

The Evolution of Comparisons of Laws in Bankruptcy Legislation: The Case of China and Mongolia

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Abstract

The purpose of this study is to comprehensively evaluate China's and Mongolia's current bankruptcy law frameworks, uncover the legal basis and social functions of the enterprise and personal debt solution system, and make legislative recommendations for results to construct a modern bankruptcy system. It focuses on the main processes of Asian countries' bankruptcy laws, meticulously comparing essential links such as the requirements for commencing bankruptcy procedures, administrator functions, debtor property handling, and reorganization and liquidation rules. In the context of global economic integration, bankruptcy law, as the primary system of firm exit and debt repayment, is critical to maintaining market order and protecting creditors' interests. In particular, as the personal bankruptcy pilot in China has progressed, the need to link the personal debt clearance mechanism with the existing enterprise bankruptcy law has become more apparent, providing a new dimension for improving the full-chain system of market entities exiting. China and Mongolia, as major Asian nations, have different economic models and legal traditions, and their bankruptcy law systems reflect this. It is worth noting that the rebirth rules for "honest but unfortunate" debtors in the personal bankruptcy pilot in Shenzhen, China, provide a link between business owners and natural person bankruptcy, whereas Mongolia does not have personal bankruptcy legislation, and its bankruptcy law still lacks a systematic arrangement for natural person debt resolution. The variations between the two nations' legal systems serve as a comparative sample for cross-border bankruptcy study, revealing both the similarities and problems of bankruptcy system reform in developing countries.

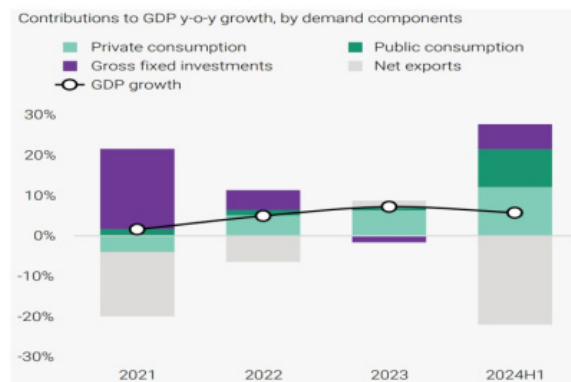
Keywords: Bankruptcy Law, Corporate Bankruptcy, Personal Bankruptcy

1. Introduction

Bankruptcy law, as the core system of enterprise exit and debt repayment, is crucial to maintaining market order and protecting the interests of creditors. With the introduction of the personal bankruptcy legislation in Shenzhen China in 2021, the need to connect the personal bankruptcy legislation with the existing enterprise bankruptcy law has become increasingly prominent, which provides a new dimension for improving the full-chain system of market entities exiting. And based on existing practical cases, it has preliminarily verified the feasibility of the "honest but unfortunate" debtor regeneration mechanism. As important economies in Asia, the differences in the legislation of China

and Mongolia provide a comparative sample for cross-border bankruptcy research, and also reveal the commonalities and challenges of bankruptcy system reform in developing countries.

The global bankruptcy law system is undergoing an institutional transformation from "corporate-centrism" to "personal debt relief". The personal bankruptcy system has gradually become a core tool for resolving social debt crises and maintaining economic stability through debt exemption and reorganization procedures. However, Mongolia's current Bankruptcy Law still adheres to the traditional framework, only covering corporate debt clearance, and lacks an institutional response to personal debt crises.



