of long-term success among new entrepreneurs is relatively low.<sup>166</sup> Indeed, of the *new* entrepreneurs in Israel during the late 1980s, only forty-five percent were still operating a business eight years later.<sup>167</sup> The reasons for the high failure rate are numerous, but one study found that over half of the *new* small business owners in Israel had no prior business experience.<sup>168</sup> Studies have demonstrated the adverse impact of lack of business experience on the success of a small business owner.<sup>169</sup> Indeed, the lack of business experience among Israeli entrepreneurs may have led in part to the trend beginning in the late 1980s of declining profitability of small businesses in Israel.<sup>170</sup>

This lack of business experience, the associated decline in profitability, the increase in credit availability to small business owners, and a reduction in credit standards, have all contributed to over indebtedness, financial distress and failure among many of Israeli entrepreneurs during the 1990s.

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<sup>166</sup> See ARNOLD C. COOPER ET AL., SURVIVAL AND FAILURE: A LONGITUDINAL STUDY (1989) (suggesting that 67% of new businesses fail within four years); A.B. Cochran, *Small Business Mortality Rates: A Review of the Literature*, 19 J. SMALL BUS. MGMT. 50 (1981); R. Dickinson, *Business Failure Rate*, 6 AM. J. SMALL BUS. 17 (1981); Robert D. Doyle & Harsha B. Desai, *Turnaround Strategies for Small Firms*, 29 J. SMALL BUS. MGMT. 33, 33 (1991) (“The failure rate among small firms is high, although the exact rate is not known.”); Duane R. Ireland & Philip M. Van Auken, *Entrepreneurship and Small Business Research: An Historical Typology and Directions for Future Research*, \_\_ AM. J. SMALL BUS. 9 (1987) (reporting that nearly one-half of start-ups fail within 18 months).

<sup>167</sup> See Gordon & Tolido, *supra* note 42, at 6 (“In summary, the likelihood of a person, who is registered as a small business owner with Social Security Administration, to remain so for at least a year is relatively high at 85%. Naturally, the likelihood declines as years go by and reaches approximately 50% in the sixth year and 45% in the eighth year.”).

<sup>168</sup> See Gordon & Tolido, *supra* note 42, at 14 (“Half of the new small business owners in 1995 never worked prior to becoming self-employed. That is, they started their career as entrepreneurs. Another 25% were previously registered with the Social Security Administration as students, retirees, unemployed, etc.”).

<sup>169</sup> See H. M. & J. Duker, *Survival and Failure in Small Business*, 24 J. SMALL BUS MGMT. 30 (1986); Jim Everett & John Watson, *Small Business Failure and Extern Risk Factors*, 11 SMALL BUS. ECON. 371, 372 (1998) (“The two primary causes of small business failure appear to be a lack of appropriate management skills and inadequate capital.”); S. Haswell & S. Holmes, *Estimating the Small Business Failure Rate: A Reappraisal*, 27 J. SMALL BUS. MGMT. 68 (1989) (reporting poor managerial skill, incompetence, inefficiency, and inexperience to be a common theme explaining small firm failure); R. A. Peterson, et al., *Perceived Causes of Small Business Failures: A Research Note*, 8 AM. J. SMALL BUS. 15 (1983).

<sup>170</sup> See Gordon & Tolido, *supra* note 42, at 21-22 (reporting that the approximately 46% of the self-employed in Israel in 1995 had total income that was lower than the average earnings in the labor market and that the median income of the self-employed in Israel declined by more than 50% between 1985 and

The data in the bankruptcy files support this hypothesis that the significant presence of entrepreneurs in bankruptcy is largely due to the recent credit deregulation and lax credit standards, which prompted many inexperienced individuals to choose the ultimately ill-fated path of entrepreneurship. First, almost sixty percent of the business-related bankruptcy cases specifically reported lack of business experience as the cause of the business failure and the subsequent bankruptcy filing.<sup>171</sup> Second, the average debt of the small business owner bankruptcy petitioner was an enormous \$303,159, with a median of \$228,571.<sup>172</sup> These high average and median debt figures suggest that significant amounts of credit were available to small business owners in Israel during the late 1980s and early 1990s, and that high indebtedness may have led to their financial vulnerability and subsequent demise. Lastly, the average former small business owner bankruptcy petitioner had an enormous debt burden most of which was unsecured.<sup>173</sup>

While some of the funds were obtained from trade merchants, family members, friends

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1995, from a high of 127% of the average income in the labor market in 1985 to a low of 57% of the average income in the labor market in 1995).

<sup>171</sup> Specifically, 58.5% of cases, where reasons were reported in the bankruptcy file, attributed lack of prior business experience as the cause of the business failure. Petitioners were allowed to report several factors leading to their business demise. This finding coincides with other studies relating to small businesses in Israel. See TAMARI, *supra* note 128, at 20 (reporting that lack of management experience has been identified as the major obstacle facing a small business entrepreneur in Israel); Bar, *Government Policy Towards Small Businesses in Israel*, in HETCHADSHUT VE'ZMICHA BA'MIGZAR HA'ASAKIM HAKTANIM [MODERNIZATION AND GROWTH IN THE SMALL BUSINESS SECTOR: LESSONS FOR PUBLIC POLICY], *supra* note 140, at 107 (suggesting that the cause of many small business failures, that participated in a government financing program, was lack of effective managerial skills). Studies in the U.S. and in the U.K. also identify debtor's mismanagement arising out of lack of business management skills and experience as an important contributor to small business failure. See Warren & Westbrook, *supra* note 88, at 554-57; The Insolvency Service Executive Agency of the Department of Trade and Industry, *Bankruptcy: A Fresh Start - A Consultation on Possible Reform to the Law Relating to Personal Insolvency in England and Wales*, 30-31 (2000) <<http://www.insolvency.gov.uk>> (last visited on June 26, 2000).

<sup>172</sup> After removing outliers, petitioners who were self-employed at the time of bankruptcy had average total debts of 1,061,058 NIS, with a median of 800,000 NIS. The outliers were cases with average total debts in excess of 3,258,312 NIS and lower than 95,352 NIS. Before outliers were removed, the average total debt of entrepreneurs in the sample was 1,184,021 NIS.

<sup>173</sup> Approximately, 89% of the reported debts by the average bankruptcy entrepreneur were identified as unsecured. This figure was calculated by dividing the unsecured debt of each former entrepreneur in the

and the black market, most of the outstanding loans came from financial institutions.<sup>174</sup>

Granting so much unsecured credit, or allowing initially secured debt to become largely unsecured, suggests that these financial institutions failed at times to employ the necessary due diligence measures.<sup>175</sup>

While lack of business experience was the most frequently cited reason for the financial failure, other reported causes include bad luck,<sup>176</sup> fraud by a business partner or an employee,<sup>177</sup> political problems,<sup>178</sup> injurious regulatory environment,<sup>179</sup> natural disaster,

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sample by the related total debt owed by that individual and then computing the average for all these petitioners' individual ratio.

<sup>174</sup> Approximately, 43% of the reported debts by the average bankruptcy entrepreneur were owed to a financial institution. This figure was calculated by dividing the average total debt owed to financial institutions by the average of total debts owed by bankruptcy petitioners who were self-employed at the time of filing.

<sup>175</sup> See *supra* note 163 and accompanying text. Financial institutions in the United States have recently similarly began to expand their unsecured lending portfolio to small business entrepreneurs. See Mann, *supra* note 99, at 13 (“Whatever the reasons for the trend toward unsecured small-business lending . . . , the trend demonstrates that small-business borrowers have an opportunity to borrow unsecured from a bank if that is what they prefer.”). However, such practices by the lending institutions in the United States have not necessarily resulted in relaxation of the credit standards to small business owners. Instead, the lending institutions have been proactively using various advances in information technology, including credit scoring for small businesses and early warning systems, to minimize risk. See *id.*, at 30 (“In particular, two technological developments significantly enhance the information available to small-business lenders, thus allowing lenders to evaluate small-business loans more carefully at lower cost. By lowering the general riskiness of those loans, the technological developments limit the opportunities for secured credit to offer an improvement in the lender’s position.”).

<sup>176</sup> Specifically, 57.3% of cases, where a reason for the business loss was reported, have attributed bad luck as a cause of the business failure. To the extent more than one factor led to the business demise, more than one cause was tabulated.

<sup>177</sup> Specifically, 20.7% of cases reporting a reason for business failure listed fraud by business partner or an employee as a cause of the business failure. See *e.g.*, Official Receiver Case Number 96/588 (Central District)(the main reason for the bankruptcy filing identified by the former business owner was embezzlement by a high level employee while the petitioner was hospitalized for chemotherapy).

<sup>178</sup> Specifically, 12% of cases reporting a reason for business failure attributed their business failure to political instabilities, such as the Gulf War, terrorist activities, and cancellations of government granted work permits to Palestinians from the territories. See Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel’s Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 247-48 (“The uprising in the territories that began in December 1987 affected the Israeli economy through its contractionary effects on the supply of labor to the business sector (mainly in the construction industry) and on the output demand side (mainly a decline in tourism and in Israel’s exports to the territories). See *e.g.*, Official Receiver Case Number 1554/96 (Southern District) (as a reason for the business failure, the debtor cited difficulties in obtaining Palestinian workers from the territories to work at his contractor business); Official Receiver Case Number 184/96 (Jerusalem)(debtor’s business failed in part due to a significant decline in tourism following Palestinian riots); Official Receiver Case Number 135/97 (Jerusalem)(debtor’s construction business collapsed after he was unable to complete several jobs on time following a Palestinian bus bombing in Jerusalem); Official Receiver Case Number

and other reasons. Among the “other reasons” were petitioner’s debtors not paying their obligations to him,<sup>180</sup> the need to care for an ailing relative or to take care of a medical problem facing the entrepreneur,<sup>181</sup> high interest black market debt,<sup>182</sup> and adverse macro-economic conditions<sup>183</sup>.

