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Bankruptcy around the World: Explanations of its Relative Use

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Abstract:

The recent literature on law and finance has drawn attention to the importance of creditor rights in influencing the development of financial systems and in affecting firm corporate governance and financing patterns. Recent financial crises have also highlighted the importance of insolvency systems to resolve corporate sector financial distress. The literature and crises have highlighted the complex role of creditor rights, affecting not only the efficiency of ex-post resolution of distressed corporations, but also influencing ex-ante risk-taking incentives and an economy's degree of entrepreneurship more generally. This paper starts with documenting how often bankruptcy is actually being used for a panel of 37 countries. It next investigates the effects of specific design features of insolvency regimes, in relationship to the quality of countries' overall judicial systems, on the use of bankruptcy. We find, correcting for overall financial development and macroeconomic shocks, that bankruptcies are higher in Anglo-Saxon countries and in market-oriented financial systems characterized by weaker and multiple banking relationships. We also find that greater judicial efficiency is associated with more use of bankruptcy, but that the combination of stronger creditor rights with greater judicial efficiency leads to less use. Interestingly, we find that the presence of a "stay on assets" leads to fewer bankruptcies independently of the efficiency of the judicial system. These findings suggest that there are important incentive effects of insolvency systems encouraging less risky behavior and more out-of-court settlements.

1. Introduction

The recent literature on law and finance has drawn attention to the importance of equity and creditor rights in influencing the development of financial systems and in affecting firm corporate governance and financing patterns (see La Porta et al. 1997). This literature finds that greater investor protection encourages the development of financial markets and instruments and that countries that better protect creditors have generally larger credit markets. An important aspect of the strength of creditor rights is a country's insolvency regime and its specific features, and recent financial crises have highlighted the importance of insolvency systems to resolve corporate sector financial distress.

In its design features, an insolvency regime tries to balance several objectives, including protecting the rights of creditors and other stakeholders – essential to the mobilization of capital for investment and working capital and other resources – and obviating the premature liquidation of viable enterprises (see Stiglitz 2001 and Hart 2000 for reviews).¹ A good insolvency regime should be ex ante efficient, in that it prevents managers and shareholders from taking imprudent loans and lenders from giving loans with a high probability of default. It should also positively influence an economy's degree of entrepreneurship more generally. An insolvency regime should also deliver an ex post efficient outcome, in the sense that the highest total value is obtained for the distressed firm. The working of a country's judicial system further complicates balancing

¹ Regimes can have several features, such as whether the law provides for an automatic trigger when a company needs to file for bankruptcy, who can file for reorganization or liquidation, the weight given to the debtor, the creditors (bank loans, trade financing), the company's management, and the other stakeholders in preparing reorganization

these incentives. In addition to adequate legal rights, there is a need for an efficient judicial system to enforce these rights, or at least to serve as a credible threat (see Modigliani and Perotti, 2000).

As the structure of economic production and values of stakeholders are changing, as well as in response to recent crises, countries are also continuously reevaluating the features of their creditor rights regimes and how their insolvency systems deal with financially distressed firms. This has proven to be a complicated area, with discussions on reform in many countries taking considerable time. The analytical literature and recent crises already highlighted the complex role of creditor rights in affecting not only the ex-post resolution of distressed corporations, but also influencing ex-ante incentives and an economy's degree of entrepreneurship more generally.

Reform may also be hampered by the lack of much empirical evidence across countries on the effects of bankruptcy use and efficiency. While more data are being collected on difference in regimes across countries, to date, cross-country empirical evidence is largely limited to the general effects of creditor rights.² Much less is known on the effects of specific creditor right features and their interaction with the judicial system and other country characteristics. While it is clear, for example, that bankruptcy procedures can be an important mechanism to resolve financial distress, it not known how often bankruptcy is actually being used in countries around the world. Neither do we know why its usage varies by country depending on characteristics like variations in

proposals, the ability of management to stay during the reorganization, and whether an automatic stay of assets exists. See further Hart (2000) and Stiglitz (2001).

² The World Bank, ADB, and IDB have started to document the detailed features of bankruptcy systems in many countries. The World Bank has undertaken a review of desirable principles and guidelines for bankruptcy systems.

legal systems, accounting standards and regulatory frameworks, as well as differences in the development of financial and capital markets and macroeconomic conditions.

The purpose of this paper is to explore the effects of different type of creditor rights and the relative importance of country characteristics that can help explain the relative use of bankruptcy. For this, we collect from various government and private sources a unique dataset of the number of commercial bankruptcies in 37 countries.

Almost all countries in our sample have laws protecting secured creditor rights and have bankruptcy laws permitting both liquidation and restructuring of distressed firms. There is considerable variation, however, in how frequently these laws are resorted to through a formal bankruptcy filing. With this data we investigate which design features, and which legal, financial, and other country characteristics affect the likelihood that creditors use formal bankruptcy procedures as a means of resolving corporate financial distress. To our knowledge, this paper is the first attempt to identify empirically the reasons of the use of bankruptcy around the world.

We find, correcting for overall financial development and macroeconomic shocks, that bankruptcies are higher in Anglo-Saxon countries and in market-oriented financial systems characterized by weaker and multiple banking relationships. We also find that greater judicial efficiency is associated with more use of bankruptcy, but that the combination of stronger creditor rights – both aggregated and evaluated separately by specific features – and greater judicial efficiency leads to less bankruptcy use.

Interestingly, we find that the presence of a “stay on assets” leads to fewer bankruptcies independently of the efficiency of the judicial system. These findings suggest that there are important ex-ante incentive effects of insolvency systems encouraging less risky

behavior and more out-of-court settlements. But the findings also suggest that efficient legal mechanisms themselves help speedy resolution of corporations when in financial distress.