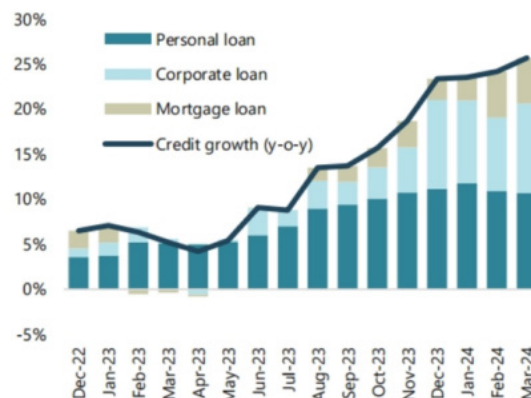
Source: NSO

Figure 1: Rising Private Consumption in Contributions to Mongolia's GDP

The lag in economic recovery after the COVID-19 pandemic has become increasingly evident. According to World Bank data, Mongolia experienced a significant expansion in private consumption, fueled by rising real incomes and robust growth in personal lending. This surge in consumption was supported by higher wages, improved labor market conditions, and increased access to credit, including both personal and corporate loans. Since 2019, Mongolia's household debt as a share of GDP has risen rapidly, reaching 64% in 2021. From December 2022 to March 2024, credit in Mongolia continued to grow each year, with

increases observed in both personal and corporate lending. This trend reflects the broader pattern of post-pandemic recovery, where strong domestic demand and easier access to credit have driven economic growth, but also raised concerns about rising household indebtedness and potential risks to financial stability [1].

We could conclude that Mongolia's post-pandemic economic recovery has been marked by strong private spending and rising household debt, supported by increased incomes and expanding credit, but also by emerging risks to debt sustainability.



Source: The World Bank

Figure 2: Loan and Credit Growth in Mongolia

As a result of the lack of bankruptcy protection, a huge number of natural persons have become trapped in a "debt-poverty" cycle. Such conflicts not only jeopardize the rights and interests of microeconomic entities, but they are also likely to escalate into systemic social problems, necessitating the immediate reconstruction of the debt order through legislation.

2. Theoretical Framework as Current State of Bankruptcy Law

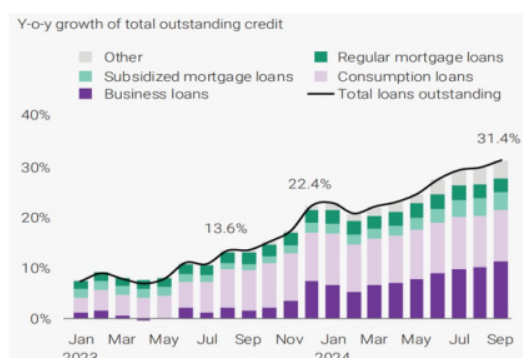
The theoretical framework for Mongolia's current bankruptcy law centers on balancing creditor recovery, debtor rehabilitation, and systemic financial stability. The existing 1997 Bankruptcy Law (as amended) provides a structured process for insolvency resolution but faces modernization pressures due to evolving

economic challenges, including rising household and corporate debt post-pandemic. The institutional design of modern enterprise bankruptcy law has always revolved around two core functions: protection of creditor interests and optimization of market resource allocation. In the international community, the corporate reorganization mechanism stipulated in the U.S. Bankruptcy Code (which allows companies to maintain their operating value through debt restructuring under court supervision) saved giants such as General Motors during the 2008 financial crisis, proving the positive role of bankruptcy law in correcting market deviations [2].

However, corporate bankruptcy law has clear boundaries - it can only regulate the debt relationship of legal entities and is helpless

against natural person debt crises. Data from the People's Bank of China show that the balance of personal consumer credit increased year by year from 2018 to 2022, and the number of personal debt dispute cases accepted by courts across the country increased sharply each year during the same period, among which "involuntary debts" caused by medical and education expenses accounted for a very high proportion [3]. Many micro-enterprise owners in Ulaanbaatar use their personal property to guarantee corporate loan. Once the company goes bankrupt, their family assets will face the risk of paying the debt. The lack of jurisdiction

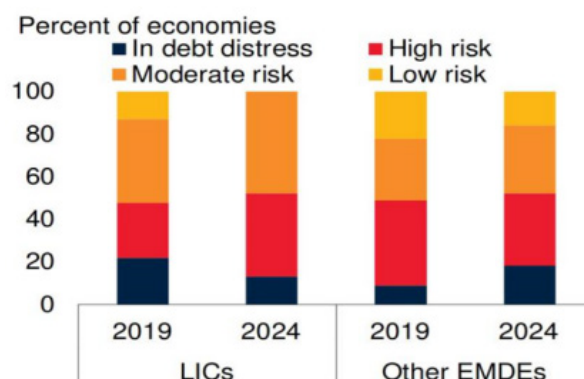
over such "enterprise-individual" debt bundling in the corporate bankruptcy law has caused a large number of natural persons to become the ultimate bearers of market risks, exposing the structural defects of the traditional bankruptcy law system in terms of subject coverage. According to data provided by the World Bank, with the end of the COVID-19 pandemic and the recovery of the global economy, Mongolia's private consumption will rise year by year from 2021 to 2024, along with an increase in consumer loans and commercial loans.