While former entrepreneurs primarily resorted to bankruptcy due to a failing business,<sup>184</sup> some non-entrepreneurs also identified business failure as the cause of their

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1060/97 (Northern District)(debtor’s auto parts wholesale business failed in part due to a rising trend of car thefts by Palestinians who then sold the spare parts at below cost in Israel).

<sup>179</sup> Specifically, 2.4% of cases where reason for the business loss were reported have attributed their business failure to injurious regulatory environment in Israel, including changes in law that adversely affected one’s business and high taxation. *See* TAMARI, *supra* note 128, at 24-25 (describing the tax burdens facing small business entrepreneurs in Israel). *See e.g.*, Official Receiver Case Number 1060/97 (Northern District)(the debtor’s auto parts distribution business failed partly due to changes in government import duties).

<sup>180</sup> *See e.g.*, Official Receiver Case Number 101/988 (Central District)(defaulting debtors of the petitioner caused significant distress to the petitioner’s business as he incurred additional collection costs, he was unable to buy new inventory for his business or to pay down existing obligations); Official Receiver Case Number 263/97 (Central District)(debtor’s meat production business collapsed after three big customers failed to pay outstanding accounts receivable in excess of two million dollars); Official Receiver Case Number 380/97 (Central District)(customers’ failure to pay on time led to the debtor’s financial deterioration).

<sup>181</sup> *See e.g.*, Official Receiver Case Number 96/588 (Central District)(the former business owner’s financial demise was partly related to her absence from her business due to a prolong hospitalization undergoing chemotherapy treatment); Official Receiver Case Number 1058/97 (Northern District)(petitioner’s business failed because she was unable to devote her time to running it as she was needed to care for her ailing father); Official Receiver Case Number 546/96 (Central District)(debtor’s shoe business failed partly due to his addiction to heavy drugs).

<sup>182</sup> *See e.g.*, Official Receiver Case Number 1597/96 (Southern District) (the debtor’s entire financial trouble arose out of signing outstanding personal guarantees many of which substantially increased in the amounts outstanding due to accrual of extraordinarily high interest as they were owed to creditors from the black market); Official Receiver Case Number 183/96 (Central District)(financial trouble reportedly an outgrowth of undertaking of credit from the black market to finance debtor’s business); Official Receiver Case Number 185/98 (Jerusalem District)(the debtor’s reported downfall was due to the taking of business loans from the black market at exceedingly high interest rates).

<sup>183</sup> *See* Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel’s Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 247 (“The recession [in Israel] deepened, reaching its nadir in mid- 1989.”). *See e.g.*, Official Receiver Case Number 132/96 (Northern District)(the debtor cited recessionary market conditions and high interest rates as the causes of his business failure).

<sup>184</sup> Specifically, 98% of the bankruptcy petitioners, who were former entrepreneurs, identified business failure as the cause of the bankruptcy filing. The vast majority of former entrepreneurs in the bankruptcy sample had to sign a personal guaranty of their business debts to obtain the loans from the financial institution. Specifically, 71% of the petitioners who were self-employed at the time of the bankruptcy filing had personally guaranteed their business loan. Obtaining a personal guaranty from the principal of the small business owner is a common practice in the United States. *See* Jeremy Berkowitz & Michelle J. White, Bankruptcy and Small Firms’ Access to Credit 2 (June, 2000) (Discussion Paper #00-005 John M.

financial distress.<sup>185</sup> These individuals were driven into bankruptcy due to failure of a business owned by someone else whose debts they had guaranteed.<sup>186</sup>

The financial condition of the average former entrepreneur in bankruptcy is dire.<sup>187</sup> The former small business owner had average debts more than ten times higher than those of individuals in the general population.<sup>188</sup> At the same time, the average former entrepreneur had total assets equal to one half of what is owned by the average individual in the general population,<sup>189</sup> and an income at the time of filing equal to only

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Olin Center for Law & Economics at the University of Michigan Law School) (“[L]enders to small corporations often require that the owner guarantee the firm’s debts . . . .”); Mann, *supra* note 99, at 23 (“The practices of small-business lenders support that analysis. The lenders to whom I spoke uniformly reported policies requiring personal guaranties by the principals of their borrowers in all but the most unusual circumstances.”). As a result, many of the small business owners filing bankruptcy in the United States (and elsewhere) do so due to the personal guaranty they have signed in favor of their now defunct business. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 109 (“Most small businesses [in the U.S.] can get credit only when the owner agrees to personal liability, so it was no surprise to find small business owners in bankruptcy.”); Ramsay, *supra* note 6, at 60 (“The relatively large number of bankruptcies [in Canada] related to personal guarantees for business debts deserves further investigation . . . .”).

<sup>185</sup> Specifically, 27.1% of bankruptcy petitioners, who were employees at the time of filing, identified business failure as a cause of their bankruptcy filing.

<sup>186</sup> While the majority of the petitioners who have guaranteed a business debt did so to obtain a loan for his or her business (58.1%), 26.6% of them did so in favor of a family member and 15.3% of them did so in favor of a colleague or a friend. See e.g., Official Receiver case number 1597/96 (Southern District) (the debtor’s entire financial trouble arose out of signing 18 personal guarantees benefiting his brother’s now defunct business enterprise); Official Receiver case number 5037/97 (Southern District) (the debtor, an unemployed unskilled laborer, filed for bankruptcy protection after signing several personal guarantees in favor of his former employer); Official Receiver case number 106/98 (Central District) (the 51 years old clerk has filed for bankruptcy protection because the personal guarantees he signed on behalf of his son’s business were now in default).

<sup>187</sup> Similar observation was made relating to bankrupt entrepreneurs in the United States. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 116 (“A distinctive feature of bankrupt entrepreneurs was that they carry extraordinary high debt levels, with particularly high levels of unsecured debt.”).

<sup>188</sup> After removing outliers, the average amount of debts owed by petitioners who were self-employed at the time of the bankruptcy filing was \$303,159 or 1,061,058 NIS. The outliers were cases with average total debts in excess of 3,258,312 NIS and lower than 95,352 NIS. Before outliers were removed, the average total debt of entrepreneurs in the sample was 1,184,021 NIS, or \$338,291. At the end of 1998, the average amount of debts owed by individuals in the general population in Israel was \$33,650 (117,777 NIS). See *supra* note 81 and accompanying text.

<sup>189</sup> After removing outliers, the average value of assets owned by petitioners who were self-employed at the time of the bankruptcy filing was \$71,104, or 248,864 NIS. The outliers were cases with average total assets worth more than 1,300,000 NIS. Before outliers were removed, the average worth of total assets was 304,389 NIS, or \$86,968. At the end of 1998, the average value of assets owned by individuals in the general population in Israel was \$132,865. See *supra* note 71 and accompanying text.

half the average earnings of the general population.<sup>190</sup> Lastly, the average debt to income ratio of former entrepreneurs was seventeen times higher than of the general population.<sup>191</sup>

#### G. WAGE EARNERS IN BANKRUPTCY

In the Israeli bankruptcy sample, only twenty-four percent of the petitioners were wage earners, compared to over sixty-three percent who were entrepreneurs.<sup>192</sup> Wage earners filed bankruptcy for variety of reasons, but they primarily identified excess personal debts<sup>193</sup> and failing health as the leading causes of their bankruptcy filing.<sup>194</sup>

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<sup>190</sup> After removing outliers, the average aggregate income of petitioners who were self-employed at the time of the bankruptcy filing was \$1,667, or 5,837 NIS. The outliers were cases with average total income greater than 15,000 NIS. Before outlier were removed, the average income of the entrepreneur in the sample was 6,116 NIS, or \$1,747. In 1997, the average aggregate income of individuals in the general population was \$3,118 (10,915 NIS). *See supra* note 49 and accompanying text.

<sup>191</sup> The average debt to income ratio among the bankruptcy petitioners who were identified as self-employed at the time of bankruptcy filing was calculated by dividing total debts for each such petitioner in the sample by his or her average total annualized household income and then computing the average for all such petitioners' individual debt-to-income ratio. After removing outliers, the average debt-to-income ratio of entrepreneurs was 17.2. The outliers were cases with debt-to-income ratio higher than 71. Before outliers were removed, the debt-to-income ratio was 23.8. The median debt to income ratio for the former entrepreneurs in the Israeli bankruptcy sample was 14. The standard deviation was 45. The average debt to income ratio in the general population was less than one. *See supra* note 119 and accompanying text.

<sup>192</sup> This figure may in fact overstate the composition of wage earners in the Israeli bankruptcy sample. A number of petitioners, who were classified as wage earners, were in fact former entrepreneurs who became employed just before filing their bankruptcy petition after their business failed. Indeed, while only 63% of the bankruptcy sample identified themselves as entrepreneurs, 78% reported business failure as the cause of bankruptcy filing.

<sup>193</sup> Almost 17% of wage earners reported excessive personal debt undertaking as a cause of bankruptcy. Approximately 60% of wage earner petitioners had non-mortgage consumer debt. The median non-mortgage consumer credit held by the Israeli wage earner in the bankruptcy sample was \$4,584 (or 16,044 NIS). Since banks in Israel commonly extend non-mortgage consumer credit in the form of an overdraft account, the figure reported here includes credit card balances as well as overdraft account balances. In contrast, in the U.S. between 80% and 90% of the bankruptcy petitioners list credit card debt when they file. *See THE FRAGILE MIDDLE CLASS, supra* note 3, at 120. Also, in the U.S. 24% of the petitioners reported excessive personal credit as the cause of bankruptcy. *See id.* at 133. Lastly, the median non-mortgage consumer debt of wage earners in the American bankruptcy sample in 1997 was \$9,345, more than twice that of the Israeli wage earner petitioner. *See id.* at 122.

<sup>194</sup> A little over 12% reported failing medical condition as a cause of insolvency. To the extent more than one factor led to the bankruptcy filing, more than one cause was tabulated.