2. Previous Literature and Hypotheses

The central role played by law and regulatory institutions in the development of financial markets in general and in corporate finance in particular has received considerable attention in recent years. King and Levine (1993) and Demirguc-Kunt and Maksimovic (1998) find a positive relationship between the quality of laws and the growth of industrial firms across a wide cross-section of countries. La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997) examine cross-country differences in the quality of laws, regulations, and enforcement, including creditor rights. They document considerable variation in the protection offered to creditors and minority shareholders across countries and find a significant association between the legal origins of a country and the quality of investor protection. Their findings show that common law countries (English) provide the best investor protection whereas civil law origin (French, German, and Scandinavian) countries provide the least investor protection. They have reported significant relationship between legal origins and various corporate governance issues, such as dividend payout and corporate ownership around the world.

Importantly, La Porta et al. (1997 and 1999) have drawn attention to the importance of equity and creditor rights in influencing the development of financial systems and in affecting firm corporate governance, ownership and financing patterns. To show these relationships, La Porta et al. (1997) created an index of CREDITOR RIGHTS

consisting of the summation of four dummy variables, where the highest possible score is 4. The dummy variables are: TIME, equal to 1 if the timetable for rendering a judgment is less than 90 days, and 0 otherwise; MANAGER, equal to 1 if incumbent management does not stay during a restructuring or bankruptcy, and 0 otherwise; STAY, equal to 1 if there is no automatic stay on assets, and 0 otherwise; CREDITOR, equal to 1 if secured creditors have the highest priority in payment, and 0 otherwise. They then report a positive relationship between the ratio of domestic debt to GDP and this index, controlling for the country's legal origin (Anglo-Saxon, French, Germanic, and Scandinavian) and the existence of the rule of law in the country.

La Porta et al. 1997 do not investigate the effects of each of the specific sub-indexes on the development of the credit markets. We may expect, however, that there are considerable differences between the effects of each specific creditor rights on firm and creditor behavior. A stipulation in the insolvency law which provides creditors with the right of no automatic stay on assets, for example, provides creditors with some bargaining power which may allow to more easily negotiate debt restructuring out of court. The presence in the law of secured creditor priority and absolute priority of claims in bankruptcy or restructuring (i.e., senior creditors are paid first, then junior creditors, followed finally by shareholders if any residual remains) may deter ex-ante risky financial behavior and thus reduce the likelihood of financial distress. Such feature can also help overcome creditor coordination problems when in restructuring. At the same time, if the law stipulates that shareholders receive nothing in bankruptcy, a firm may attempt to delay or avoid bankruptcy, including undertaking high-risk projects when the corporation runs into financial distress. Depending on whether the insolvency law at the

same time stipulates whether managers have to automatically leave when a firm is in bankruptcy, incentives will vary whether managers will act or not on behalf of shareholders. These and other examples show that the specific features of creditor rights may influence firm and creditor behavior differently, and that this in turn may be reflected in the relative use of bankruptcy across countries.

We may expect that the usage of bankruptcy to vary with the strength of (specific) creditor rights. But this is provided creditors have the ability to use these rights, which depends on the efficiency of the judicial system. Modigliani and Perotti (2000) draw attention to that when a country's enforcement regime is unreliable, transactions may be carried out through some form of private enforcement. Corporate financial distress provides one setting to examine this prediction. Claessens, Djankov, and Klapper (2002) find that in a sample of East Asian countries, creditors are more likely to incur the costs of bankruptcy if ex-ante creditor rights and ex-post judicial efficiency indicate a likely recovery of losses. More generally, if bankruptcy laws were broadly similar across various legal origins, then variation in enforcement efficiency would cause differences in the use of formal bankruptcy procedures. For example, a country with strong legal enforcement would see a more frequent use of the statutory provisions provided in the legal code. Alternatively, if enforcement is weak, we may expect debtors and creditors to work out the reorganization through private negotiations, as the transaction costs of using an inefficient enforcement system may be too high.

The impact of the (lack of) judicial efficiency may also vary by specific creditor right as the need for enforcement in courts varies. The absence of an automatic stay on assets may, for example, be very valuable to creditors when the judicial system is weak

as it can force debtors to negotiate out of court. More generally, whether courts are asked to help resolve financial distress will depend on the efficiency of the judicial systems – creditors are more likely to undertake the costs of bankruptcy if they are able to effectively use the courts in the case of default. Berkowitz, Pistor and Richard (2000) argue then also that the quality of laws, as often measured by the country's legal origin, is only a crude proxy for the effectiveness of legal systems – instead it is the effective enforcement of laws rather than the quality of laws that matters.³

In addition to exploring the relationship between the use of bankruptcy and the subindexes of creditor rights, we also want to investigate the relative role of bank-oriented versus market-oriented financial systems. As discussed by Allen and Gale (1997), Levine (1999), and Demirguc-Kunt and Levine (1999), countries differ in the structure of their financial system. In bank-oriented economies, firms often depend on a single, powerful banking relationship as a primary source of all forms of external finance, which may include both debt and equity financing. Alternatively, in market-oriented economies, firms often have multiple bank lenders and widely held publicly traded equity. We would expect that the arms-length banking relationship found in market-oriented systems presents more incentive for creditors to use formal bankruptcy measures to coordinate among creditors. As shown in Gilson, John, and Lang (1990), firms in the United States that use in-court bankruptcy proceedings have a smaller percentage of debt owed to banks and a greater number of lenders. This suggests that creditors in market-based economies may benefit more from those aspects of bankruptcy law that aim to overcome collective action problems among creditors. Also, in bank-based systems there

³ Rajan and Zingales (2000) also provide evidence that argues for factors other than legal

may be more scope for conflicts between the role of banks as creditors and equity holders and more perverse relationships. Claessens, Djankov, and Klapper (2000) show that firms in East Asia with a bank as their controlling shareholder are less likely to use bankruptcy as a means of resolving financial distress.

Furthermore, we want to test whether countries with more significant entry restrictions have fewer bankruptcy filings. The lack of entry would make for a less competitive industry that in turn could imply fewer exits, as discussed extensively in the industrial organization literature, such as Hopenhayn (1992).⁴ In previous literature, Dunne, Roberts, and Samuelson (1988) find that entry and exit rates within industries are highly correlated – industries with higher than average entry rates tend to also have higher than average exit rates.