Source: BOM

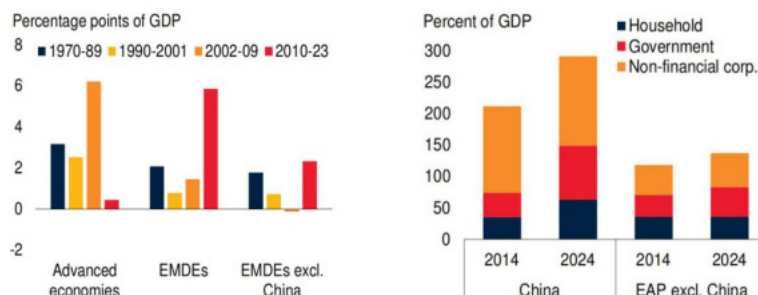
Figure 3: Consumption Loans and Business Loans are Increasing Sharply

By 2023 and 2024, debt distress, debt percentage in total GDP and household debt in EMDEs countries will continue to increase, and Mongolia is one of them.



Sources: World Bank-IMF Debt Sustainability Framework; World Bank [4]

Figure 4: EMDEs in or at Risk of Debt Distress [5]



Sources: Kose et al; Institute of International Finance (database); World Bank [6].

Figure 5: Average Annual Changes in Total Debt & Debt in GDP

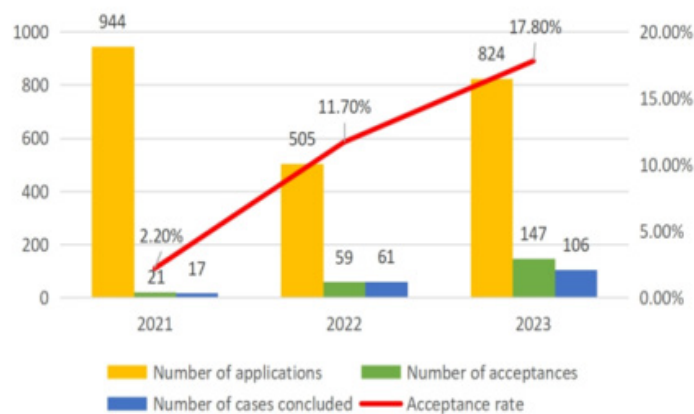
The fundamental flaw of Mongolia's current bankruptcy law system is its unidirectionality; excluding individual debtors has resulted in three dilemmas: first, the debt collection market is disordered, breeding usury and violent debt collection behaviors; second, debt backlogs stifle consumption and economic innovation; and third, social equity values are harmed. All theoretical pluralism ensures bankruptcy law remains adaptable, balancing efficiency with equity in dynamic economic landscapes. The construction and innovation of bankruptcy legislation are deeply intertwined with competing theoretical frameworks that balance creditor recovery, debtor rehabilitation, and broader socioeconomic stability. These systems evolve through the interplay of creditor-centric theories, holistic value-based approaches, and procedural-market hybrid models, reflecting diverse priorities in insolvency resolution. Creditors' Bargain Theory views bankruptcy as a collective mechanism to maximize creditor returns by resolving the "common pool" problem of competing claims. Prioritizes efficiency in asset distribution, minimizing transaction costs through unified proceedings rather than individual creditor actions. Risk-Sharing Theory compels creditors and investors to share risks of business failure, particularly exogenous (e.g., economic downturns) and endogenous (e.g., managerial decisions) risks. Aligns with modern systems where creditors accept partial losses to preserve enterprise value.