Layoffs from work<sup>195</sup> and family turmoil were reported in fewer cases as causes of bankruptcy.<sup>196</sup>

That wage earners constitute less than a quarter of the bankrupts in Israel marks a change from thirty years ago, when the majority of the bankrupts were employees.<sup>197</sup> Also, the Israeli sample's percentages of wage earners vs. entrepreneurs are diametrically different from the composition in the United States and Canada, in which the majority of the bankruptcy petitioners are wage earners.<sup>198</sup>

There are three reasons for so few wage earners in the Israeli bankruptcy sample. First, since Israel is largely a welfare state, the government provides a relatively generous welfare package to wage earners who lose their jobs.<sup>199</sup> As a result, being laid off from work does not necessarily amount to financial ruin since government safety net relieves, to a great extent, the financial stress of job loss. In contrast, entrepreneurs in Israel do not enjoy similar levels of safety net and hence are financially more vulnerable.<sup>200</sup>

Second, wage earners may be discouraged from filing because of the bankruptcy legal culture's harsh informal practices and attitudes directed at wage earners who

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<sup>195</sup> Approximately, 6% of the wage earners reported unemployment as a cause of their insolvency petition. The laid off petitioners attributed their job loss primarily to financial difficulties of the employers (33% of known cases); to creditors' collection activities including garnishment of wages and imprisonment (25% of known cases); and to debtor's own performance problems at work (20% of known cases).

<sup>196</sup> A little over 8% reported family break-up as a cause of their bankruptcy filing. In more than 56% of the cases, the cause of the bankruptcy filing among the wage earners was either unknown or none of the above.

<sup>197</sup> During the early 1970s nearly sixty percent of the bankrupt population in Jerusalem were wage earners. See Shuchman, *supra* note 15, at 354.

<sup>198</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 85 ("The wage earners [in the United States] comprise the largest group in bankruptcy; about 90% of the debtors currently work for someone else. The currently self-employed ... make up the remaining 10% of the sample."); Schwartz, *supra* note 26, at 111 (reporting entrepreneurship rate among the Canadian bankrupts of roughly twenty-five percent).

<sup>199</sup> For example, the unemployment benefits program provides unemployment benefits for more than four months at the rate of the wages the unemployed individual earned before becoming unemployed. Additionally, the unemployed individual may be entitled to receive supplemental income support from the government. See <<http://www.btl.gov.il/English/benefit>> (last visited Jan. 29, 2001).

<sup>200</sup> See *supra* note 132 and accompanying text.



become insolvent due to undertaking excessive non-mortgage consumer debt. In a number of cases in the bankruptcy sample, the Official Receiver opposed the debtor's adjudication as bankrupt principally because the petitioner had undertaken significant consumer debt prior to bankruptcy filing in order to finance living expenses.<sup>201</sup>

Lastly, and probably most important, the relatively small number of wage earners filing for bankruptcy may be due to the limited availability of non-mortgage consumer credit in Israel. Traditionally, banks in Israel have been reluctant to extend personal credit to individuals, preferring to lend to the more profitable business sector.<sup>202</sup> The banks' reluctance was based on the Central Bank's policy of reducing demand for consumer credit.<sup>203</sup> This policy was pursued to curve inflationary pressures,<sup>204</sup> discourage high standards of living in Israeli society,<sup>205</sup> and minimize the perceived tendencies of individuals to act irrationally to the extent they had access to credit.<sup>206</sup>

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<sup>201</sup> See e.g., Official Receiver file number 160/97 (Central District) (The petitioner, a bus driver with two dependents, had undertaken significant personal debt for consumption purposes. The investigator in the Official Receiver's office recommended to oppose the petitioner's bankruptcy adjudication, reasoning that the debtor's pre-petition consumer debt undertaking constitutes bad faith and to allow such an individual to obtain bankruptcy protection would be against public order); Official Receiver file number 5005/98 (Southern District) (The Official Receiver initially opposed the petitioner's bankruptcy adjudication as the Official Receiver believed that the petitioner lived pre-petition beyond his means and hence acted in bad faith when he incurred significant consumer debt to finance his wedding, buy gifts for his baby, and pay for his girlfriend's son Bar-Mitzvah).

<sup>202</sup> See 2 HA'T, *supra* note 153, at 103 ("Until few years ago, banks almost never engaged in consumer credit. They extended credit to individuals simply to satisfy examiners' concerns, but did not find this area of lending as sufficiently profitable justifying their efforts.").

<sup>203</sup> See AHARONI, *supra* note 129, at 233 ("[The Israeli Central Bank] generally has managed a very restrictive monetary policy aimed at reducing the demand for [consumer] credit.").

<sup>204</sup> See BAR-YOSEF, *supra* note 137, at 143 (noting that Israel Central Bank has traditionally limited bank's credit [to the consumers] as a way to control inflationary pressures).

<sup>205</sup> See *id.*, at 144 (suggesting that part of the Central Bank's policy of limiting consumer credit has been a desire to deter consumers from improving their standards of living through credit).

<sup>206</sup> See GIL BRITZMAN, EMZAEI TASHLUM: KARTESEI HIUV VE'KARTESEI ASHRAI [PAYMENT SYSTEMS: DEBIT CARDS AND CREDIT CARDS] 8 (1998) (referring to an Israeli government commission report which voiced a concern that an individual who is provided with access to consumer credit is likely to act irrationally in making excessive purchases of consumer goods and services).

While banks in Israel began in earnest during the late 1980s to extend consumer credit to individuals,<sup>207</sup> they have generally employed relatively stringent credit standards and they continuously monitored the borrower's subsequent financial condition.<sup>208</sup> These strict practices for non-mortgage personal credit must have contributed to the relatively small number of overly indebted wage earners in Israel, and hence to the small number of wage earners who have resorted to bankruptcy.

The current limited availability and high credit standards for non-mortgage consumer credit in Israel may be due to lack of robust competition in the banking industry. Competition in the non-mortgage consumer banking industry is limited partly due to its oligopoly nature<sup>209</sup> as well as to the costs associated with customers' switching

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<sup>207</sup> See *id.* (“The conspicuous change in the distribution of credit [among Israeli banks] is the increase in the portion of credit extended to individuals. . . . In recent years, the banks changed their approach beginning to actively market credit to individuals.”). But see ZE’V ABLES, MA’ARECHET HA’BANKAOT BE’ISRAEL-SKIRA [THE BANKING SYSTEM IN ISRAEL- AN OVERVIEW] 58 (1996) (reporting a trend beginning in the mid 1990s of a reduction of consumer credit, other than mortgage credit). As non-mortgage consumer credit became more available, consumers have begun to rely on it more often. See AHARON BARAK & AMIR FRIDMAN, KARISE HIUV: HEBETIM MISPATIYIM VE’MA’ASUYIM SHEL KARTISE ASHRAI VE’BANK [CHARGE CARDS: LEGAL AND PRACTICAL EXAMINATION OF CREDIT CARDS AND BANK] 34-35 (1997) (detailing the recent growth of credit card use in Israel); SHUV, *supra* note 157, at 21-22 (unpublished manuscript on file with author) (“The share of credit cards in total retail spending was 35 percent in 1996, exceeding for the first time proportion of cash or checks in the total retail ‘basket’”); Boaz Gaon, *Zahav Be’Yarok [Gold in Green]*, 27 HA’TIKSHORET 26, 26 (1995) (reporting that in 1990 credit card debt accounted for 15% of the total personal consumption in Israel, and by the end of 1994 it amounted to approximately 27%).

<sup>208</sup> While it is relatively easy for a wage earner to obtain a credit card or an overdraft protection plan in Israel, banks generally extend credit in an amount no greater than the applicant's monthly salary. Banks generally insist that the credit be repaid by the end of the month, generally through a direct deposit of the account holder's monthly salary. As a result, banks continuously monitor the account balance and the account holder's employment status. See generally BRITZMAN, *supra* note 206, at 34-36. See also BARAK & FRIDMAN, *supra* note 207, at 36 (describing the banks' policy of closely monitoring credit card use by their customers). Since banks generally insist on getting repaid in full at the end of the month, most of the banks' earnings in Israel arising out non-mortgage consumer credit activities are derived from fees paid by merchants and annual membership fees as opposed to interest. See *id.* 15-17. The tighter credit standards and higher scrutiny undertaken by banks relative to non-mortgage consumer credit in Israel may partly explain the reason for the lower proportionate share of consumer credit as part of the total bad debts portfolio in the Israeli banking industry in 1999. See Harris, *supra* note 15, at 690.

<sup>209</sup> See BRITZMAN, *supra* note 206, at 13-14 (“Due to the highly concentrated overall banking system in Israel, the credit card industry is also highly concentrated market. There are very few issuers of credit cards in the Israeli market. Due to the relatively low number of credit card issuers . . . it can be concluded with reasonable degree of probability that there is little competition [in the credit card market in Israel].”); SHUV, *supra* note 157, at 21 (reporting that the Israeli credit card market is a derivative of the banking

banks.<sup>210</sup> In contrast, while the business lending industry in Israel is an oligopoly as well, the higher availability of credit and lower credit standards employed by the financial sector for business loans in Israel may be due to the presence of greater number of players in the business lending industry.<sup>211</sup>

In sharp contrast, American non-mortgage consumer credit issuers reportedly use rather liberal lending standards,<sup>212</sup> which together with a deregulated credit environment and limited social safety net,<sup>213</sup> have significantly increased non-mortgage consumer

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oligopoly that exists in the Israeli banking system. “Israel’s only two credit card companies (as of December 1996), which dominate the market, are controlled by the three largest banks.”); Gaon, *supra* note 207, at 26 (“The credit market in Israel has traditionally been dominated by Visa (owned by Bank Leumi and Discount Bank) and Isracard (owned by Bank Hapoalim).”).