In addition to these institutional variables, we also expect that the general development of the country, the occurrence of a systemic banking crisis and the degree of macro-stability and economic growth will affect the relative use of bankruptcy.

3. Summary Statistics

The number of total commercial bankruptcy filings was collected from government and private sources around the world for all available years between 1990-1999.⁵ In order to compare the relative use of bankruptcy cross-country, we normalize the number of bankruptcy filings. We use the total number of firms, as provided by Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2000) and official country statistical

origin as predictors of stock market growth.

⁴ For a review of the literature see Caves (1998).

handbooks. Tables 1 and 2 show summary statistics for the countries in our sample panel.⁶

To explain the relative use of bankruptcy, we include as dependent variables measures of macroeconomic performance, financial structure, efficiency of judicial system and the specific creditor rights. We expect that the number of failed firms to depend on a country's current and expected economic performance, as measured by the performance and growth of GDP. We include lagged real GDP per capita in US\$, $GDPPC_{t-1}$, and the lagged growth rate of real GDP, $GDPG_{t-1}$.⁷ We expect that countries experiencing negative growth or greater uncertainty about future growth should have higher rates of defaults. We also control for periods of systemic banking crises with data from Caprio and Klingebiel (2000), D_CRISIS_{t-1} , which may indicate periods during which borrowers are more constrained in finding additional bank financing and more likely to file for bankruptcy. We also include lagged real interest rates as a measure of the cost of financing, $RINTEREST_{t-1}$.

To measure the relative orientation of banks versus equity markets, we include a dummy variable estimated by Demirguc-Kunt and Levine (1999), $D_BNKORIENT$, that identifies countries as market- versus bank-oriented, depending on the size of the intermediated versus direct markets. The relationship of this measure with bankruptcy is unclear. On the one hand, as discussed, firms in bank-oriented economies tend to have

⁵ Although there is variation across countries in the definition and implications of bankruptcy, we include all legal proceedings designed to either liquidate or rehabilitate an insolvent firm. See Appendix 1 for the country sources.

⁶ For 7 countries, only the total number of manufacturing firms is available. For these countries we extrapolate the total number of firms by sector and legal origin (English, French, etc.). All empirical results are robust to the exclusion of these countries.

closer relationships with their primary bank, which may also have an equity investment in the firm, and may therefore be less inclined to use formal (and costly) bankruptcy filings to resolve financial distress. Alternatively, however, since firms in bank-oriented economies have typically greater percentages of bank debt, we could expect that the higher leverage would be reflected in higher number of bankruptcies in bank-oriented systems.

To test whether countries with more significant entry restrictions have fewer bankruptcy filings, we use the data collected in Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2000) on the restrictiveness of entry—the time to establish a new business—to test whether these rates tend to be correlated across countries. This variable is called TIME.

We include dummies to proxy for legal origins—FRENCH, ENGLISH, GERMAN, SCANDINAVIAN, and TRANSITION—to proxy broadly for debtor-friendliness.⁸ However, in addition to legal origins, which are exogenously determined, we expect the implementation of laws to be significant and therefore also include an index of judicial efficiency from Berkowitz and Pistor (1999), LEGALITY.⁹ This index is the weighted average of indexes of Efficiency of the Judiciary, Rule of Law, Corruption, Risk of Expropriation, and Risk of Contract Repudiation (Berkowitz, et al., 2002). We expect bankruptcy rates to be highest in countries where debtors can ex-ante write strong contracts and ex-post enforce their contracts in court.

⁷ The subscript, *t*, indicates a time series. All other variables are constant over time, by country.

⁸ We include a dummy for transition countries that is not included in previous literature.

⁹ This index is missing for transition economies.

Finally, we use the La Porta et al. (1998) index of CREDITOR RIGHTS, consisting of the summation of four dummy variables, where the highest possible score is 4.¹⁰ We also use the individual sub-indexes. RESTRICTIVE REORGANIZATION, equal to 1 if the timetable for rendering a judgment is less than 90 days, and 0 otherwise; NO AUTOMATIC STAY ON ASSETS, equal to 1 if there is no automatic stay on assets, and 0 otherwise; SECURED CREDITOR PRIORITY, equal to 1 if secured creditors have the highest priority in payment, and 0 otherwise; MANAGEMENT DOESN'T STAY, equal to 1 if incumbent management does not stay during a restructuring or bankruptcy, and 0 otherwise.

4. Empirical Results

We set up the regressions as a panel of country and years. Since we do not have the same number of years in which we have observation on bankruptcy rates for each country (Table 2), we end up with an unbalanced panel of some 260 observations. Our first regression results are shown in Table 3. The specification used includes every time the level of GDP per capita, lagged GDP growth rate, a dummy for whether the country experienced a systemic financial crisis during this period, and the real interest rate. Column (1) shows the base regression results. We find that countries with higher levels of real GDP per capita have higher uses of bankruptcy. This suggests that greater overall development is consistent with greater judicial efficiency and more court usage. Lagged GDP growth rate has the expected negative sign, and is statistically significant at the 10% level. The systemic crisis dummy has the expected positive sign, but is not statistically

¹⁰ Almost all countries have formal liquidation and reorganization laws (see Appendix 2).

significant. The real interest variable has a positive sign as well, but is also not statistically significant.

When also introducing individual country-dummies (Column 2), the significance of some of the variables changes. In particular, the level of GDP per capita and the lagged output growth rates are no longer statistically significant, which can be expected as the country dummies control for much of each country's overall macroeconomic environment. The systemic crisis dummy becomes statistically significant, however, while the real interest rate keeps its positive, but still insignificant sign.