Procedure Theory treats bankruptcy as an extension of civil procedure, enforcing non-bankruptcy entitlements without redistributing assets to third parties (e.g., communities or employees). Emphasizes legal coherence, opposing ad hoc priority rearrangements inconsistent with pre-insolvency rights. Value-Based Theory advocates for insolvency law to address multidimensional impacts, including non-creditor stakeholders (e.g., employees, suppliers). Recognizes bankruptcy as a forum to resolve social and political tensions arising from financial distress. Social Utility Theory prioritizes public interest by rehabilitating debtors and preventing systemic economic harm. Influences discharge policies and safeguards against predatory lending practices. Contractualisation of Bankruptcy embraces

market-based mechanisms like pre-packaged administrations and debt-for-equity swaps to expedite restructuring. Balances creditor autonomy with regulatory oversight to prevent abusive practices. Commons/Anti-Commons Analysis addresses complex proprietary entitlements in globalized finance, ensuring equitable resource allocation amid competing claims. Guides reforms such as the EU's Centre of Main Interest rules to harmonize cross-border insolvency. Contemporary systems, like India's Insolvency and Bankruptcy Code integrate these theories by mandating value maximization through collective creditor decision-making.

3. Comparative Study

The construction and innovation of the bankruptcy legislation have always been rooted in the interaction of multiple theoretical systems. From the perspective of basic legal theory, Rousseau's social contract theory provides a legitimate support - when an individual fall into debt due to force majeure, the state has the obligation to rebuild his contractual ability to participate in economic life through legal procedures [7]. Rousseau, in addition, North's institutional change theory reveals the deep driving force of Mongolia's bankruptcy law reform-when the transaction cost of informal debt clearance mechanisms exceeds the judicial process, the mandatory change of the legal system will become an inevitable choice [8]. John Rawls's theory of distributive justice further explains the value orientation of bankruptcy law: "Social and economic inequalities are to be arranged so that they are to the greatest benefit of the least advantaged." [9]. This balance is reflected in contemporary bankruptcy law as the symbiosis of the "honest debtor" exemption system and the principle of equal compensation for creditors. In terms of specialized bankruptcy law theory, the traditional paradigm of "maximizing creditor interests" is being revised by "debtors' new start theory". The modern bankruptcy law school represented by Elizabeth Warren and Jay Lawrence Westbrook argues that bankruptcy procedures are not only a tool for debt clearance, but also should assume the economic function of restoring the productivity of debtors and maintaining the stock of social capital [10].



Source: Data from Shenzhen Bankruptcy Court

Figure 6: Personal Bankruptcy Cases Data

The birth of the personal bankruptcy law marks the functional leap of the bankruptcy system from an "economic efficiency tool" to a "social safety net". Its necessity is first reflected in the institutional

relief of individual debt crises: Since the implementation of the personal bankruptcy regulations in Shenzhen, China in 2021, 184 debtors have obtained debt relief through the legislation till 2023.

Category	Mongolia	China
Structure	5 chapters	12 chapters
Applicants	Debtors or creditors	Debtors, creditors, liquidation responsible persons
Acceptance conditions	Insolvency if obligations exceed 10% of equity	"Inability to repay debts" + insolvency/obvious lack of repayment ability"
Court Review Period	Five days to decide case initiation	10-15 days (varies by applicant type)
Administrator System	Trustee: Seals assets, reviews transactions, drafts plans	Administrator: Manages property, investigates finances, represents litigation
Debtor's Property Scope	Fixed/current assets minus liabilities (excludes intangibles)	All property from acceptance to termination; includes voidable transfers
Creditor Claim Declaration	All creditors must declare within 21 days	Employees exempt; others declare within 30 days-3 months
Reorganization Applicants	Debtors, creditors (>1/3 claims)	Debtors, creditors (>10% capital)
Reorganization Plan Approval	Requires 2/3 creditor approval; no forced court approval	>1/2 attendees + >2/3 claims approval; court can enforce approval
Special Provisions	Reorganization ≤2 years; state guarantees for SOEs	Special procedures for financial institutions
Noted by: The comparison results of our study.		