<sup>210</sup> See SHUV, *supra* note 157, at 43 (“Things are different in Israel. Consumers are indifferent about switching banks because the commissions are the same everywhere. Furthermore, switching banks is complicated because the banks encumber the matter in red tape and commissions.”); BRITZMAN, *supra* note 206, at 23 (“It is difficult for a customer to obtain a credit card issued by a bank other than the one in which the customer has his bank account in . . . .”); Gaon, *supra* note 207, at 27 (describing the difficulties faced by a customer of one bank to get a credit card issued by another bank).

<sup>211</sup> See SHUV, *supra* note 157, at 14 & 21 (reporting that by the end of 1996, there were 10 commercial banks in Israel, but only 2 credit card companies).

<sup>212</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 136 (“Few forms of debt can be so easily acquired [in the U.S.] as credit card debt. There are no serious talks with a bank president of careful reviews of outstanding debts and assets before undertaking a credit card obligation); *id.* 137 (“The practices show that credit card companies increasingly fail to ask for vital information, such as employment and income, even at the start of the credit relationship.”); Susan L. DeJarnatt, *Once is Not Enough: Preserving Consumers’ Rights to Bankruptcy Protection*, 74 IND. L.J. 455, 499 (1999) (“In large part, the credit industry, which has chosen to increase profits by extending credit in large amounts to people with weak credit histories, wants to be saved from itself. Increased bankruptcy filings are part of the cost of these trends in lending.”); Ellis, *supra* note 7, at 7 (“Another group that benefited from the expansion of credit was high-risk borrowers, or individuals with poor credit ratings regardless of their income level. The ability to generate more income allowed lenders to lend to individuals who were further down the spectrum of credit quality because lenders could be compensated for a higher rate of credit losses.”); Bernard R. Trujillo, *The Wisconsin Exemption Clause Debate of 1846: An Historical Perspective on the Regulation of Debt*, 1998 WISC. L. REV. 747, 749 (“One likely reason for the explosion in consumer bankruptcies is the explosion in the extension of credit to ‘subprime’ borrowers; that is, people whose low income, youth, prior credit history or other factors make it more likely that they would default on the loan. The number of subprime loans (mainly in the form of credit cards issued to high-risk borrowers) increased as lenders realized that charging higher interest rates created a handsome profit even after writing off the loans that went bad.”); Warren, *supra* note 54, at 1083 (“When the cards are highly profitable, credit card issuers have a strong incentive to distribute them to marginal borrowers and to borrowers already loaded with debts, which increases both the issuer’s profits and its loan defaults.”). *But see* Todd J. Zywicki, *Economics of Credit Cards* 118-122 (2000) (unpublished manuscript on file with author) (contesting the proposition that increasing bankruptcies and credit card defaults in recent years have been driven by greater extension of credit to high risk borrowers).

<sup>213</sup> See generally THE FRAGILE MIDDLE CLASS, *supra* note 3, at 135 (suggesting that the growth in credit card issuance is directly linked to the deregulation of consumer interest rates); Lawrence M. Ausubel,

credit availability and have contributed to the higher rates of wage earners' financial distress and bankruptcy.<sup>214</sup>

#### H. CONSUMER CREDIT

As stated earlier, starting in the 1980s, banks in Israel began to actively extend consumer credit to individuals through the issuance of credit cards and overdraft protection plans.<sup>215</sup> Coinciding with the significant increase in the supply of consumer credit, the demand for consumer credit has also dramatically rose.<sup>216</sup> The rise in demand for consumer credit was fueled primarily by an increase in personal consumption in Israel beginning in earnest in the late 1980s.<sup>217</sup> By the late 1990s, the average individual in Israel held non-mortgage consumer debt of approximately \$11,185.<sup>218</sup>

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*Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 260-61 (1997) (tracing the evolution of deregulation in the credit card market in the U.S).

<sup>214</sup> THE FRAGILE MIDDLE CLASS, *supra* note 3, at 129 (“As the fastest growing proportion of consumer debt, credit card debt has led the way to bankruptcy for an increasing number of Americans.”); Ellis, *supra* note 7, at 9 (“This paper has argued that interest rate deregulation altered the credit markets and led to a substantial expansion in credit card availability and an increase in the level of personal bankruptcies.”).

<sup>215</sup> See BRITZMAN, *supra* note 206, at 8 (“The conspicuous change in the distribution of credit [among Israeli banks] is the increase in the portion of credit extended to individuals. . . . In recent years, the banks changed their approach beginning to actively market credit to individuals.”); *But see* ABLES, *supra* note 207, at 58 (reporting a trend beginning in the mid 1990s of a reduction of consumer credit, other than mortgage credit).

<sup>216</sup> See BARAK & FRIDMAN, *supra* note 207, at 34-35 (detailing the recent growth of credit card use in Israel); SHUV, *supra* note 157, at 21-22 (unpublished manuscript on file with author) (“The share of credit cards in total retail spending was 35 percent in 1996, exceeding for the first time proportion of cash or checks in the total retail ‘basket’”); Gaon, *supra* note 207, at 26 (reporting that in 1990 credit card debt accounted for 15% of the total personal consumption in Israel, and by the end of 1994 it amounted to approximately 27%).

<sup>217</sup> See RUTH LOVENTHAL ET AL., KALKALAT YISRAEL BE'DAGESH KAL [ISRAELI ECONOMY] 101-103 (2d ed. 1998) (reporting that private consumption per capita has increased in 1997 at the annual rate of 3.6% and that by 1995 the real annual private consumption per capital was five times greater than it was in 1950).

<sup>218</sup> Unfortunately, no published data is available relating to the average non-mortgage consumer debt in general or credit debt in particular that is owed by individuals in Israel. See BRITZMAN, *supra* note 206, at 10 (“The main problem [in discussing outstanding credit card balances in Israel] is the lack of public and reliable data on the credit card industry in Israel.”); HA'T, *supra* note 153, at 117 (alluding to the lack of published data relating to outstanding credit card balances in Israel). As a result of the unavailability of published data on outstanding non-mortgage consumer debt held by individuals in Israel, the approximate figure of \$11,185 reported here was deduced based on unofficial and unpublished but yet reliable sources by dividing total outstanding non-mortgage consumer credit held by individuals in Israel in 1998 by the number of individuals living in Israel at the end of 1997 who were 20 years of age or older. See Memorandum from Benjamin Shalev, Director of Investment Strategy, Bank Ha'Poalim, Isr., to the author

More than sixty percent of the petitioners in the bankruptcy sample reported credit card or overdraft outstanding balance at the time of filing.<sup>219</sup> The average outstanding non-mortgage consumer debt owed by these individuals was just under \$16,902.<sup>220</sup> That is, debtors in bankruptcy holding credit card or overdraft account were, on average, carrying non-mortgage consumer credit one and a half as much as individuals in the general population.<sup>221</sup>

The outstanding non-mortgage consumer credit of the petitioners in the Israeli bankruptcy sample was not only considerably higher than the balance owed by individuals in the general population, but it was also somewhat higher than their American and Canadian counterparts.<sup>222</sup> This disparity is possibly attributed to the significant number of entrepreneurs making up the Israeli bankruptcy sample.<sup>223</sup> As has been observed in the United States, many small business proprietors resort to ‘consumer

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1 (June 16, 2000) (on file with author) (estimating that in 1998 the outstanding non-mortgage consumer credit held by individuals was 40,458,000,000 NIS); STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 2000, *supra* note 15, at Figure 2.19 (reporting that the total population in Israel in 1997 of individuals 20 years old or older was 3,617,000).

<sup>219</sup> A recent study found a similar percentage of the Israeli general population burdened by non-mortgage consumer credit. See Sharon Berger, *Nearly 70% of Israelis in Overdraft*, Jerusalem Post Internet Edition (Apr. 19, 2001) available at <http://www.jpost.com...19/LatestNews/LatestNews.24903.html> (reporting that a recent study conducted by an Israeli bank found that 70% of Israelis find themselves in overdraft for at least part of the month, and approximately 20% of them are in overdraft the entire month). In contrast to the Israeli bankruptcy sample, almost 90% of bankruptcy petitioners in the U.S. and 81% of bankruptcy petitioners in Canada had credit card debt of some kind at the time of filing. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 120; Ramsay, *supra* note 6, at 55.

<sup>220</sup> After removing outliers, among those petitioners who had outstanding credit card or overdraft balance at the time of filing, the average credit card/overdraft balance was 59,159 NIS. The outliers were cases with average non-mortgage consumer credit greater than 291,308 NIS and lower than 2,000 NIS. Before outliers were removed, the average total non-mortgage consumer debt in the sample was 73,162 NIS or \$20,903. The median was 37,000 NIS. The standard deviation was 95,698. The lowest quartile of debtor sample reported only 13,000 NIS in non-mortgage consumer credit, but the highest quartile of debtor sample reported non-mortgage consumer credit of 103,250 NIS.

<sup>221</sup> In contrast, in the U.S. “the debtors in bankruptcy, at the median, were carrying card debts more than six times higher than other card holders.” THE FRAGILE MIDDLE CLASS, *supra* note 3, at 122.

<sup>222</sup> The mean credit card debt among bankruptcy petitioners in Canada was \$7,615 in 1994. See Ramsay, *supra* note 6, at 55. The range of average credit card debt among bankruptcy petitioners in the United States was between \$14,260 and \$28,955. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 121.