The next regression (Column 3) includes the market orientation variable. The significantly positive coefficient on D_MKTORIENT shows that bankruptcy use is greater in countries with more use of market financing and less in bank-based systems. This supports our hypothesis that countries in which banks have closer relationships with borrowing firms—and have less need for court-driven coordination among creditors—are less likely to use bankruptcy to resolve financial distress. The fact that bank-oriented systems have also higher leverage does not seem to offset this effect.

Table 3, Column (4) shows the effect of the ease of new business entry on the use of bankruptcy. We find a significantly positive relationship between the time required to operate a new business and the use of bankruptcy—countries in which it is more restrictive and difficult to open a new business also have lower rates of bankruptcy. One explanation is that both procedures—registering a new business and filing for bankruptcy—are dependent on efficient and honest judicial systems. This seems not generally the case, however. Germany, for example, which has a high index of judicial efficacy, requires a relatively long time to start a new business, 90 working days, and has

a relatively low average bankruptcy rate of 1.03% (on average). In contrast, Canada, which also has a high level of judicial efficiency, requires only 2 days to start a new business and has a relatively high average bankruptcy rate of 2.96%. Rather, this relationship suggests that countries that allow easy business entry permit a natural “learning-curve”, during which more firms are expected to fail, while countries that require, for example, more documentation of qualifications and financial backing, can be expected to have lower rates of business defaults. Another, complementary explanation is that countries which restrict competition through entry also allow more inefficient firms to survive, thus keeping the overall bankruptcy rate low.

Finally, we include (Column 5) the share in total employment by small and medium sized enterprises (SMEs). This variable is collected from a variety of sources, and as such perhaps not as robust and indicator of the importance of the small firms to the economy. It is, however, very significantly negative, suggesting that SMEs are less likely to use bankruptcy courts. This may be because SMEs are less likely to run into financial distress or because of fixed costs involving in using courts, which makes using formal bankruptcy less efficient for SMEs.

We next introduce the legal variables. We start with the relationship between legal origins and bankruptcy rates. Table 4, Column (1) shows that civil-law countries (French and Germanic), which are categorized as having weaker creditor rights, use bankruptcies significantly less than countries in other legal orientations.¹¹ Column (2) includes the index of judicial efficiency, LEGALITY, which proxies for the efficiency of

¹¹ The exception is Scandinavia, which has significantly higher bankruptcies than English countries, although this may be a result of Scandinavia’s recent banking crisis and the

the courts and the rule of law. We find judicial efficiency to be significant positively related to the occurrence of bankruptcy—the greater the likelihood of a creditor speedily and successfully collecting in the court, the more likely creditors are to use formal and costly bankruptcy proceedings in the case of default. When we include both legal origin and legality, Column (3), we find that both are statistically significant, but that the coefficient for the LEGALITY variable loses some of its significance. This is probably as there is a correlation between the legal family of a country and the efficiency of its legal system (as already noted by La Porta et al. (1998)).

Next we study the importance of the overall strength of creditor rights by including the index CREDITOR RIGHTS in the regression (Column 4). Interesting, the overall strength of creditor rights is not statistically significant related to the occurrence of bankruptcy across countries. An argument could be made that on one hand stronger laws deter bankruptcy—as debtors and creditors both avoid risky financing patterns and prefer to negotiate out of court¹²—while on the other hand stronger rights allow bankruptcy procedures to be used more effectively. The net effect may be that the aggregate creditor rights are not statistically significantly related to the occurrence of bankruptcy. When we also include the degree of judicial efficiency (Column 5), we find that the coefficient for creditor rights changes sign, although it still remains statistically insignificant. This provides some support for the hypothesis that the overall strength of creditor has two offsetting effects: the deterrence part, with a negative relationship with

fact that all Scandinavian countries are high-income. Also the coefficient for Scandinavia is not statistically significant at the 10% level.

¹² However, often, even in the US, when parties reach an agreement outside of court they frequently formally file for bankruptcy to avoid future contract disputes.

bankruptcy usage, and the actual usage part, with a positive relationship with bankruptcy usage. The latter relationship is picked up in part in this regression by the efficiency of the legal system, making the coefficient for creditor rights more negative.

This may still be the incorrect interpretation since we analyzed the strength of the aggregate creditor rights, and not yet its individual components. As discussed before, each of the four separate creditor rights may have a different effect on the occurrence of bankruptcy. We therefore analyze next the relationships between the four separate indexes and the occurrence of bankruptcy (Table 5a). Of the four subindexes, one is statistically significant positive (RESTRICTIVE REORGANIZATION, Column 1) and one is statistically significant negative (NO AUTOMATIC STAY ON ASSETS, Column 2). The other subindexes are not statistically significant. This suggests that the deterrence and actual usage effects vary by creditor rights. The presence of restrictions for going into reorganization, such as creditors' consent, seems to provide a tool to actually force more bankruptcy. The ability of secured creditor to seize assets even when a firm has filed for reorganization, in contrast, seems to deter bankruptcy. Note that in these regressions we control for the effects of the judicial efficiency on the likelihood of bankruptcy by including our legality variable that has consistently a positive relationship with the number of bankruptcies.

To further check the interaction between the effects of the judicial efficiency and the individual and aggregate creditor rights, we run a set of regressions where we include, in addition to the creditor rights (sub-) indexes and the judicial efficiency index, also interaction variables between the two (Table 5b). We find that the coefficients for the interaction variables between the aggregate creditor rights index and most of the creditor

rights subindexes have statistically significant negative signs. At the same time, the creditor rights index and the subindexes themselves are mostly statistically significant positive.¹³ This suggests that in countries with high judicial efficiency, the credible threat of speedy action by the courts combined with strong creditor rights deters risky behavior and encourages out-of-court negotiations. However, speedy action by the courts in itself leads to more usage of bankruptcy, as does the presence of stronger creditor rights. This in turn suggests that in countries with weak judicial proceedings, creditors will use bankruptcy—a costly resolution—only if they have strong entitlements. In other words, in weak judicial settings, rights may have to be stronger compensate.

