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Yury Yur'evich Karaleu

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This study focuses primarily on the scope of measures that have helped national governments withstand the destructive consequences of the COVID-19 pandemic and save domestic businesses from bankruptcy. The aspect is explored from the point of view of employee rights in insolvency. Looking back over the insolvency situation in the pandemic period, the unprecedented measures of national governments that inhibit the significant growth of bankruptcies were discussed. The review of crisis measures has highlighted that, once temporary emergency measures conclude, countries will still require effective insolvency protecting workers' rights to manage the resulting employee debt burden.

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End of Covid-19 Insolvency Emergency Measures in Post-Soviet Countries

(COVID-19 Insolvency Tendencies that are not Supported and Employee Claims Guarantees
that don't Work)

Yury Yur'evich Karaleu

ABSTRACT

This study focuses primarily on the scope of measures that have helped national governments withstand the destructive consequences of the COVID-19 pandemic and save domestic businesses from bankruptcy. The aspect is explored from the point of view of employee rights in insolvency. Looking back over the insolvency situation in the pandemic period, the unprecedented measures of national governments that inhibit the significant growth of bankruptcies were discussed. The review of crisis measures has highlighted that, once temporary emergency measures conclude, countries will still require effective insolvency protecting workers' rights to manage the resulting employee debt burden.

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I. INTRODUCTION

The adverse consequences of the COVID-19 pandemic and drastic changes in civilized character in some countries have escalated the main socio-economic problems (a drop in income and wages, unemployment, the polarization of the society, destruction of social infrastructure, and social assistance) that had a negative impact on the condition of the population and especially in the case of business insolvency and in its extreme form – bankruptcy. In the context of the COVID-19 pandemic, business insolvency risk has surged, and when a company faces insolvency,

protecting workers' rights, especially their wage claims, becomes crucial.

Among the most significant and important support measures of workers' protection in such situations, experts highlight the following (ILO, 2020; Karaleu, 2021; Nuno de Oliveira Fernandes, 2021; Huaiyu, 2007):

Priority of Wage Claims: Workers are among the first to be paid from the remaining assets of the company.

Wage Guarantee Funds: Wage guarantee funds established in some countries ensure that workers receive their unpaid wages (total or up to a certain limit) if their employer becomes insolvent.

Severance Pay: Workers may be entitled to severance payment (usually calculated based on their length of service and last drawn salary) that essentially represent a kind of financial support during the transition period.

Social Insurance Benefits: Ensuring that social insurance benefits like disability, maternity, unemployment benefits, etc. are calculated based on the full wage, including unpaid amounts, is essential.

Legal Frameworks and Conventions: National legislation and International conventions, such as the ILO Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173) or Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring framework, on discharge of debt and disqualifications, and on measures to increase the efficiency of

procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132, provide guidelines and standards for protecting workers' claims in insolvency situations.

Rehabilitation and Restructuring: Efforts to rehabilitate and restructure insolvent companies can help preserve jobs and ensure that workers continue to receive their wages.

These measures aim to mitigate the financial impact on workers and their families during insolvency, ensuring they receive the compensation they are owed.

II. POSTPANDEMIC RECOVERY

The 2022 results did not meet post-pandemic expectations and were far short of hope in the euphoria of post-pandemic recovery. Mr. Jean-Christophe Caffet, Coface Group Chief Economist, has warned that the macroeconomic outlook for 2023, in contrast, looks bleak, to say the least (Coface, 2023). Most of the identified risks were confirmed, and in 2023, company insolvencies continued a growth trend that began in 2020.

According to Dun & Bradstreet, the number of corporate bankruptcies in the world's major economies increased in 2023 for the second year in a row amid high interest rates, the withdrawal of post-Covid support measures, inflationary pressure, and unstable demand (Dun & Bradstreet, 2024).

Observers of bankruptcy trends have long expected an increase in bankruptcies following the surge in corporate borrowing that took place during the extended period of near-zero interest rates set by National Banks. Interest rates began to rise just before the pandemic but were subsequently slashed during COVID-19 to prevent economic collapse. Businesses took advantage of this period by borrowing trillions of dollars at historically low rates and spending freely. Some pursued ambitious growth plans and accumulated significant debt. In recent years, these companies have started to run out of cash and are unable to secure new financing, resulting in a wave of bankruptcy.