<sup>223</sup> See *supra* note 123 and accompanying text.

type credit' to finance their business venture.<sup>224</sup> Since the financing needs of a small business entrepreneur tend to be more extensive than the borrowing needs of the average wage earner,<sup>225</sup> it should be no surprise to find the largely former entrepreneur population in the Israeli bankruptcy sample reporting significant 'consumer-type credit'. Indeed, the Israeli bankruptcy petitioners in the sample, who were former small business entrepreneurs, had a median 'consumer-type credit' twice as much as compared to the wage earners in the sample.<sup>226</sup>

While a fair share of that outstanding non-mortgage consumer debt may have arose out of business related activities, some of it apparently stems exclusively from consumer related activities. Although it is unclear the exact magnitude of pure consumer debt in the Israeli bankruptcy sample, it is apparent that consumer debt has led, at least in part, to the financial demise of approximately nine percent of the bankruptcy petitioners in the sample.<sup>227</sup> In contrast, almost nineteen percent of the bankruptcy petitioners in Canada and as much as twenty-four percent of the American bankruptcy petitioners have attributed excessive consumer credit as the cause of their bankruptcy filing.<sup>228</sup> The

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<sup>224</sup> The use of consumer credit to finance business activities has recently become routine in the United States. See Warren & Westbrook, *supra* note 88, at 539 (describing the recent increase in efforts of card companies in the U.S. to issue credit cards to proprietors of small business); Rodney Ho, *Credit-Card Use to Finance Business is Soaring, Says Survey of Small Firms*, WALL S. J., Sept. 25, 1997, at B2 (reporting results of a survey indicating that one-third of responding businesses with less than 20 employees use credit cards "as one of their financing options," but that 60% of responding businesses that use credit cards pay off their balances each month); Sarah Oppenheim, *Bank Financing Up, Loans from Relatives Down*, AM. BANKER, Mar. 10, 1997, at 5 (reporting that credit cards provide the primary source of working capital for 5% of small businesses).

<sup>225</sup> See *supra* note 93 and accompanying text.

<sup>226</sup> While the median credit card/overdraft outstanding debt balance of the former entrepreneur bankruptcy petitioners was 42,009 NIS, the wage-earner petitioners had a median outstanding balance of 16,044 NIS.

<sup>227</sup> Specifically, 9.2% of the bankruptcy petitions, where the cause of bankruptcy was apparent, attributed the financial failure to excessive personal debt.

<sup>228</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 133 ("When Judge Sellers did that with her bankruptcy cases [directly examined the bankruptcy files] in the Southern District of Ohio, she concluded that credit card debts were the reason for filing in about 24 percent of the cases."); Schwartz, *supra* note 26, at 92 (reporting that 18.8% of the bankruptcy petitioners in Canada identified credit card debts as the triggering event of the bankruptcy filing).

apparent reason for the much lower percentage in the Israeli bankruptcy sample of individuals, who have identified excessive consumer debt as the cause of bankruptcy, may be due to the tighter credit underwriting scrutiny adopted by the financial sector in the Israeli consumer credit market.<sup>229</sup>

#### I. THE UNEMPLOYED:

Unemployment is a dark reality for a significant number of petitioners in the Israeli bankruptcy sample. While unemployment rate in Israel was under seven percent in 1996,<sup>230</sup> forty percent of the bankruptcy petitioners were reportedly unemployed at the time of bankruptcy and on average they were unemployed for almost seven months by that time.<sup>231</sup>

Despite the large number of unemployed petitioners in the Israeli bankruptcy sample, less than five percent of individuals in the sample identified unemployment as a cause of their bankruptcy filing.<sup>232</sup> That is, for the vast majority of the unemployed

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<sup>229</sup> See *supra* note 208 and accompanying text.

<sup>230</sup> See ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 1996, *supra* note 36, at 7 (reporting an unemployment rate of 6.7% in 1996).

<sup>231</sup> Specifically, 40.4% of the sampled bankruptcy petitioners were unemployed at the time of bankruptcy filing. This figure includes petitioners who were homemakers, retired, or disabled. At the time of bankruptcy filing, the average length of the unemployment period was 6.6 months. Similar unemployment rate was reported in the Israeli bankruptcy population in the early 1970s. See Shuchman, *supra* note 15, at 355 (reporting that 45% of the bankrupt petitioners in Israel were unemployed at the date of the bankruptcy petition or within few months thereafter). Similar substantial overrepresentation of unemployed individuals among bankrupt debtors was also detected in the United States and in Canada. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 80-81 (“As a proportion of all the valid responses, these numbers yield 17.9 percent unemployment, more than two and a half times the prevailing national rate [in the U.S.] in 1991 of 6.7 percent. . . . Without claiming an undue precision for these numbers, we can nevertheless assert that the unemployed are substantially overrepresented among bankrupt debtors.”); Ramsay, *supra* note 6, at 36 (“At the time of filing for bankruptcy, only 63 per cent of [Canadian] debtors indicated that they were employed, 31 per cent indicated that they were unemployed, and 6 per cent were retired, students, disabled, or classified themselves as home-makers. The unemployment rate in Ontario in 1992 and 1993 was 10.9 per cent and 10.6 per cent, respectively, and in 1994 it was 9.6 per cent.”)

<sup>232</sup> Specifically, only 4.9% of the sampled bankrupts reported unemployment as the cause of their bankruptcy filing. In contrast almost a quarter of all Canadian bankruptcy petitioners and two-thirds of

petitioners, who were former entrepreneurs, unemployment was a mere manifestation of the underlying cause of their bankruptcy filing: a highly insolvent and unsuccessful business enterprise.<sup>233</sup>

While more than forty percent of the bankruptcy petitioners were unemployed at the time of filing, less than fourteen percent of them reported receiving unemployment benefits. The reasons why so few unemployed petitioners in the sample received unemployment benefits are two folds. First, since many unemployed petitioners have been unemployed for an extended period of time, it is plausible that their unemployment benefits period has simply ran out.<sup>234</sup> Also, as the unemployed petitioners were primarily former entrepreneurs,<sup>235</sup> the lack of unemployment benefits they received may simply reflect the limited entitlement self-employed individuals have to such welfare benefits.<sup>236</sup>

#### J. MEDICAL DEBTS & BANKRUPTCY:

The relationship between medical debt and bankruptcy in Israel provides another illustration of the impact society's safety net has on the propensity to seek bankruptcy protection. In the Israeli sample, a little over four percent of the bankrupts reported medical related debts.<sup>237</sup> Not only were there few individuals reporting medical debt, but

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American bankruptcy petitioners have identified a job related problem as a cause of their bankruptcy filing. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 78-79; Ramsay, *supra* note 6, at 61.

<sup>233</sup> Specifically, 63.3% of the unemployed individuals in the bankruptcy sample were former entrepreneurs.

<sup>234</sup> See *supra* note 199.

<sup>235</sup> See *supra* note 233.

<sup>236</sup> See Greenwood, *supra* note 128, at 15 (“By venturing out of the welfare-state cocoon that protects fully employed Israelis, the small-business owner maneuvers without the wage-earner’s sturdy safety net, precisely while he finances this set of safeguards for employees. Most conspicuous among the forfeited benefits is unemployment compensation, second only to reserve-duty compensation in importance for the wage earner. The entrepreneur receives neither credit nor discount from the [National Insurance Institute] for this handicap.”).

<sup>237</sup> Specifically, 4.2 percent of the sampled bankrupts reported either medical or dental debt at the time of the petition.



also the median amount of medical debt was relatively low, just under \$540.<sup>238</sup> The medical debt burden of the average petitioner was negligible.<sup>239</sup>

The relatively low medical debt of the Israeli bankruptcy sample is surprising, given that more than twenty seven percent of the sample reported some form of disability or major illness.<sup>240</sup> Even within that twenty-seven percent group, the average total medical debt was only \$2,141.<sup>241</sup> Nonetheless, the combination of a heavy debt burden,<sup>242</sup> older age,<sup>243</sup> limited prospects of higher income and higher government assistance dependency,<sup>244</sup> made this group of disabled or seriously ill petitioners uniquely vulnerable.<sup>245</sup>

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<sup>238</sup> The median medical/dental debt amount in the sampled population was 1,887 NIS. The average amount of medical/dental debt in the sampled population was 3,088 NIS, or \$882.

<sup>239</sup> The mean medical debt to income ratio was 0.055. The average medical debt to income ratio was calculated by dividing total medical debt for each petitioner in the sample, who had medical debts outstanding, by the total annualized household income for each petitioner in the sample and then calculating the mean ratio for all petitioners in the sample. The median medical debt to income ratio was .02. The median medical debt to income ratio was calculated by dividing total medical debt for each petitioner in the sample, who had any medical debts, by the total annualized household income for each petitioner in the sample and then calculating the median ratio for all petitioners in the sample.

<sup>240</sup> Specifically, 27.2% of the sampled population reported disability or seriously illness. Of those who reported disability, 89.3% identified their disability or major illness as physical and 10.7% identified their disability or major illness as mental. However, only 18.1% of the sampled population reportedly received disability related financial aid from the government. Disability or serious illness were also frequently cited in the Israeli bankruptcy population during the 1970s. *See* Shuchman, *supra* note 15, at 354.

<sup>241</sup> Specifically, the average of the total medical/dental debts outstanding for the disabled or seriously ill was 7,494 NIS.

<sup>242</sup> The average total debt owed by disabled or seriously ill bankruptcy petitioners in this sampled population was \$296,472 (or 1,037,653 NIS), with a median of \$176,865 (or 619,028 NIS).

<sup>243</sup> The median age of the healthy bankruptcy petitioners was 41, but the median age of the petitioners who were disabled or seriously ill was 49. A similar observation was made in the U.S. *See* THE FRAGILE MIDDLE CLASS, *supra* note 3, at 164 (“There is a close relation between age [of the petitioner] and medical reasons for bankruptcy.”).

<sup>244</sup> The government benefits dependency rate of the otherwise healthy bankruptcy petitioner was 64%, compared to the government dependency rate of the disabled or seriously ill of 76%.