5. Conclusion

In this paper we report the relative number of commercial bankruptcies filings in 37 countries and use this data to investigate which legal, financial, and other country characteristics affect the likelihood that formal bankruptcy procedures is used as a means of resolving corporate distress. We find, correcting for overall development and macroeconomic shocks, that firms in market-oriented economies are more likely to use bankruptcy to resolve financial distress. This may be attributed to the weaker banking relationships and the stronger need for a legal framework to assist with coordination among creditors. We also find that countries with more efficient and speedy procedures to open a new business also have greater bankruptcy use. This may reflect not only an overall more effective legal and regulatory process, but also a relationship between greater firm entry and exit. And we find that the presence of more small and medium is

¹³ The only exception is that of the NO AUTOMATIC STAY ON ASSETS index.

associated with less usage of bankruptcy, which may reflect the costs of using formal bankruptcy procedures.

We find that bankruptcies are higher in Anglo-Saxon countries, but that stronger creditor rights alone are not associated with more use of bankruptcy. There are important differences in these effects by individual creditor rights, however, and we find that the presence of a “no automatic stay on assets” leads to fewer bankruptcies and the presence in the law of a “restriction on reorganizations” to more bankruptcies. These results are also not independent of the efficiency of the judicial system. We find that greater judicial efficiency is associated with more use of bankruptcy, but that the combination of stronger creditor rights with greater judicial efficiency leads to less use. These findings suggest that there are important incentive effects of insolvency systems combined with good judicial systems encouraging less risky behavior and more out-of-court settlements. They also suggest that in countries with weak judicial proceedings, strong creditor rights are more necessary to compensate for weaknesses on the judicial side.

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Table 1: Summary Statistics, by Country

Number of Bankruptcies was collected from sources listed in Appendix 1. *BNKRPT_FRM* is the ratio of the number of bankruptcies to the number of firms (Djankov, et al., 2000.) Real GDP per capita (*GDPPC*), GDP growth (*GGDP*), and real interest rates (*RINTEREST*) are from the International Financial Statistics. Statistics are reported as the average over the period of available years.

Country	Available Years	Number of Bankruptcies	BNKRPT_FRM (%)	GDPPC (US\$)	GGDP (%)	RINTEREST (%)
<i>ARGENTINA</i>	92-99	2,144.4	0.12	10,622.13	6.38	6.96
<i>AUSTRALIA</i>	94-99	8,253.3	3.15	21,105.05	4.16	7.65
<i>AUSTRIA</i>	90-99	2,065.1	1.33	20,716.48	2.55	3.65
<i>BELGIUM</i>	90-99	4,850.2	2.59	20,890.22	2.01	7.21
<i>CANADA</i>	90-98	12,696.7	2.96	21,407.05	1.68	6.25
<i>CHILE</i>	90-99	88.6	0.28	6,728.21	7.62	11.38
<i>COLOMBIA</i>	96-99	109.0	0.08	6,137.86	2.65	17.94
<i>CYPRUS</i>	90-98	81.9	0.06	14,829.36	4.73	5.18
<i>CZECH REPUBLIC</i>	92-96	1,729.4	1.49	11,295.20	-0.78	-1.00
<i>DENMARK</i>	90-99	2,375.9	1.53	21,063.87	2.31	7.81
<i>FINLAND</i>	90-98	5,106.1	4.14	17,723.61	1.45	6.36
<i>FRANCE</i>	98	53,223.6	1.89	19,251.36	1.95	6.34
<i>GERMANY</i>	92-98	21,152.6	1.03	20,614.87	1.52	8.42
<i>HONG KONG</i>	94-98	567.2	0.21	21,869.24	4.98	4.01
<i>HUNGARY</i>	92-96	8,425.4	1.99	8,633.83	-2.22	5.85
<i>ICELAND</i>	96-98	1,665.3	8.00	23,807.20	3.67	10.13
<i>INDIA</i>	90-99	205.6	0.04	1,719.58	5.73	6.06
<i>IRELAND</i>	90-99	788.6	2.74	15,290.29	7.31	6.11
<i>ISRAEL</i>	95-99	518.0	2.89	17,220.60	4.74	9.20
<i>ITALY</i>	90-96	8,663.1	0.54	18,318.86	1.53	7.54
<i>JAPAN</i>	90-99	14,000.6	0.22	21,832.26	2.08	3.64
<i>NETHERLANDS</i>	95-99	3,996.0	1.30	19,893.80	3.58	4.57
<i>NEW ZEALAND</i>	93-98	716.0	3.67	16,863.32	3.54	9.48
<i>NORWAY</i>	90-98	3,546.6	1.83	22,103.02	3.36	8.04
<i>PERU</i>	93-99	145.1	0.05	4,055.07	4.98	23.16
<i>POLAND</i>	90-96	3,319.6	0.23	6,567.78	1.33	4.92
<i>PORTUGAL</i>	91-99	516.4	0.08	12,990.27	2.66	7.55
<i>RUSSIA</i>	95-98	1,357.3	0.15	7,060.41	-4.80	42.83
<i>SINGAPORE</i>	90-99	227.8	3.06	19,050.80	8.08	4.49
<i>SOUTH AFRICA</i>	90-99	2,918.6	4.62	8,265.64	1.38	7.31
<i>SPAIN</i>	90-99	518.6	0.02	14,225.33	2.51	5.30
<i>SWEDEN</i>	90-99	13,917.1	7.61	18,911.67	1.22	7.56
<i>SWITZERLAND</i>	90-99	4,014.9	1.45	24,453.86	1.15	3.66
<i>THAILAND</i>	90-99	346.7	0.12	5,189.06	5.86	8.49
<i>TURKEY</i>	98-99	1,496.0	0.86	6,384.34	5.24	-0.09
<i>UNITED KINGDOM</i>	92-98	17,037.3	0.67	18,398.50	1.76	3.81
<i>UNITED STATES</i>	90-99	55,752.6	3.65	25,768.34	2.91	5.79

Table 2: Summary Statistics, by Country

D_MKTORIENT is a dummy equal to 1 if the country is market-oriented and equal to 0 if the country is bank-oriented (Demirguc-Kunt and Levine, 1999). *TIME* is the number of business days required for a business to become operational (Djankov et al., 2000). *SME_SHARE* is the percentage of total employment in the SME sector (Klapper and Sulla, 2002.) *Legality* is an index of legal and judicial efficiency (Berkowitz, et al., 2002) *Creditor Rights* is an index from 1 to 4 (La Porta, et al., 1999).