The number of businesses declared insolvent increased in more than half of the 45 countries for which Dun & Bradstreet analyzed data annually. Simultaneously, in 14 countries, including the United States, France, Great Britain, Canada, and Poland, the 2023 figure exceeded the pre-pandemic level.

In the United States, the number of bankruptcies increased by 79% over the year and reached a record high of 10 years, in Canada — 70% in, Poland — 56% in India and the Netherlands — by 53%, Ukraine 48% in Ukraine.

At the same time, 10 countries, on the contrary, recorded a decrease in bankruptcies by more than 10% — in particular, in Croatia (35%), Belarus (29%), Italy (23%), Turkey (19%), Russia (18%).

On average, across all countries, the number of bankrupt businesses increased in 2022-2023 by an average of 12% per year, against about 5% in 2020-2021, when government support measures were in place in most economies. During the pandemic, despite the freezing of activities in all sectors of the economy, the number of bankruptcies was below the level of 2018-2019.

Experts from Dun and Bradstreet, whose global database covers almost 600 million companies, point to the risk of further growth in the number of bankruptcies this year due to geopolitical risks, expensive loans, inflationary pressure, and rising costs.

The described business environment is expected to continue through 2024. Coface's experts expect that insolvencies in the CEE region will increase further in 2024, but this will be with onedigit dynamics, i.e. at a lower rate than last year (Coface, 2024).

Under these conditions, specialists observed the "paradox" of insolvencies resulting from the COVID-19 pandemic and have witnessed the situation in recent years, when the number of bankruptcy declarations decreased dramatically. How possible and what are the main triggers of this process are the key reasons for the present research.

III. RESEARCH METHODS AND AIMS OF THE STUDY

In this study, we have addressed the issues mentioned above and, consequently, have a strong interest in discussing unwinding support measures that we have studied from the point of view of the protection of workers' claims in the event of an employer's insolvency. These two topics could not be discussed in isolation, and the scope of governments' unwinding support measures was concentrated on the support of workers' claims that were the most vital and urgent during the pandemic.

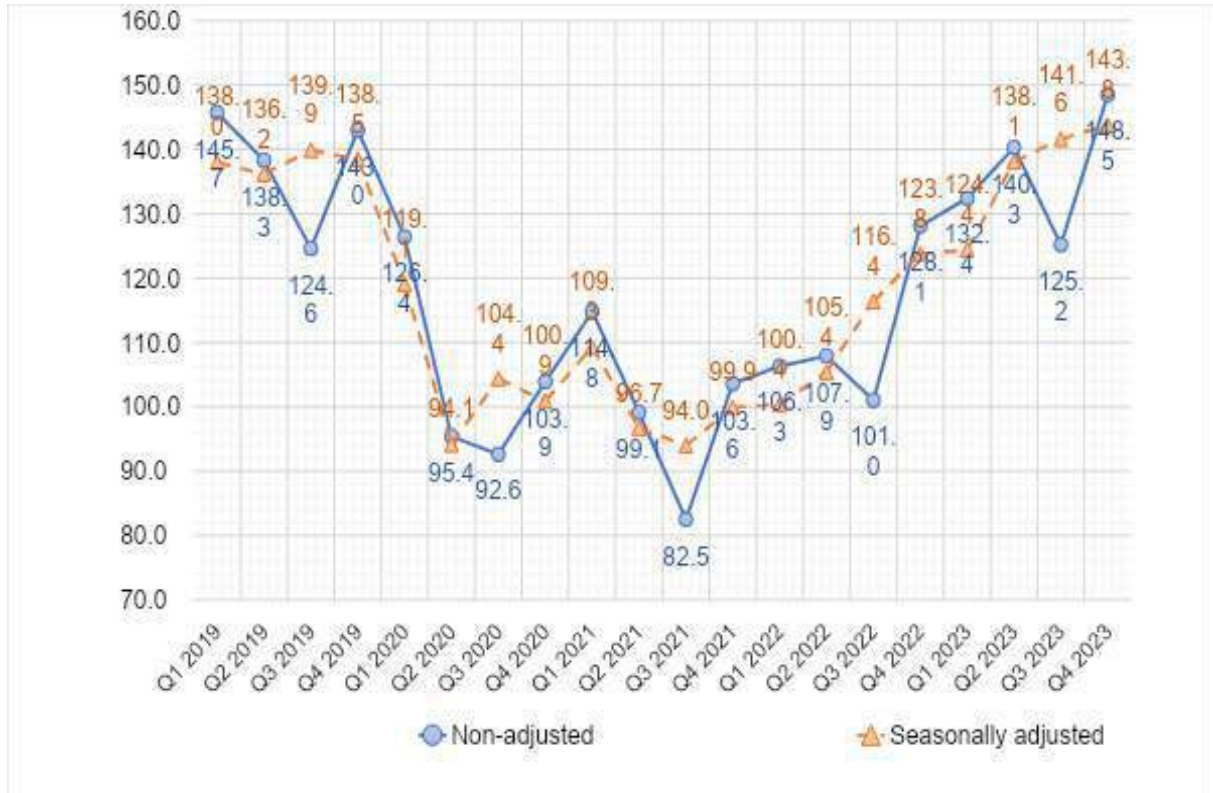
In addition to discussion of the issues related to corporate social responsibility aspects and the protection of workers' claims in the event of insolvency (see, for example, Karaleu, 2018, Karaleu, 2020) or the progress that has been made by EU countries in having a balance of interests between employers, employees, and society in the protection of outstanding claims of employees in the event of their employer's insolvency (see Karaleu, 2021, Karaleu, 2022), we intended

