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## Bankruptcy of Natural Persons in Lithuania: Reasons and Problems

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### Abstract

In the context of the research and practice The Law of Bankruptcy of the Natural Persons in Lithuania is a relatively new subject and scientifically very fragmentally analysed. The bill of Bankruptcy of Natural Persons in Lithuania was proposed in 2009 (No. XIP-450, 24.03.2009), but met with a considerable amount of criticism and was delayed for further improvements. However, the Law of Bankruptcy of the Natural Persons in Lithuania has come into force on the March 1, 2013. The article aims to identify the main reasons that cause bankruptcy of natural persons in Lithuania as well as to figure out some problems related with it. Through the systematic and comparative analysis there are presented the concept of bankruptcy of natural persons, models, advantages and disadvantages together with reasons and problems. The paper also presents the results of the semi-structured interview with two expert groups.

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### Introduction

Bankruptcy of natural persons and its' consequences is particularly relevant topic in Lithuania. The law is applicable to natural persons that are not able to fulfil their financial obligations to respective institutions and the sum of the financial obligations exceeds 25 minimum monthly wages approved by the Government of the Republic of Lithuania. First scientific publications where personal bankruptcy topic was analysed in Lithuania appeared in 2010. There was examined problems and legal aspects of bankruptcy of natural persons (Grudytė, Kiršienė, & Astromskis, 2010); regulations and problems of bankruptcy of natural persons (Bazylienė, Žuk-Butkuvienė, &

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Novickytė, 2013); procedures of bankruptcy of natural persons (Aitis, 2013). Meanwhile, in other countries the topic of personal bankruptcy has been corroborated by the number and variety of scientific publications analyzing different aspects of bankruptcy of natural persons: models of bankruptcy of natural persons (Porter & Thorne, 2006), the advantages and disadvantages of the institute of bankruptcy of natural persons (Jackson, 1998; Mankart & Rodano, 2012; Han & Li, 2011), reasons causing bankruptcy of natural persons (Arnst, 2009; Fan & Yavuzoglu, 2013; Skiba & Tobacman, 2009; Niemi, Ramsay, William & Whitford, 2009; Berthoud & Kempson, 1992; Mangan, 2013; Himmelstein, Warren, Thorne & Woolhadler, 2004; Boardman & Perry, 2007;), the problems of the institute of bankruptcy of natural persons (Clancy, 2007).

The process of analysis of scientific researches on the subject of bankruptcy of natural persons has established the fact of insufficient attention to the subject of bankruptcy of natural persons in Lithuania. For this reason, the aim of the research is to 1) *identify the main reasons that cause bankruptcy of natural persons in Lithuania* and 2) *to figure out the problems related with bankruptcy of natural persons in Lithuania*. Systematic and comparative scientific literature analysis together with the semi-structured interview with two expert groups will help to supplement in scientific literature rather randomly analyzed reasons and problems as well as to achieve practical and more profound results of the application of this law.

### **1. The concept and peculiarities of bankruptcy of natural persons**

Scientifically, the term “bankruptcy” with its pejorative connotation can be replaced by the terms “rehabilitation”, “exemption from debts”, or “fresh start” (Gruodytė, Kiršienė & Astromskis, 2010). According to Aitis (2013), bankruptcy is a legal procedure beginning with the declaration of a debtor about their incapability to fulfil their financial obligations while the obligatory reason to declare bankrupt is the insolvency of a natural person.

There are two models of bankruptcy of natural persons. The first is a so-called Anglo-American “fresh start” model which gives the opportunity to go bankrupt whenever one wishes (Porter & Thorne, 2006). The “fresh start” model has originated in Great Britain and the United States of America as an automatic right to be exempt from debts promptly while observing formal legal procedures of bankruptcy (Gruodytė & Kiršienė, 2010). The second model is a so-called European “earned fresh start” model which gives the possibility to declare bankruptcy only in those cases when responsible debtors get into hopeless situations at somebody else’s fault (Paukštė & Streckytė, 2012).

Lithuanian Free Market Institute (2009), Gruodytė, Kiršienė, & Astromskis (2010), underlined that the Law of Bankruptcy of Natural Persons protects natural persons against impoverishment and could promote more active business development by encouraging enterprising to assume higher risks, which in its turn influences the growth of economy in the country. The research of Mankart and Rodano (2012) has shown that optimal regulation of bankruptcy of persons in the country can increase entrepreneurship by 4 percent.

On the other hand, The Free Market Institute (2009) has noted that the legalization of the institute of bankruptcy of natural persons could contribute to the formation of incorrect expectations of the people that might encourage natural persons to make more risky decisions. In the worst case scenario this risk would have to be covered by unrelated people – creditors and users of credit services. From the creditors’ side, they would have to adapt to new risks that could eventually lead to the growth of borrowing services costs. From the side of natural persons that suffered bankruptcy, those individuals will have lower possibility to borrow again (Han & Li, 2011).

### **2. Reasons and problems of bankruptcy of natural persons**

The studies of the scientific literature show that there are two groups of the reasons determining bankruptcy of natural persons: economic and social. Among the economic reasons, Arnst (2009) indicated job loss as the most significant reason influencing a person’s insolvency. Approximately 32 percent of the cases of bankruptcy of natural persons occur due to a person’s job loss, the following economic reason is irresponsible, excess usage of credits. The study of Fan and Yavuzoglu (2013) has named job loss and excess arrearage as two main economic reasons making people insolvent. Skiba and Tobacman (2009) have tried to clarify whether fast loans as one of the economic reasons influence bankruptcy of natural persons. The study showed that a fast loan is a repetitive process. Once a person has borrowed, the psychological urge for further borrowing is usually unstoppable and natural

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