Country	D_MKTORIENT	TIME	SME_SHARE	LEGAL ORIGINS	LEGALITY	CREDITOR RIGHTS
ARGENTINA	0	71	70	French	12.34	1
AUSTRALIA	1	3	40	English	20.44	1
AUSTRIA	0	154	57	German	20.76	3
BELGIUM	0	42	55	French	20.82	2
CANADA	1	2	56	English	21.13	1
CHILE	1	78	90	French	14.7	2
COLOMBIA	0	N/A	67	French	11.58	0
CYPRUS	0	N/A	N/A	French	N/A	N/A
CZECH REPUBLIC	0	97	65	Transition	N/A	N/A
DENMARK	1	21	70	Scandinavian	21.55	3
FINLAND	0	32	45	Scandinavian	21.49	1
FRANCE	0	N/A	64	French	19.67	0
GERMANY	0	90	76	German	20.44	3
HONG KONG	1	41	60	French	19.11	4
HUNGARY	0	53	64	Transition	N/A	N/A
ICELAND	0	N/A	N/A	Scandinavian	N/A	N/A
INDIA	0	61	39	English	12.8	4
IRELAND	0	25	50	English	18.92	1
ISRAEL	0	32	N/A	English	16.54	4
ITALY	0	121	73	French	17.23	2
JAPAN	0	50	78	German	20.36	2
NETHERLANDS	1	68	60	French	21.67	2
NEW ZEALAND	0	17	54	English	21.55	3
NORWAY	0	24	54	Scandinavian	21.78	2
PERU	1	171	68	French	10.1	0
POLAND	0	26	75	Transition	N/A	N/A
PORTUGAL	0	99	70	French	17.2	1
RUSSIA	0	N/A	10	Transition	N/A	N/A
SINGAPORE	1	36	N/A	English	19.53	4
SOUTH AFRICA	1	30	N/A	English	14.52	3
SPAIN	0	83	70	French	17.13	2
SWEDEN	1	17	57	Scandinavian	21.56	2
SWITZERLAND	1	88	70	German	21.91	1
THAILAND	1	39	N/A	French	12.94	3
TURKEY	1	55	61	French	11.84	2
UNITED KINGDOM	1	11	43	English	20.41	4
UNITED STATES	1	7	52	English	20.85	1

Table 3: Cross-Country Regressions

The dependent variable is the ratio of the number of bankruptcies to the number of firms. The regressions are estimated using ordinary least squares with robust standard errors. $LN(GDPPC)$ is the log of GDP Per Capita. $GGDP$ is the 1-year growth rate of real GDP. $D_SYSTCRISIS$ is a dummy equal to 1 in the case of a systemic bank crisis (Caprio and Klingebiel, 2000). $RINTEREST$ is real interest rates. $D_MKTORIENT$ is a dummy equal to 1 if the country is market-oriented and equal to 0 if the country is bank-oriented (Demirguc-Kunt and Levine, 1999). $TIME$ is the number of business days required for a business to become operational (Djankov et al., 2000). SME_SHARE is the percentage of total employment in the SME sector (Klapper and Sulla, 2002.) t-statistics are in parenthesis, *, **, and *** indicate significance at 1%, 5%, and 10% respectively.

	(1)	(2)	(3)	(4)	(5)
	Base Regression	With Country Dummies	Market Orientation	Business Entry	SMEs
<i>Constant</i>	-0.0794*** (-4.89)	-0.0090 (-0.14)	-0.0087*** (5.75)	-0.0419*** (-2.98)	-0.0633*** (-6.37)
$LN(GDPPC_{t-1})$	0.0103*** (6.73)	0.0015 (0.18)	0.0105*** (7.10)	0.0071*** (5.51)	0.0125*** (11.85)
$GGDP_{t-1}$	-0.0006* (-1.75)	-0.0002 (-0.87)	-0.0400 (-1.56)	-0.0008*** (-2.65)	-0.0002 (-0.60)
$D_SYSTCRISIS_{t-1}$	0.0050 (0.85)	0.0081*** (2.98)	0.5700 (1.30)	0.0011 (0.26)	0.0099* (1.93)
$RINTEREST_{t-1}$	0.0002 (1.18)	0.0002 (1.25)	0.0000 (0.18)	0.0004*** (3.36)	0.0005*** (2.36)
$D_MKTORIENT$			0.0099*** (3.84)	0.0048** (2.11)	
$TIME$				-0.0002*** (-9.13)	
SME_SHARE					-0.0007*** (-9.49)
<i>Country Dummies</i>		yes			
<i>Year Dummies</i>	yes	yes	yes	yes	yes
<i>Adj. R-Squared</i>	0.15	0.93	0.20	0.36	0.40
<i>Observations</i>	260	260	281	260	212

**Table 4: Cross-Country Regressions with Legal Origins,
Legality and Creditor Rights**

The dependent variable is the ratio of the number of bankruptcies to the number of firms. The regressions are estimated using ordinary least squares with robust standard errors. $LN(GDPPC)$ is the log of GDP Per Capita. $GGDP$ is the 1-year growth rate of real GDP. $D_SYSTCRISIS$ is a dummy equal to 1 in the case of a systemic bank crisis (Caprio and Klingebiel, 2000). $RINTEREST$ is real interest rates. $FRENCH$, $GERMAN$, and $SCANDINAVIAN$ are dummies indicating legal origin (La Porta, et al., 1999). $LEGALITY$ is an index of legal and judicial efficiency constructed as a weighted average of Efficiency of the Judiciary, Rule of Law, Corruption, Risk of Expropriation, and Risk of Contract Repudiation (Berkowitz, et al., 2002) $CREDITOR RIGHTS$ is the sum of dummies identifying Restrictive Reorganizations, No Automatic Stay on Assets, Secured Creditors Paid First, and Management Does Not stay in Reorganization (La Porta, et al., 1999). t-statistics are in parenthesis, *, **, and *** indicate significance at 1%, 5%, and 10% respectively.