<sup>245</sup> *See e.g.*, Official Receiver case number 5073/97 (Southern District) (74 years old debtor was a retired policeman living in public housing with one dependent child and a wife that worked as cleaning person earning less than \$600 per month. Creditors garnished sixty percent of the debtor’s pension. The debtor suffered from high blood pressure, heart problem and diabetes.); Official Receiver case number 1072/97 (Northern District) (The debtor was 61 years old, widow, 100% disabled living on dialysis. He had debts arising out of a failed coffee shop of approximately \$275,000, mainly owed to banks. The debtor stopped his business partly due to its continuous sustained losses and partly due to his disability. He lived off government welfare, but his reported expenses exceeded the monthly government benefits.); Official Receiver case number 1058/97 (Northern District) (Debtor, who was in his early 50s, was unemployed,

Indeed, a third of the disabled or seriously ill petitioners and almost twelve percent of the total bankruptcy population in the sample identified their medical condition as a cause of filing for bankruptcy.<sup>246</sup> However, no one in the Israeli sample filed due to the burden of medical debts.<sup>247</sup> Instead, the catalyst of bankruptcy for most of them was that their medical condition impaired their ability to operate their business or to serve their employers.<sup>248</sup>

The relatively small impact of medical debt on the financial vulnerability of individuals in Israel is dramatically different from medical debt's influence in the United States.<sup>249</sup> While only four percent of the Israeli bankrupts reported medical related

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100% disabled, with an unemployed wife and two dependent children. Both the debtor and his wife were dependent on various government welfare benefits.); Official Receiver case number 5037/97 (Southern District) (The debtor, who is unemployed unskilled laborer has filed for bankruptcy protection after signing several guarantees in favor of his former employer. The debtor was recently diagnosed with cancer and his wife does not work as she is disabled. The debtor and his wife, who rely exclusively on government welfare, have five dependents); Official Receiver Case Number 1592/96 (Southern District)(The currently unemployed 65 years old debtor, who has cancer and high blood pressure, used to operate a moving business that collapsed after the loss of a major client. The debtor's wife is unemployed and has diabetes. The couple has two dependent children).

<sup>246</sup> Specifically, 33.33% of the petitioners, who have identified themselves as disabled or seriously ill, claimed that their medical condition was a cause of their bankruptcy filing. Also, 11.7% of the total sampled bankrupts identified their medical condition as a cause of their financial demise.

<sup>247</sup> This can be primarily explained by the relatively low average medically related debts owed by the Israeli bankruptcy sample. *See supra* note 238 and accompanying text.

<sup>248</sup> In fact, 23.1% of the petitioners who were unemployed at the time of bankruptcy filing indicated that their medical condition was a cause in their bankruptcy filing. *See e.g.*, Official Receiver case number 1072/97 (Northern District) (The debtor was 61 years old, widow, 100% disabled living on dialysis. He had debts arising out of a failed coffee shop of approximately \$275,000, mainly owed to banks. The debtor stopped his business partly due to its continuous sustained losses and partly due to his disability.); Official Receiver case number 96/588 (Central District) (The debtor, a woman, 49 years old, went into financial trouble after a failing operation of a coffee place. Part of the reason for the business failure was that the debtor was diagnosed with a spreading cancer, which required immediate hospitalization and chemotherapy for a prolonged period of time.). For more on the intersection between loss of work and medical condition in the bankruptcy population, see THE FRAGILE MIDDLE CLASS, *supra* note 3, at 160-61.

<sup>249</sup> The differences between the findings relating to the impact of medical issues on bankruptcy in the two countries may be partly due to data collection methodological differences. While the data collection in this study relied primarily on analysis of petitions that debtors submitted when they filed for bankruptcy, some of the contrasting studies in the United States collected their data by directly asking the debtors for the relevant information. This difference may have resulted in the understatement of the role played by medical debts in the Israeli bankruptcy population. *See* Melissa B. Jacoby, Teresa A. Sullivan & Elizabeth Warren, *Rethinking the Debates Over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U.L. REV. 375, 382-84 (2001).

debts,<sup>250</sup> as much as eighty percent of the petitioners in American bankruptcy samples reported medical debts.<sup>251</sup> Also, the American bankruptcy petitioners had a median medical debt of approximately \$2,500,<sup>252</sup> compared to the Israeli median of \$540.<sup>253</sup> Similarly, the average medical debt to income ratio among the sampled American petitioners was over five times higher than in the Israeli bankruptcy sample.<sup>254</sup> Also, while less than twelve percent of the petitioners in Israel filed because of a medical condition,<sup>255</sup> approximately twice as many in the American bankruptcy population cited medical reasons for their bankruptcy.<sup>256</sup> Most importantly, while no one in the Israeli bankruptcy sample reported overwhelming medical debt as a cause of bankruptcy, seven

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<sup>250</sup> See *supra* note 237 and accompanying text.

<sup>251</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 173 (“About half of all debtors carry some medical debt.”); VISA, BANKRUPTCY PETITION STUDY: VISA CONSUMER BANKRUPTCY REPORTS, *supra* note 26, at 42 (“Between 30 percent and 70 percent of petitioners from all states claimed some medical expenses or debts); Jacoby, Sullivan & Warren, *supra* note 249, at 387 (finding that 31.2% of the bankruptcy petitioners in the sample reported that they had debts owed to health care providers, services or suppliers); Kovac, *supra* note 103, at 712-13 (finding that 80% of the judgment proof debtors owed some medical debt); Shuchman & Rhorer, *supra* note 26, at 12 (“Over two-thirds of the cases in Group A (68%) listed medically related debt. . .”). The wide disparities in these studies have been attributed to differences in study methodologies (the study of data from the petitions that debtors submit when they file for bankruptcy vs. direct interviews of debtors), differences in creditor behavior, and differences in debtor attribution. See Jacoby, Sullivan & Warren, *supra*, at 382-85.

<sup>252</sup> See VISA, BANKRUPTCY PETITION STUDY: VISA CONSUMER BANKRUPTCY REPORTS, *supra* note 26, at 42 (“[F]or the majority of those claiming [medical debt], the total was under \$2,500.”).

<sup>253</sup> See *supra* note 238 and accompanying text.

<sup>254</sup> The mean medical debt to income ratio in Israel was 0.055. See *supra* note 239. The mean medical debt to income ratio in the United States was 0.2 in the early 1980s. See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 170.

<sup>255</sup> See *supra* note 246 and accompanying text.

<sup>256</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 144 (“Overall, almost 20 percent of the debtors in our bankruptcy sample cited medical reasons for their bankruptcies. . . . Judge Barry Russell . . . calculated that 25-30 percent of the debtors in his court from 1975 to 1985 were there because of medical problems, including both medical expenses and loss of work owing to medical causes.”); Jacoby, Sullivan & Warren, *supra* note 249, at 387 (“One in every four families in the sample (25.2%) identified an illness or injury as a reason for filing bankruptcy.”). *But see* VISA U.S.A. INC., CONSUMER BANKRUPTCY: BANKRUPTCY DEBTOR SURVEY 8-9 (1996) (16.5% of sampled debtors identified medical and health related problems as the main reason that they had to file for bankruptcy).

percent of petitioners in the United States identified medical debt as a major cause of their bankruptcy filing.<sup>257</sup>

The universal care in the Israeli socialized medical system is the reason for the significant disparities in medical debt between the American and the Israeli bankruptcy samples.<sup>258</sup> In Israel few, if any, individuals have much medical debts because all citizens enjoy comprehensive medical coverage subsidized by the government.<sup>259</sup> In contrast, the United States government provides no universal health coverage, and as a result, a significant number of Americans lack medical insurance or are under-insured.<sup>260</sup> The lack of universal coverage, coupled with skyrocketing medical costs in the United States,<sup>261</sup> have resulted in a significant proportion of the American population at risk of financial failure due to medical debts.<sup>262</sup>

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<sup>257</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 155 (“Of our sample of debtors, 7 percent specifically reported medical debt or the loss of medical insurance as a major cause of their bankruptcy.”). However, one study using an empirical qualitative choice model based on bankruptcy case data from 1980 implied that 30% of the debtors in 1994 could be declaring bankruptcy based on medical debt alone. See Domowitz & Sartain, *supra* note 262, at 413.

<sup>258</sup> Scholars in the U.S. have previously made a similar observation relating to the relationship between the extent of a country’s universal health coverage and the propensity to commence bankruptcy protection. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 158 (“Both [Canada and Australia] have comprehensive medical care systems that make it unlikely that medical costs or debts per se will cause many bankruptcies.”).

<sup>259</sup> See David Chinitz et al., *Israel’s Basic Basket of health Services: The Importance of being Explicitly Implicit*, 317 BRITISH MED. J.1005, 1005 (1998) (“Under [the Israeli] National Health Insurance all citizens are required to join one of the sick funds, which now must accept all comers. . . . Sick funds receive a risk adjusted (based on age) capitation payment from the government for providing a standard basic basket of services defined by law.”); David Chinitz & Avi Israeli, *Health Reform and Rationing in Israel*, 16 HEALTH AFF. 205, 205-06 (1997).

<sup>260</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 147-150 (reporting that at least 40 million people in the U.S. were uninsured at some point during 1996 and as many as 29 million Americans who had some form of health insurance were underinsured).

<sup>261</sup> See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 146 (“Medical costs from 1950 to 1990 increased [in the U.S.] almost tenfold, after adjusting for inflation.”) (emphasis in the original).

<sup>262</sup> See *id.*, at 150. Other scholars in the U.S. have also demonstrated the significant impact medical debt has on the propensity to file for bankruptcy. See Ian Domowitz & Robert L. Sartain, *Determinants of the Consumer Bankruptcy Decision*, 54 J. FIN. 403, 413 (1999)(finding that health problems leading to “medical debt ha[d] the greatest single impact of any household condition in raising the conditional probability of bankruptcy . . . . Households with high medical debt exhibit a filing probability greater than 28 times that of the baseline.”); Ian Domowitz, Statement before the Senate Judiciary Subcomm. On Administrative Oversight and the Courts, (Apr. 11, 1992) (arguing that uninsured medical debt is the

## K. HOMEOWNERSHIP AND BANKRUPTCY:

Homeownership is highly valued in Israeli society. The strong emphasis placed on homeownership is manifested in the government sponsored programs aimed at assisting individuals to buy a home.<sup>263</sup> The importance of homeownership is also reflected in the parental financial support young couples frequently receive when buying their first house.<sup>264</sup> Homeownership is highly valued as it enhances individuals' stake in society and establishes strong financial base.<sup>265</sup>

Despite the perceived association between homeownership and a solid financial condition, this study finds that homeownership does not necessarily insulate individuals

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largest single contributor at the margin to bankruptcy filings in the U.S.). One aggregated study suggested that there is a link between lack of medical insurance or underinsurance and the propensity to commence bankruptcy petition. *See* SMR RESEARCH CORP., *THE PERSONAL BANKRUPTCY CRISIS, 1997: DEMOGRAPHICS CAUSES, IMPLICATIONS AND SOLUTIONS* 94-95 (1997) (comparing bankruptcy filing rates with health insurance coverage rates at the state level, the author identified medical debt as a "central problem in bankruptcy," noting that the bankruptcy filing rate was lower than the national average in states where at least 92% of the population had health insurance.").