- To assess the results of pandemic-time efforts that helped to save the European economy from bankruptcy and evaluate archived results;
- To outline both positive and negative consequences;
- To predict further steps that can be taken to improve the situation.

To accomplish these tasks and establish sound conclusions and recommendations, a comparison of the statistical data and an analysis of legal regulations were used. To make relevant assumptions and formulate our proposals, a literature review and comparative studies of local legislation and the applicable European insolvency regulations associated with the protection of workers' benefits were analyzed. More specifically, the inductive method, revealing cause-effect relationships, generalization, etc. were applied to elucidate the conceptual and operational relations between the higher level of inflation, financing costs, and the deteriorated

sentiment and global challenges affecting both the international economic system and domestic economies, for which the proper functioning of the insolvency regime is vitally important.

In particular, the methods listed above helped to reveal the tendency based on the data presented in the quarterly registrations of new businesses and declarations of bankruptcies statistics by Eurostat released on August 16, 2024 (Eurostat, 2024) (Fig. 1).



Source: Eurostat, 2024

Fig.1: Declarations of bankruptcies of businesses in the EU, Q1 2019 to Q3 2022 (2021 = 100)

There was an upward trend in the number of bankruptcy declarations until almost the end of 2019. We can then note considerable decreases in the first and second quarters of 2020. This kind of “paradox” can be explained by the temporary emergency measures of the business support, such as tax exemptions and deferrals, loans, subsidies, and other financial assistance, employees’ salary supplementary payments, simplifying various administrative procedures, etc. (Karaleu, 2022). Such measures also called “flattening the bankruptcy curve,” helped to prevent viable firms from prematurely being pushed into insolvency and keep courts from “being overwhelmed by insolvency cases” (Menezes and Muro, 2020).

Subsequently, as shown in Figure 1, the number of bankruptcy declarations increased for three consecutive quarters until the first quarter of 2021. The bankruptcy declarations slightly decreased in the second and third quarters of 2021 and were considerably below the levels of the pre-COVID pandemic period for the whole of

2021. Then, for the following quarters (since the third quarter of 2021), the number of bankruptcies declarations has increased substantially and reached the highest levels at the end of 2023 since the start of the data observation in 2019 (the seasonally adjusted number of declarations of bankruptcies increased by 5.8 percentage points in the EU, compared with the first quarter of 2019). Thus, unwinding support measures have already triggered an increase in business insolvencies in the EU, and the Russian-Ukrainian military conflict in this region would only serve to compound the problem.