	(1)	(2)	(3)	(4)	(5)
	Legal Origin	Legality	Legal Origin and Legality	Creditor Rights	Creditor Rights and Legality
<i>Constant</i>	-0.0449*** (-3.34)	0.0009 (0.05)	0.0582** (2.29)	-0.0747*** (-4.82)	0.00658*** (0.34)
$LN(GDPPC_{t-1})$	0.0080*** (6.41)	-0.003* (-1.66)	-0.0034 (-1.28)	0.0097*** (6.83)	-0.00438 (-1.60)
$GGDP_{t-1}$	-0.0007*** (-2.97)	-0.0004 (-1.02)	-0.0011*** (-3.78)	-0.0006* (-1.78)	-0.00036 (-0.99)
$D_SYSTCRISIS_{t-1}$	0.0005 (0.11)	0.0047 (0.88)	0.0008 (0.19)	0.0050 (0.86)	0.00463 (0.87)
$RINTEREST_{t-1}$	0.0002* (1.72)	0.0003 (1.51)	-0.0001 (-1.03)	0.0002 (0.89)	0.00023 (1.25)
<i>FRENCH</i>	-0.0218*** (-12.86)		-0.0237*** (-9.21)		
<i>GERMAN</i>	-0.0231*** (-11.56)		-0.0370*** (-11.26)		
<i>SCANDINAVIAN</i>	0.0083* (1.69)		0.0043 (0.92)		
<i>LEGALITY</i>		0.0030*** (5.22)	0.0013* (1.82)		0.00313*** (4.82)
<i>CREDITOR RIGHTS</i>				0.0007 (0.78)	-0.00056 (-0.56)
<i>Year Dummies</i>	yes	yes	yes	yes	yes
<i>Adj. R-Squared</i>	0.52	0.22	0.52	0.15	0.22
<i>Observations</i>	260	248	238	248	248

Table 5A: Cross-Country Regressions with Creditor Rights and Legality

The dependent variable is the ratio of the number of bankruptcies to the number of firms. The regressions are estimated using ordinary least squares with robust standard errors. $LN(GDPPC)$ is the log of GDP Per Capita. $GGDP$ is the 1-year growth rate of real GDP. $D_SYSTCRISIS$ is a dummy equal to 1 in the case of a systemic bank crisis (Caprio and Klingebiel, 2000). $RINTEREST$ is real interest rates. $LEGALITY$ is an index of legal and judicial efficiency constructed as a weighted average of Efficiency of the Judiciary, Rule of Law, Corruption, Risk of Expropriation, and Risk of Contract Repudiation (Berkowitz, et al., 2002) $CREDITOR RIGHTS$ is the sum of dummies identifying Restrictive Reorganizations, No Automatic Stay on Assets, Secured Creditors Paid First, and Management Does Not stay in Reorganization (La Porta, et al., 1999). t-statistics are in parenthesis, *, **, and *** indicate significance at 1%, 5%, and 10% respectively.

	(1)	(2)	(3)	(4)	(5)
	Creditor Rights	Restrictive Reorganization	No Automatic Stay on Assets	Secured Creditor Paid First	Management Does Not Stay
<i>Constant</i>	0.00658*** (0.34)	-0.0125 (-0.76)	0.0268 (1.41)	0.0024 (0.15)	-0.0079 (-0.39)
$LN(GDPPC_{t-1})$	-0.00438 (-1.60)	-0.0020 (-0.84)	-0.0070*** (-2.66)	-0.0037* (-1.65)	-0.0029 (-1.01)
$GGDP_{t-1}$	-0.00036 (-0.99)	-0.0004 (-1.07)	-0.0004 (-1.09)	-0.0004 (-1.02)	-0.0004 (-1.06)
$D_SYSTCRISIS_{t-1}$	0.00463 (0.87)	0.0052 (0.99)	0.0019 (0.37)	0.0048 (0.90)	0.0042 (0.75)
$RINTEREST_{t-1}$	0.00023 (1.25)	0.0003* (1.69)	0.0001 (0.92)	0.0002 (1.11)	0.0003* (1.76)
<i>CREDITOR RIGHTS</i>	-0.00056 (-0.56)				
<i>RESTRICTIVE REORGANIZATION</i>		0.0044* (1.79)			
<i>NO AUTOMATIC STAY ON ASSETS</i>			-0.0090*** (-4.09)		
<i>SECURED CREDITOR PAID FIRST</i>				-0.0019 (-0.55)	
<i>MANAGEMENT DOES NOT STAY</i>					0.0025 (0.81)
<i>LEGALITY</i>	0.00313*** (4.82)	0.0027*** (4.58)	0.0036*** (5.96)	0.0031*** (5.23)	0.0030*** (5.01)
<i>Year Dummies</i>	yes	yes	yes	yes	yes
<i>Adj. R-Squared</i>	0.22	0.23	0.27	0.22	0.22
<i>Observations</i>	248	248	248	248	248

