Does Merging Small Bankruptcy Courts Increase Their Efficiency?

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Introduction

Between 2010 and 2018, the number of courts in Europe decreased by 10% (CEPEJ, 2020).

Reorganizing judicial maps often involves merging courts to eliminate smaller entities, deemed less efficient than large ones:

1- Low number of cases in small courts would not allow judges to develop sufficient expertise.

2- Judges may be more prone to continuation bias (because of local, social or political pressure, lack of anonymity, bad local habits, etc.)

In 2008, France reformed its judicial map by merging 55 small commercial courts (out of 186) into larger ones.

What can the 2008 reform of the French judicial map teach us about the impact of court mergers on court efficiency?

Identification Strategy

- We classify courts affected by the 2008 French judicial map reform into three types: absorbing, absorbed, and unaffected (control) courts.
- Court mergers were determined by a rule based solely on court size and the number of courts in the "*département*", not on other court characteristics.
- No forum shopping: firms must file for bankruptcy in the jurisdiction of their headquarters, with no evidence of relocations in the two years prior to filing.
- We measure the impact of the reform on firm bankruptcy outcomes using a difference-in-differences strategy.

Figure 1. Close-up example before reform

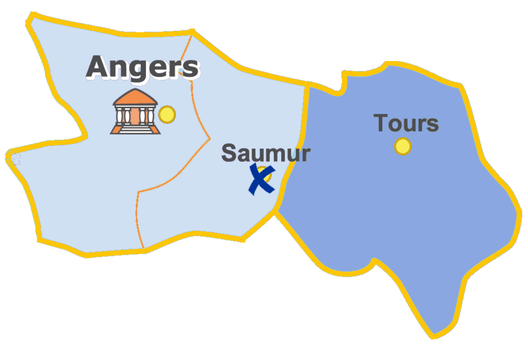


Figure 2. Close-up example after reform

Source: French Ministry of Justice

$$Y_{ijt} = \alpha + \sum_{k=g,d} \beta_{Yk} \left(Reform_k \times Post_t\right) + \gamma_1 X_i + \gamma_2 u_{jt} + \theta_j + \theta_{s\times t} + \epsilon_{ijt} \quad (1)$$

where Y_{ijt} is a dummy for restructuring (P_{ijt}) or survival (S_{ijt}) for firm i in jurisdiction j in year t. $Reform_k$ identifies if the firm is in an absorbed ($k = d$) or absorbing ($k = g$) jurisdiction. X_i is a vector of firm characteristics. u_{jt} is the local unemployment rate. θ_j and $\theta_{s\times t}$ captures jurisdiction and industry-year fixed effects.

The Reform's Impact

The impact of the reform is assessed by comparing firms in absorbed and absorbing jurisdictions to those in control jurisdictions.

- We use cross-sectional data on nearly 600,000 bankruptcy cases in France from 2000 to 2019.
- Firms in absorbing jurisdictions are unaffected by the reform.
- Firms in absorbed jurisdictions experience:
  - a lower probability of restructuring,
  - no change in the probability of survival.

Table 1. Impact of the Reform on Firm Bankruptcy Outcomes

	Restructuring β_P (1)	Survival β_S (2)
Absorbing × Post	-0.00746	-0.00240
	(-1.21)	(-0.77)
Absorbed × Post	-0.0346***	-0.00265
	(-5.66)	(-0.67)
FE and controls	√	√
Observations	580,227	451,820
Adj. R^2	0.090	0.071

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Defining Court Efficiency

We move away from traditional measures of court efficiency such as the speed of the bankruptcy process or the congestion rate (Iverson, 2018). Instead:

Method : we consider courts as screening devices aiming to avoid Type 1 and Type 2 errors:

- T_1: restructuring a non-viable firm (continuation bias),
- T_2: liquidating a viable firm.

The signs of the coefficients for the reform's impact on firms' probabilities of restructuring (β_P) and survival (β_S) indicate the reform's impact on the two types of errors.

Table 2. Matrix of T_1 and T_2 errors

	β_P > 0	$= 0$	< 0
> 0	$?T_1 \downarrow T_2$	$\downarrow T_1 \downarrow T_2$	$\downarrow T_1 \downarrow T_2$
$\beta_S = 0$	$\uparrow T_1 = T_2$	$= T_1 = T_2$	$\downarrow T_1 = T_2$
< 0	$\uparrow T_1 \uparrow T_2$	$\uparrow T_1 \uparrow T_2$	$?T_1 \uparrow T_2$

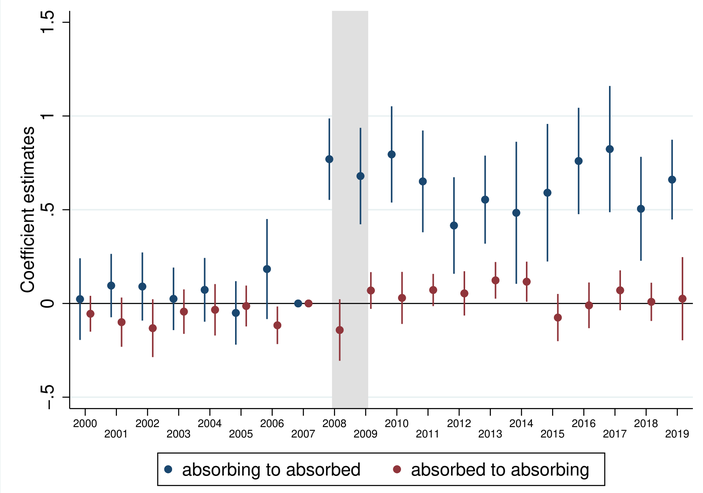
Results : the reform reduces Type 1 errors while having no impact on Type 2 errors for firms in absorbing jurisdictions (in blue). The effect is heterogeneous by firm size (no impact on large firms, heterogeneous impact among small firms). No impact on firms from absorbed jurisdiction.

An Explanatory Channel

We capture the difference in behavior between absorbing and absorbed courts by differencing their average restructuring rates ($\Delta ShareP_{jk}$) .

$$P_{ijt} = \alpha + \sum_{k=g,d} \sum_{t\neq 2007} \beta_{kt}(\mathbb{1}_t \times Reform_k) + \gamma_1 X_i + \gamma_2 u_{jt} + \theta_j + \theta_{s\times t} + \epsilon_{ijt} + \sum_{k=g,d} \left(\sum_{t=2000}^{2007} \tau_{kt}(\mathbb{1}_t \times \Delta ShareP_{jkt}) + \sum_{t=2008}^{2019} \delta_{kt}(\mathbb{1}_t \times \overline{\Delta ShareP_{jk}}) \right) \quad (2)$$

Figure 3. Coefficients Estimates τ_{kt} and δ_{kt}



- The behavior of the absorbing court explains the probability of restructuring (P_{ijt}) of firms from absorbed jurisdictions after reform.
- The reverse is not true.
- This could reveal a break in bad local habits (Abrams et al., 2021).

Conclusion

- The 2008 reform of the French judicial map reduced the continuation bias in small courts.
- The gain in efficiency comes from the quality of the absorbing court.

References

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