The “paradox” of insolvencies resulting from the COVID-19 pandemic is set to disappear for two key reasons. The first relates to government intervention, which is under much more pressure now than two years ago due to the return of inflation and conflicting objectives with monetary policy. Budgetary support introduced during the pandemic is not currently available, and national governments are more cautious about spending. In other words, the “whatever the cost” approach

adopted by governments is not applicable (Coface, 2023).

The second reason relates to the essential nature of the current crisis, which is diametrically different from the health crisis: the COVID-19 pandemic was a temporary shock that extinguished almost all the variable costs borne by companies. On the other hand, the current crisis is more of a permanent shock, leading to increased costs across the board, which the state cannot bear in its entirety. Under these conditions, it is difficult to anticipate a steep rise in corporate insolvency over the next quarter.

In the situation of the ongoing global liquidity crisis, the international community, together with national governments, should do all in its power to avoid further escalation of the situation, which may entail dire consequences of insolvency. For example, the UK Government has already set out new proposals to reform and simplify the

regulation of the insolvency sector. Business Minister Lord Callanan said: “The proper functioning of the insolvency regime is vitally important to support business investment and growth and to provide a safety net for individuals in severe financial difficulty.” (Insolvency Service & Lord Callanan, 2021).

Based on the global trends and main challenges identified as the first output of the research process, it is possible to identify and classify all unwinding support measures by stage when they are introduced.

The first stage provides an overview of short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak to prevent businesses from being systematically pushed into insolvency. As an initial policy emergency response to restrain business distress arising from COVID-19, many countries introduced interim measures in early or mid-2020, which are classified in Table 1.

Table 1: Classification of short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak

Adopted measures	The nature of the authorized measures	Countries
1. Temporary barriers to creditor-initiated insolvency filings	Suspension of creditors’ rights to initiate insolvency, restrictions on those rights by increasing thresholds for creditors to initiate insolvency proceedings or extending statutory periods to respond to written demands, or both	Australia, India, Italy, Singapore, Spain, Switzerland, Turkey
2. Suspension of the directors’ duty to file for insolvency	Suspension of the statutory requirement for directors to initiate insolvency proceedings once a company is insolvent	Bulgaria, France, Germany, Luxembourg, Poland, Portugal, Russia, Spain, Switzerland
3. Suspension or relaxation of liability for wrongful trading	Suspension or relaxation of liability of directors for trading while insolvency have been suspected (without changing the directors’ liability for fraudulent trading)	Australia, New Zealand, Singapore, United Kingdom

<p>4. Moratoria or restrictions on debt enforcement actions</p>	<p>Suspension of insolvency filings along with suspension of specific debt enforcement actions as consequences of insolvency (evictions, foreclosures, debt collections, etc.) to protect debtors against enforcement of debt or security interests and to prevent social disruption</p>	<p>Argentina, Bangladesh, Belgium, Brazil, Bulgaria, Egypt, France, Germany, Guatemala, Indonesia, Italy, Kenya, Latvia, Malaysia, New Zealand, Nigeria, Portugal, Singapore, Spain, Sri Lanka, Switzerland, Thailand, Turkey, Uganda, United States</p>
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Source: World Bank, 2021

Other short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak can be found in *Coronavirus (COVID-19) tracker of insolvency reforms globally* by INSOL Europe (INSOL Europe, 2024).

Thanks to the prompt follow-up action that countries had taken to resist the COVID-19 crisis and the massive scale of support measures provided by the national governments during such a significant crisis, a paradoxical situation emerged whereby business insolvencies in CEE countries dropped in 2020, as shown in the research methods and aims of the study.

IV. ACTIONS TAKEN

The second stage examines the actions taken by some countries during the previous financial crises, as well as the COVID-19 crisis, to address medium- and long-term challenges. Reforms in the second stage were categorized into three categories.

- Reforms to strengthen insolvency implementing institutions;
- Reforms to strengthen insolvency legislative frameworks for addressing both corporate and MSME financial distress; and
- Centralized or government-coordinated frameworks for out-of-court workouts.