Table 1: Comparison of Bankruptcy Laws between China and Mongolia

Category	Mongolia	China
Legal Framework	Bankruptcy Law (1997), with Draft Insolvency Law under consultation.	Enterprise Bankruptcy Law (2006) with 2020 amendments.
Insolvency Definition	Inability to meet obligations ≥10% of equity by contractual/legal deadlines.	Inability to pay due debts with assets insufficient to cover liabilities.
Creditor Hierarchy	Secured > wage claims > taxes > unsecured.	Secured > employee claims > taxes > unsecured
Institutional Gaps	Inefficient debt resolution timelines and inconsistent court oversight.	Uneven judicial expertise across regions.
Reform Focus	Introducing pre-insolvency mediation and streamlining enforcement	Expanding pre-packaged restructurings and digital case management.
Noted by: The comparison results of our study		

Table 2: Comparison Aspects of Bankruptcy Laws between China and Mongolia

4. Analysis of the Importance of Personal Bankruptcy and Evolution Path

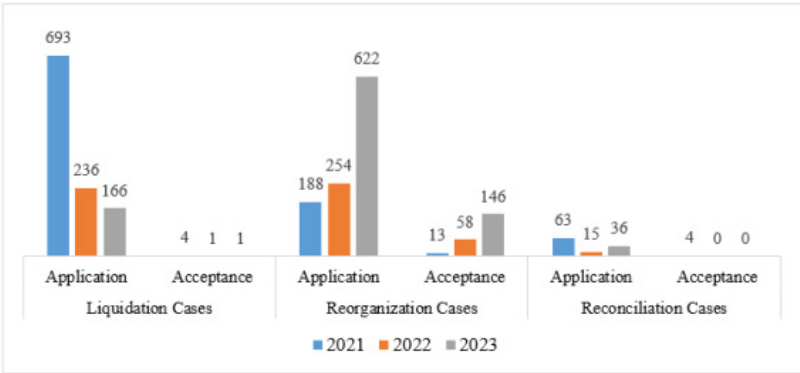
As a double-edged sword for debt crisis governance, personal bankruptcy law not only carries the institutional goodwill of saving "honest but unfortunate" people, but also hides the undercurrent of exacerbating moral risks and social exclusion. The core of its institutional effectiveness lies in balancing the relief strength of debt exemption and the constraint strength of risk prevention. The statutory exemption mechanism not only breaks the traditional shackles of "lifelong debt system", but also gives debtors the possibility of returning to society through the credit repair procedure - the regulations require debtors to submit income and expenditure reports regularly and limit high consumption behavior during the inspection period, thus forming a "punishment-incentive" closed loop. Therefore, the personal bankruptcy law is not only a tool for individual rights relief, but also a stabilizer for social governance: it can systematically reduce

the violent tendency of debt clearance, release the consumption and entrepreneurial ability locked by debt and curb the restoration of feudal debt ethics such as "father's debt and son's repayment". In this sense, the absence of personal bankruptcy law is not only a loophole in the legal system, but also an unfinished business in the construction of a modern civilized society. The risk prevention and control system of modern personal bankruptcy law has broken through the single judicial intervention framework and turned to the collaborative governance of legislative constraints and administrative intervention. The personal bankruptcy procedure in Shenzhen, China has introduced a pre-trial counseling procedure. Before applying for bankruptcy, the applicant will be interviewed and counseled by the Bankruptcy Administration.

On the one hand, it helps personal bankruptcy debtors clarify the operation and legal consequences of personal bankruptcy procedures; on the other hand, it improves the efficiency of the

court's review of the judicial system, reduces pressure, saves judicial resources, and serves personal bankruptcy parties in need more efficiently. It diverts unqualified debtors, standardizes the application materials of bankruptcy applicants, and gives the Bankruptcy Affairs Management Office the role of popularizing the law and providing legal aid. It also assists the court in improving the efficiency of application review. Since the introduction of Shenzhen's personal bankruptcy legislation in 2021, official data from 2021 to 2023 show the core changes in the implementation of China's personal bankruptcy system: Bankruptcy applications

have shifted from mainly liquidation (73% in 2021) to mainly reorganization (75.5% in 2023), reflecting that market entities prefer debt relief rather than direct exit. The acceptance rate of reorganization cases has increased by 241% in three years (6.91%→23.5%), and the applicability of the system has been significantly enhanced. The number of applications for liquidation cases has plummeted by 76%, and there have been no settlement cases accepted for two consecutive years, which also warns that these procedures need to be optimized.