<sup>263</sup> *See* LOVENTHAL ET AL., *supra* note 217, at 111 (attributing high home ownership rate in Israel to government subsidized mortgages); Wisebrod et al., *supra* note 73, at 67 & 70 (discussing government mortgage subsidy programs in Israel targeted at the financial disadvantaged); Greenwood, *supra* note 128, at 13 ("Government social policy, too, stresses the importance of owning, as opposed to renting, one's residence."). Similar government policy of supporting homeownership was also noted in the U.S. *See* *THE FRAGILE MIDDLE CLASS*, *supra* note 3, at 200 ("To help Americans achieve homeownership has been one of the most persistent, well-supported domestic goals of all levels of government for more than fifty years.").

<sup>264</sup> *See* Simor Spierlman, *Horashat Nechasim Kalkaliyim: Ba'a lot Dira [Asset Inheritance: Home Ownership]*, in *HAKZAT MASHAVIM LE'SHIRUTIM CHEVRATIYIM 1996 [ALLOCATION OF RESOURCES FOR SOCIAL SERVICES 1996]* 99, 103 (The Center Social Policy Research in Israel 1997) (reporting that by the end of the 1980s, 64% of newly wed couples received financial assistance from parents or other family relatives in the purchase of a home).

<sup>265</sup> *See* Lewin-Epstein, *supra* note 32, at 1440 ("In Israel, as in Britain and the U.S., the state deliberately encouraged the middle and the working classes to purchase housing in order to increase their stake in society and in the existing social order."); Spierlman, *Horashat Nechasim Kalkaliyim: Ba'a lot Dira [Asset Inheritance: Home Ownership]*, in *HAKZAT MASHAVIM LE'SHIRUTIM CHEVRATIYIM 1996 [ALLOCATION OF RESOURCES FOR SOCIAL SERVICES 1996]*, *supra* note 264, at 102 (contending that in Israel homeownership is essential for establishing a solid financial base for a family unit). *See generally* Mark Baldassare, *Timing and Position in the Housing Market*, 70 *SOC. & SOCIAL RESEARCH* 279 (1986) (contending that home ownership often provides economic security as a hedge against inflation); Moira Munro, *Housing Wealth and Inheritance*, 17 *J. SOC. POLICY* 417 (1988) (suggesting that for most families, equity accumulated in housing is the single most important form of wealth).

from financial trouble. Specifically, more than forty percent of the bankruptcy petitioners in this sample owned a house at the time of filing.<sup>266</sup> The reason for this rather counter intuitive finding is that by in large the homeowners, who enter bankruptcy, were in deep financial trouble manifested primarily in their extremely high debt level.

When compared with bankruptcy petitioners in the sample who were not homeowners at the time of filing, the data suggest that while homeowners earned a third more and had significantly higher asset value than the non-homeowners, the debt undertaking of the homeowners was substantially greater than the debt level of the non-homeowners.<sup>267</sup>

The dire financial trouble of the bankrupt homeowners becomes even more evident when they are compared with the group from which they came from, the general population and more specifically homeowners in the general population. Outside of bankruptcy, the average family earned about \$3,118 in 1997,<sup>268</sup> but the average family

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<sup>266</sup> In the files where such information was available, 42.4% of the bankruptcy debtors reported owning or co-owning a house at the time of the bankruptcy petition. This figure may understate the true percentage of homeowners in the bankruptcy population as some may have voluntarily or involuntarily disposed of their homes right before commencing bankruptcy protection. Canadian and American bankruptcy samples have similar homeownership rate. See Ramsay, *supra* note 6, at 43 (42% of homeownership rate at time of bankruptcy or immediately preceding it); THE FRAGILE MIDDLE CLASS, *supra* note 3, at 202 (reporting homeownership rate in the American bankruptcy sample of approximately 50%). In contrast to the 40% homeownership rate in the Israeli bankruptcy sample, more than 70% of all households in Israel own their dwellings. See Wisebrod et al., *supra* note 73, at 70 (reporting homeownership rate in Israel of 71%); Moshe Bar-Nathan, et al., *The Market for Housing in Israel*, 28 REGIONAL SCI & URB. ECON. 21, 24 (1998) (home ownership rate in Israel is 75%).

<sup>267</sup> Homeowners in the bankruptcy sample earned roughly a third more than non-homeowner petitioners. Specifically, while the average monthly household income of homeowners was \$2,132 (or 7,462 NIS), non-homeowners earned on average \$1,450 (or 5,075 NIS). Similarly, while the average asset value of homeowners in the bankruptcy sample was \$188,275 (or 658,965 NIS), the assets value of the non-homeowners in the sample was a mere fraction averaging at \$2,314 (or 8,099 NIS). However, on average homeowners in the sample had significantly more debts than non-homeowners in bankruptcy. Specifically, while homeowners had average total debts totaling \$369,356 (or 1,292,747 NIS), the average non-homeowner had total debts of \$280,808 (or 982,831 NIS). Similar disparity between homeowner bankrupts and non-homeowner bankrupts was reported in the United States. See THE FRAGILE MIDDLE CLASS, *supra* note 3, at 214-16

<sup>268</sup> See *supra* note 49. No data was available relating to the average earnings of homeowners in the general population.

income of homeowners in bankruptcy was \$2,048.<sup>269</sup> That is, homeowners in bankruptcy earned approximately two-thirds of average household income in the general population. Bankrupt homeowners not only had lower income than households in the general population, but they also reported significantly higher mortgage debt than homeowners in the general population. While the average homeowner in Israel had mortgage debt of \$18,330 in 1998,<sup>270</sup> the bankrupt homeowner in the sample had an average total mortgage debt of \$76,708.<sup>271</sup> Moreover, the total debt burden of homeowners in the bankruptcy sample was more than ten times higher than the total debt burden of individuals in the general population in Israel.<sup>272</sup>

Lastly, while the home value of the bankrupts and the non-bankrupts were approximately the same,<sup>273</sup> bankrupt homeowners had a dramatically lower equity in their

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<sup>269</sup> After removing outliers, homeowners in bankruptcy earned on average 7,168 NIS per month. The median monthly income for the homeowners was 6,750 NIS. The outliers were cases with average household income greater than 17,027 NIS and lower than 1,910 NIS. Before outliers were removed, the average household income for the homeowners in the sample was 7,462 NIS or \$2,132.

<sup>270</sup> Unfortunately, no published data is available relating to the average mortgage debt outstanding among homeowners in Israel. As a result, the approximate figure of \$18,330 reported here was deduced based on unofficial and unpublished but yet reliable sources by dividing total outstanding mortgage debt held by individual in Israel in 1998 by the number of individuals living in Israel at the end of 1997 who were 20 years of age or older. *See* Memorandum from Benjamin Shalev, Director of Investment Strategy, Bank Ha'Poalim, Isr., to the author 1 (June 16, 2000) (on file with author) (estimating that in 1998 the outstanding mortgage debt held by individuals was 66,302,000,000 NIS); STATE OF ISRAEL CENTRAL BUREAU OF STATISTICS, STATISTICAL ABSTRACT OF ISRAEL 2000, *supra* note 15, at Figure 2.19 (reporting that the total population in Israel in 1997 of individuals 20 years old or older was 3,617,000).

<sup>271</sup> After removing outliers, the average amount of outstanding mortgage debt among homeowners was 268,481 NIS. The outliers were cases with average mortgages greater than 700,000 NIS and lower than 37,000 NIS. Before outliers were removed, the average mortgage debt in the sample was 300,865 NIS, or \$85,961. The median amount of outstanding mortgage debt among homeowners was 261,791 NIS. The standard deviation was 271,683.

<sup>272</sup> On average, after removing outliers, homeowners in bankruptcy had total debts of \$332,183, or 1,162,641 NIS. The outliers were cases with total debts greater than 3,200,000 NIS and lower than 152,371 NIS. Before outliers were removed, the average total debts among homeowners in the sample was 1,292,747 NIS, or \$369,356. In contrast, the average debt amount held by individual in Israel at the end of 1998 was \$33,650. *See supra* note 81.

<sup>273</sup> After removing outliers, the average home value of bankruptcy petitioners in the sampled population was \$173,425, or 606,990 NIS. The outliers were cases with home values greater than 1,400,000 NIS and lower than 90,000 NIS. Before outliers were removed, average home value for the homeowners in the sample was 638,695 NIS, or \$182,484. In contrast, the average home value in Israel was approximately

homes as compared to homeowners in the general population due to the relatively higher mortgage debt they have accumulated.<sup>274</sup> The combination of lower incomes, higher mortgage debts, higher total debts, and lower home equity seems to have placed the bankrupt homeowners in particularly vulnerable financial position.<sup>275</sup>

The bankrupt homeowners' deep financial strain may be due to a combination of recent governmental deregulation of the credit market, governmental mortgage subsidies, and unstable income stream of many of the bankrupt homeowners. In the late 1980s, the Israeli government embarked on an ambitious plan to deregulate the credit industry in general and the mortgage sector in particular resulting in a significant increase in the market in the supply of mortgage loans.<sup>276</sup> Whereas traditionally large mortgages were virtually non-existent in Israel, they have become not only much more widely available and in large amounts, but also much more affordable as interest rates on mortgages have

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\$179,000 in 1997 (626,500 NIS). *See* Wisebrod et al., *supra* note 73, at 70 (reporting that the average price of a family home in Israel during 1997 was approximately 100 gross monthly wages).