The COVID-19 pandemic and official lockdowns have had a devastating impact on macro activity. Even though there is a subsequent decrease in rates of transmission and infection, making the actual ongoing pandemic a secondary issue, there is another challenge that affected economies and

businesses – the alarming rise in rates of inflation and economic instability because of the soaring prices of oil, natural gas, and other raw materials imports from Russia, on which European consumption depends economically. Therefore, national economies have experienced accelerated inflation, mostly due to increased energy prices at the time of growing food prices.

How do, in such a situation, the national guarantee institutions (funds) that provide resources for workers who have lost their jobs due to the insolvency of their employer and have not received the full wage or salary owed to them react? We suggest that Latvia is a good example of our conclusions.

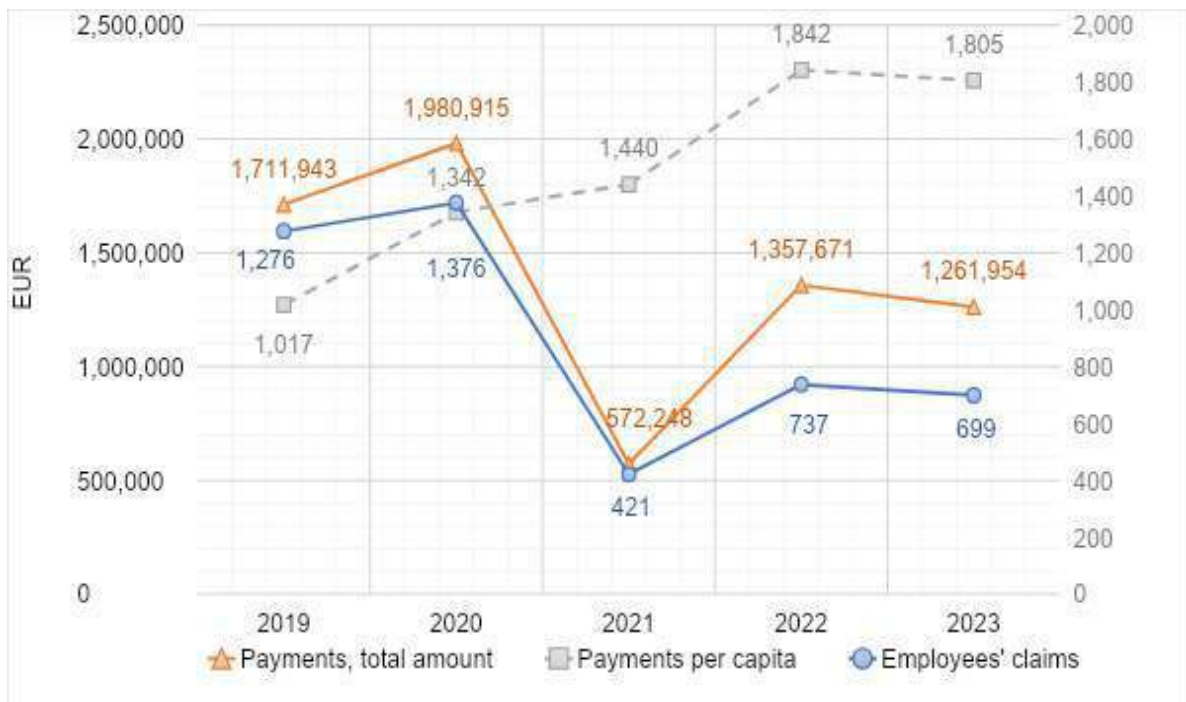
V. POST-SOVIET COUNTRIES RESPONSE TO NEW CHALLENGES

In 1991, Latvia declared its independence, and transition to a market economy started with legal reforms that determined a legal framework for entrepreneurship in the post-Soviet era. Alongside the development of “Commercial Law”, numerous changes have also occurred with regard to legal rules dealing with the insolvency process in Latvia. Introduced in 1992, the “Law on Company Insolvency and Bankruptcy” was the first law in Latvia specifically pertaining to the regulation of insolvency. Since January 1, 2003, the Employee Claims Guarantee Fund (Dar binieku aizsardzība darba devēja maksātnespējas gadījumā) (hereafter – Fund), operated by the Insolvency Control Service (state agency), has been introduced and got the power to act on behalf of employees who have lost their jobs as a result of

the insolvency (bankruptcy) and have not received the full remuneration owed to them. All employees are eligible for the satisfaction of claims and may claim wage or salary, reimbursement for annual paid leave, etc., that is owed to them by their employer.