Table 5B: Cross-Country Regressions with Creditor Rights and Legality

	(1)	(2)	(3)	(4)	(5)
	Creditor Rights	Restrictive Reorganization	No Automatic Stay on Assets	Secured Creditor Paid First	Management Does Not Stay
<i>Constant</i>	-0.0717*** (-2.21)	-0.0476* (-1.91)	0.3372 (1.20)	-0.0246 (-1.23)	-0.0905*** (-3.13)
<i>LN(GDPPC_{t-1})</i>	0.0017 (0.47)	0.0008 (0.24)	-0.0077** (-2.29)	-0.0027 (-1.13)	0.0054 (1.51)
<i>GGDP_{t-1}</i>	-0.0002 (-0.55)	-0.0002 (-0.71)	-0.0004 (-1.10)	-0.0004 (-1.03)	-0.0000 (-0.05)
<i>D_SYSTCRISIS_{t-1}</i>	0.0048 (0.90)	0.0064 (1.19)	0.0021 (0.41)	0.0050 (0.92)	0.0059 (1.10)
<i>RINTEREST_{t-1}</i>	0.0006*** (2.42)	0.0004** (2.38)	0.0001 (0.70)	0.0004 (1.63)	0.0006*** (2.61)
<i>CREDITOR RIGHTS</i>	0.0160*** (3.12)				
<i>RESTRICTIVE REORGANIZATION</i>		0.0356** (2.45)			
<i>NO AUTOMATIC STAY ON ASSETS</i>			-0.0134 (-1.16)		
<i>SECURED CREDITOR PAID FIRST</i>				0.0215* (1.88)	
<i>MANAGEMENT DOES NOT STAY</i>					0.0657*** (3.80)
<i>LEGALITY</i>	0.0041*** (6.89)	0.0031*** (5.93)	0.0035*** (5.98)	0.0041*** (7.72)	0.0030*** (4.83)
<i>LEGALITY * CREDITOR RIGHTS</i>	-0.0009*** (-3.48)				
<i>LEGALITY * RESTRICTIVE REORGANIZATION</i>		-0.0017** (-2.14)			
<i>LEGALITY * NO AUTOMATIC STAY ON ASSETS</i>			0.0003 (0.46)		
<i>LEGALITY * SECURED CREDITOR PAID FIRST</i>				-0.0014** (-2.40)	
<i>LEGALITY * MANAGEMENT DOES NOT STAY</i>					-0.0035*** (-3.75)
<i>Year Dummies</i>	Yes	yes	Yes	yes	Yes
<i>Adj. R-Squared</i>	0.25	0.25	0.25	0.23	0.27
<i>Observations</i>	248	248	248	248	248

Appendix 1: Sources of Bankruptcy Data

Country	Source
<i>AUSTRALIA</i>	Australian Securities and Investment Commission
<i>BELGIUM</i>	National Statistical Office
<i>CANADA</i>	Office of The Superintendent Of Bankruptcy
<i>CHILE</i>	Fiscal Nacional De Quiebras
<i>COLOMBIA</i>	Supersociedades
<i>CYPRUS</i>	Dept. of Registrar of Companies and official Receiver
<i>CZECH REPUBLIC</i>	European Bank of Research and Development (EBRD)
<i>DENMARK</i>	Statistics Denmark
<i>FINLAND</i>	Statistics Finland
<i>FRANCE</i>	The EULER Group
<i>GERMANY</i>	Wirtschaftsanalyse
<i>HONG KONG</i>	Government of Hong Kong
<i>HUNGARY</i>	EBRD
<i>ICELAND</i>	Statistics Iceland
<i>IRELAND</i>	Dept of Enterprise, Trade and Employment
<i>ISRAEL</i>	Ministry of Justice
<i>ITALY</i>	Annuario di Statistiche Giudiziarie
<i>JAPAN</i>	Teikoku Data Bank
<i>NETHERLANDS</i>	Statistics Netherland
<i>NEW ZEALAND</i>	NZ Insolvency and Trustee Service
<i>NORWAY</i>	Statistics Norway
<i>PERU</i>	INDECOFI
<i>POLAND</i>	EBRD
<i>PORTUGAL</i>	Ministry of Justice
<i>RUSSIA</i>	Russian Economic Trends Quarterly – Center for Economic Reforms
<i>SINGAPORE</i>	Official Receiver and Public Trustee Office, Singapore
<i>SPAIN</i>	National (Spanish) Statistics Institute
<i>SWEDEN</i>	Statistics Sweden
<i>SWITZERLAND</i>	Schweizerischen Verband Creditform
<i>THAILAND</i>	Statistical Office
<i>TURKEY</i>	Government of Turkey
<i>UNITED KINGDOM</i>	Department of Trade and Industry
<i>UNITED STATES</i>	American Bankruptcy Institute

Appendix 2: Bankruptcy Laws on the Books

<i>Country</i>	Liquidation Procedure	Reorganization Procedure
<i>ARGENTINA</i>	1	1
<i>AUSTRALIA</i>	1	1
<i>AUSTRIA</i>	1	1
<i>BELGIUM</i>	1	1
<i>CANADA</i>	1	1
<i>CHLE</i>	1	1
<i>COLOMBIA</i>	1	1
<i>CYPRUS</i>	1	1
<i>CZECH REP</i>	1	1
<i>DENMARK</i>	1	1
<i>FINLAND</i>	1	0
<i>FRANCE</i>	1	1
<i>GERMANY</i>	1	1
<i>HONG KONG</i>	1	1
<i>HUNGARY</i>	1	1
<i>ICELAND</i>	1	1
<i>IRELAND</i>	1	1
<i>ISRAEL</i>	1	1
<i>ITALY</i>	1	1
<i>JAPAN</i>	1	1
<i>NETHERLANDS</i>	1	1
<i>NEW ZEALAND</i>	1	0
<i>NORWAY</i>	1	1
<i>PERU</i>	1	1
<i>POLAND</i>	1	1
<i>PORTUGAL</i>	1	1
<i>RUSSIAN FED</i>	1	1
<i>SINGAPORE</i>	1	1
<i>SLOVAKIA</i>	1	1
<i>SOUTH AFRICA</i>	1	1
<i>SPAIN</i>	1	1
<i>SWEDEN</i>	1	1
<i>SWITZERLAND</i>	1	1
<i>THAILAND</i>	1	1
<i>TURKEY</i>	1	1
<i>U.K</i>	1	1
<i>USA</i>	1	1
<i>URUGUAY</i>	1	1