<sup>274</sup> Whereas homeowners in the general population had equity roughly in the amount of \$160,670 (calculated by subtracting average mortgage debt outstanding from average home value in the general population, *see supra* notes 271 & 273), homeowners in the bankruptcy sample had average equity of \$90,779, or 317,729 NIS after outliers were removed. Before outliers were removed, the average home equity in the sample was 342,139 NIS, or \$97,751. The average home equity was calculated by subtracting mortgage owed for each homeowner petitioner in the sample from fair market value of the home for each homeowner petitioner in the sample and then calculating the mean home equity for all homeowner petitioners in the sample. The median home equity was \$76,214, or 266,750 NIS. The median home equity was calculated by subtracting mortgage owed for each homeowner petitioner in the sample from fair market value of the home for each homeowner petitioner in the sample and then calculating the median home equity for all homeowner petitioners in the sample. The standard deviation was 286,084 NIS. The lowest quartile of debtor sample reported only \$42,785, or 149,750 NIS in home equity, but the highest quartile of debtor sample reported a home equity of \$147,276, or 515,469 NIS.

<sup>275</sup> Researchers reached similar conclusions with respect to the relative financial vulnerability of homeowners in the American bankruptcy sample. *See* THE FRAGILE MIDDLE CLASS, *supra* note 3, at 219 ("The homeowners [in the U.S.] who file for bankruptcy are loaded with inescapable mortgage obligations, on top of which they frequently carry more than twice the non-mortgage debt of other homeowners - all on incomes that are a third lower than other homeowners.").

<sup>276</sup> *See* Wisebrod, et al., *supra* note 73, at 70 (reporting a significant increase in the amount of mortgage debt supplied by banks in Israel beginning in the early 1990s following deregulation of the mortgage lending sector in 1989 at which time the Central Bank removed restrictions on the mortgage amount banks were allowed to extend).



been dramatically lowered.<sup>277</sup> Existing governmental subsidized mortgage programs for largely financially disadvantaged individuals further encouraged financially weak individuals to undertake mortgage debts.<sup>278</sup>

Concurrently, the massive immigration from the former Soviet Union into Israel beginning in the early 1990s brought an increase in demand and steep appreciation in the value of homes.<sup>279</sup> The appreciation of home values together with the emerging deregulated credit market resulted in a fertile ground for a substantial increase in the amount of mortgage debt outstanding in the Israeli economy in the 1990s.<sup>280</sup>

However, while accessibility and affordability of mortgage debt contributed to a higher indebtedness level and to an increase in financial vulnerability among many, it was a reform in the banking regulatory regime that stimulated the risky combination that later proved lethal for many homeowners: homeownership and entrepreneurship. Specifically, in 1989 the Israeli Central Bank permitted for the first time individuals to obtain a mortgage type loan from a bank and invest the mortgage loan proceeds in their business.<sup>281</sup> While homeowners may be inherently predisposed to become entrepreneurs,<sup>282</sup> this regulatory reform may have further enthused some homeowners to become entrepreneurs, as they were now able to more easily finance a small enterprise by

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<sup>277</sup> See Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel's Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 261 (“[T]he market for mortgages has opened up [in Israel beginning in the late 1980s], and as a result the real cost of mortgages has dropped from 11-12% in 1987 to 5-6% in 1989.”)

<sup>278</sup> See Wisebrod et al., *supra* note 73, at 70 (suggesting that government mortgage subsidies had been used in Israel to promote a certain settlement policy and to assist the financially underprivileged).

<sup>279</sup> See Bar-Nathan et al., *supra* note 266, at 45 (reporting that real house prices have risen by 50% between 1989 and 1995).

<sup>280</sup> See Wisebrod et al., *supra* note 73, at 70 & 72 (reporting that debt burden associated with mortgage undertaking has significantly increased beginning in the late 1980s).

<sup>281</sup> See TAMARI, *supra* note 128, at 19.

<sup>282</sup> See AS WE FORGIVE OUR DEBTORS, *supra* note 15, at 137 (“Homeownership and self-employment may go hand in hand for a variety of reasons.”).

undertaking a mortgage loan. Faced with the double risk of home ownership and small business ownership,<sup>283</sup> many home owning entrepreneurs ended up in bankruptcy.

#### L. CONCLUSION

This study finds that an overwhelming number of the bankruptcy petitioners in Israel are former entrepreneurs. Hence, the demographic characteristics of the average bankruptcy petitioner in Israel are very similar to those of entrepreneurs in Israel. That is, the gender, marital status, age, religious affiliation and ethnic background of the average bankruptcy petitioner resemble those characteristics of entrepreneurs generally in Israeli society.

However, the similarities end there. Unlike the financial position of the average citizen in Israeli society, this study paints a stark picture of the acute financial crisis facing the average debtor in Israeli bankruptcy. As a group, the debtors in bankruptcy have significantly fewer assets, ten times more debt, half of gross income and significantly less disposable income than average Israeli citizens. The bankrupts also have a higher poverty rate, larger families, higher welfare dependency rate, higher disability rate, higher divorce rate, lower home ownership rate, and lower car ownership rate than does the general population.

The contemporary predominance of entrepreneurs in the Israeli bankruptcy population reflects Israel's welfare state policy, its recent deregulation of the credit market, and the credit standards employed by the financial sector in Israel. Wage earners, who constitute less than a quarter of the Israeli bankruptcy population, have been

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<sup>283</sup> *See id.* ("We may see more homeownership entrepreneurs in bankruptcy because the double risks of home ownership and small business ownership put these people at disproportionate risk for financial collapse.").

insulated from financial trouble, to a large extent, by generous welfare benefits and socialized medicine. Entrepreneurs, in contrast, are entitled to significantly less welfare benefits.

The government contributed to the financial vulnerability of Israeli entrepreneurs beginning in the late 1980s with deregulation of the credit market, making it possible for the first time for small business owners to borrow substantial sums. Although the government had also deregulated the consumer credit market at the same time, financial institutions (with the government's subtle encouragement) have employed stringent consumer credit standards, while opting for much much-relaxed credit standards for small business loans.

Hence, the extent of the government's safety net and its approach to credit deregulation, together with financial institutions' credit policies, have contributed to the shape of the bankruptcy population in Israel today.

Unfortunately, the scope of bankruptcy relief in Israel is not appropriately tailored to the credit industry deregulation, the social safety net, and the credit extension standards currently employed by financial institutions. The generous welfare benefits the government extends to its citizens initially appears to justify a limited fresh-start policy in the Israeli bankruptcy context. However, the entrepreneurs' limited entitlement to welfare benefits, the recent de-regulation of credit market, together with banks' relaxed credit extension standards to small business owners, necessitate a broader design of fresh-start in bankruptcy, especially when it comes to financially troubled individuals who were former entrepreneurs.

Broader fresh-start policy in Israel directed especially at entrepreneurs is justified on both moral and economic grounds. First, through its recent actions of subsidizing credit to small business enterprises, deregulating the credit market including credit in the small business sector, and adopting laws to make it easier for small businesses to obtain financing, the government has indirectly contributed to the financial vulnerability of many newly formed small business enterprises in Israel. While the Israeli government has traditionally exhibited undeterred tendencies to bail out large government-promoted financially troubled enterprises,<sup>284</sup> it should likewise consider extending a financial cushion for the enterprises it recently helped to promote, the small business entrepreneurs.

A broader financial relief in bankruptcy will not only be cognizant of government own involvement in making it possible for many entrepreneurs to become overly indebted. Rather, it would also increase the level of economic activity in the form of entrepreneurship, which the government has been actively seeking to promote recently, by sending a message to the marketplace that a meaningful fresh-start will be made available to individuals who actively pursue entrepreneurship but fail.<sup>285</sup>

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<sup>284</sup> See Bruno & Meridor, *The Costly Transition from Stabilization to Sustainable Growth: Israel's Case*, in LESSONS OF ECONOMIC STABILIZATION AND ITS AFTERMATH, *supra* note 146, at 252 & 259-60.

<sup>285</sup> See John M. Czarnetzky, *The Individual and Failure: A Theory of the Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 399 (2000) (contending that individual discharge in bankruptcy is essential to the fostering of entrepreneurship in the market place as it increases an individual entrepreneur's confidence regarding the consequences of his actions and encourages the entrepreneur to act); Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and Interpretive Theory*, 21 U. RICH. L. REV. 49, 64 (1986) (stating that primary objective of fresh-start policy was to encourage undertaking of business risks); Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. 99, 125 (1990) (contending that "[b]ankruptcy discharge, we also believe, encourages beneficial, albeit risky, business activity by merchants and manufacturers."); Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity* 14 (Jan. 2000) (unpublished manuscript, on file with author) ("The bankruptcy system makes going into business more attractive to potential entrepreneurs by providing them with partial wealth insurance.").

Lastly, a broader fresh-start policy, particularly aimed at small business owners, will not only be consistent with recent government actions encouraging credit undertaking by small business owners and foster more entrepreneurship activity in the economy, but it may also force relatively sophisticated financial institutions (who are by far the lead credit extenders to small businesses in Israel) to extend loans to small business owners more efficiently. That is, with the prospects of having to forgive their small business debtors some or all of their debts in bankruptcy, these financial institutions will be more likely to end the practice of extending large amounts of credit with little, if any, due diligence.<sup>286</sup>

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<sup>286</sup> See Ausubel, *supra* note 213, at 270 (suggesting that broad fresh-start policy in bankruptcy would discourage financial institutions from overextending credit in the first place); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1426 (1985) (“[Discharge policy] leaves the determination of whether to extend credit to *creditors*, who presumably are better trained in credit policy than are legislators, and who are better able, by observing individual debtors or by employing specific contractual covenants, to monitor individuals’ consumption of credit.”).