The Fund is financed by contributions from employers – the state entrepreneurial risk fee

(which has remained unchanged since 2006 and is equal to EURO.36 per employee) – gifts and donations, and resources recovered by insolvency administrators in the insolvency procedure (Karaleu, 2022). Fig. 2 shows how payments from the Fund have evolved over the last five years.



Source: <https://www.mkd.gov.lv/lv>

Fig. 2: The Latvian Employee Claims Guarantee Fund's payments for 2019-2023

It is rather evident that the moratoria on insolvency applications introduced in response to the destructive consequences of the COVID-19 pandemic from March 22, 2020, to September 1, 2020, and from December 23, 2020, to September 1, 2021 has led to a decrease in the number of employees' claims in 2021 and caused the "paradox" of insolvencies. This is the result of the fact that only those employees whose position has been declared in an insolvency proceeding before the moratoria were entitled to benefit from the Fund and it is not a reflection on the state of the insolvency of Latvia's companies.

Out of three Baltic state countries, the only visible decrease in the number of insolvency cases in 2023 was in Latvia: -3.90%, in contrast to +14.4% in Estonia and +1.8% in Lithuania. The past year

for Lithuania did not bring any significant changes as well, since the number of insolvencies was almost the same as in 2022 and has increased only by 1.83%. Gabrielė Didžiariekytė, Senior Business Information Specialist of Coface Baltics, believes that mostly bankrupt companies were already balancing on the edge of survival before the pandemic period began; therefore, these companies have simply delayed the start of insolvency processes (Coface, 2024).

In 2023, the Fund has paid out funds in the amount of EUR1,261,954 to employees of insolvent companies. The claims of 699 employees from 62 insolvent companies are satisfied. The average amount allocated to cover the claims of one employee this year was EUR1,805. Although these figures are lower than

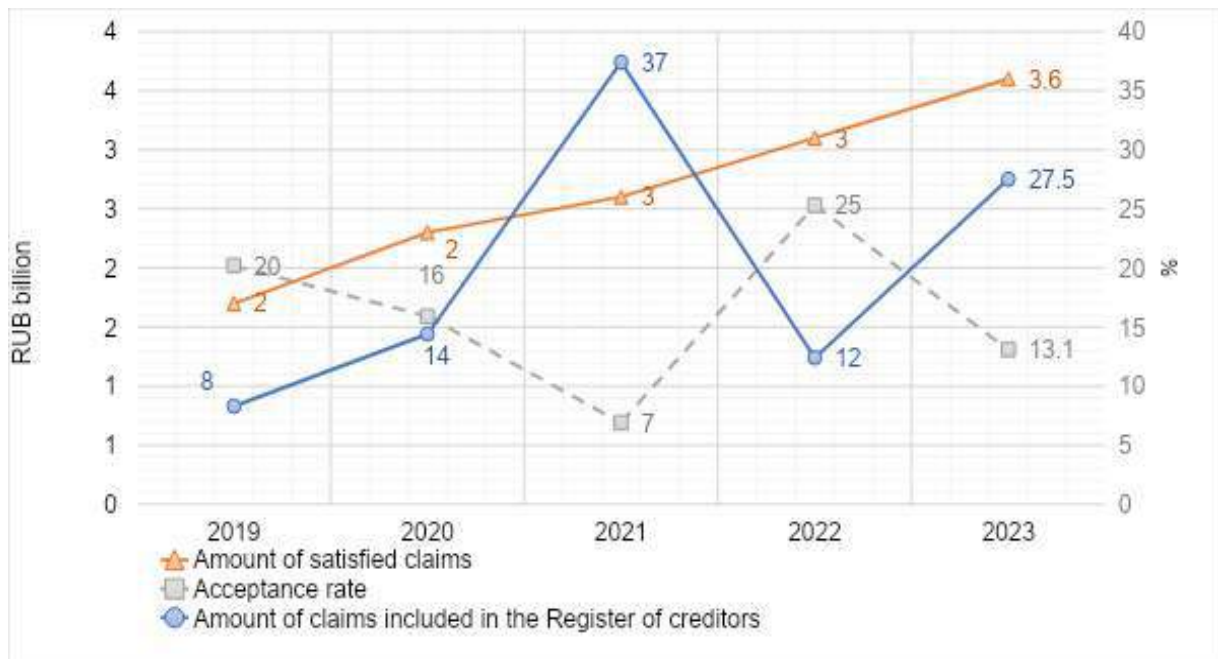
those in 2022, they are significantly higher than the 2021 results.