Source: Data from Shenzhen Bankruptcy Court

Figure 7: Data of Personal Bankruptcy Cases in Shenzhen, China, 2021-2023

In contrast, Mongolia's Bankruptcy Law still adheres to the single corporate legal person orientation. This legislative framework rupture not only exacerbates the risk of debt crisis transmission (such as the zeroing of personal guarantee assets in the event of corporate bankruptcy), but also hinders Mongolia's integration into the international investment system and the inefficiency of foreign investment dispute resolution. In view of the structural defects of Mongolia's current bankruptcy law, legislative reform needs to follow the three-stage path of "system gap filling-efficiency optimization-risk prevention". The first task is to introduce a personal bankruptcy system, setting a exemption inspection period of about 5 years, requiring debtors to use more than 50% of their disposable income to repay debts during this period, and establishing a national credit reporting system to monitor their asset changes. The Shenzhen pilot project shows that the establishment of a supporting credit information system can significantly reduce the incidence of fraudulent bankruptcy. The construction of a debt prevention system requires administrative and social coordination. Mongolia can set up a national debt consultation center to suppress irrational debt from the source by forcing credit institutions to review borrowers' debt repayment ability and provide free financial planning.

For Mongolia, the feasible path of legislative reform lies in the triple synergy of "institutional reference-cultural adaptation-international cooperation". China's "gradual" legislative experience has important reference value, however, Mongolia needs to be wary of simple institutional transplantation: the high degree of confusion of family-enterprise assets in the nomadic economy requires legislators to incorporate customary law elements into

institutional design, so that traditional informal rules and modern legal procedures can be creatively integrated, which may become a unique advantage of bankruptcy law reform. The unification of cross-border bankruptcy rules is also a strategic direction for future reforms. As important economies along the "Belt and Road", China and Mongolia can refer to the "United Nations Commission on International Trade Law Cross-Border Insolvency Model Law" and establish a cross-border bankruptcy recognition and enforcement mechanism by signing a mutual legal assistance agreement.

5. Conclusion

In sum, personal bankruptcy law serves as a modern mechanism for risk allocation and social justice, functioning as a crucial "safety valve" within the market economy by offering a dignified exit for honest but unfortunate debtors while simultaneously safeguarding the system against opportunistic abuse, thus ensuring both fairness and economic stability through carefully balanced legal procedures. The differences in practice between China and Mongolia confirm the complexity of this balance: China isolates corporate debt crises from the natural person credit system through a "dual-track" bankruptcy framework, whereas Mongolia's lack of system leads to the mutual transmission of corporate and personal bankruptcy risks, resulting in a systemic social vulnerability. Historical experience demonstrates that the modernization of legal systems is never a purely local endeavor, but rather the result of ongoing competition and cooperation among legal rules within the broader context of globalization. As legal frameworks increasingly interact across borders, national laws are shaped by trends such as legal integration, harmonization, and the adoption

of international standards, leading to the emergence of a multi-level global legal order where local and international norms are closely interconnected.

For Mongolia, this means that effective bankruptcy law reform cannot occur in isolation. By ensuring that localized legal innovations are compatible with international standards, Mongolia positions its legal system to benefit from the best practices of global jurisprudence while maintaining relevance to its unique national context. Such alignment not only enhances the credibility and functionality of Mongolia's bankruptcy regime but also marks a significant step in the broader modernization of the rule of law in Central Asia, reflecting both the opportunities and challenges presented by globalization. Ultimately, the evolution and comparative practice of bankruptcy law in China and Mongolia highlight that effective legal modernization requires not only a nuanced balance between debtor relief and creditor protection, but also the integration of local innovation with international standards—a process that strengthens both national resilience and the broader rule of law in an increasingly interconnected world [11-27].

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