In contrast to the well-established body of the EU system of administrative authorities and guarantee institutions established and launched in accordance with Directive 2002/74/EC of the European Parliament and of the Council of September 23, 2002, on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer, most post-Soviet states rely on the priority creditor status for employees (preferential treatment) in the event of insolvency (bankruptcy). It is the only form of protection conferred on employees in the case of corporate insolvency.

Preferential treatment assumes that employees (former employees) with wage and other compensation claims are given statutory priority over other classes of creditors. The highest level of such priority is absolute or so-called super-

priority, a specific mechanism to ensure that employees' claims are first in line (including over-secured creditors) to be satisfied with any liquidity difficulties of the company. The most significant disadvantage of this system is the lack of legal satisfaction of workers' claims in the situation of the absence of own funds in the insolvent company available to cover debts (Karaleu, 2022).

We think it is necessary to note related problems showing the vast increase in the volume of employees' claims as claims of priority creditors in the Russian Federation, where preferential treatment is the only tool for employee wage claims satisfaction in the case of insolvency. This trend is reflected in Fig. 3, compiled for 2019-2023 by JSC Interfax in Fedresurs (fedresurs.ru) based on the information from the published reports of arbitration managers (administrators in the insolvency procedure).



Source: <https://fedresurs.ru/news>

Fig. 3: The dynamic of the second priority creditors' claims in completed bankruptcy cases for 2019-2023 in the Russian Federation

As can be seen from Fig. 3, the total amount of priority claims included in the Register of creditors' claims showed a clear negative growth trend in their volumes, and in 2021, the

percentage of satisfaction of claims fell to an extremely low level. Thus, the acceptance rate for the second-priority creditors' claims (in the Russian Federation, wages and severance pay

claims have the second priority) in the period under consideration was only about 6.9% and must be regarded as less than satisfactory.

It can be assumed that this trend has emerged only in recent years and is associated with the economic consequences of the COVID-19 pandemic. However, our earlier studies showed that from 2016 to 2018, the average number of satisfied requirements was approximately 30% (Karaleu, 2020). It was much higher than the level formed in the last three calendar years, but at the same time, was far from full payment of priority creditors' claims for wages, severance pay, and other similar payments due to them.

The percentage of satisfaction of the priority creditors' claims in 2022 reached 25% after the introduction by the Government of the Russian Federation of a six-month moratorium on bankruptcies initiated by creditors against citizens, individual entrepreneurs, and legal entities (with some exceptions) (from April 1, 2022, to October 1, 2022), with an average of 16% for the last three years (Fedresurs, 2023). In 2023, the satisfaction rate decreased by almost two times and was approximately equal to the pre-pandemic level. While businesses initially weathered the storm and acceptance rate was increased thanks to government support measures during the pandemic, the subsequent withdrawal of these initiatives, combined with other factors, brought the situation back to its original state.

This problem will become more apparent and further aggravated for the Russian Federation if we remember that many foreign companies curtailed operations in the country last time. Under pressure from investors and consumers, many foreign companies have begun to unwind their investments, close production lines, and pause sales in the Russian Federation.

VI. CONCLUSION

Summarizing the analysis of the market situation, one may state that the companies' adaptation of their business operations and activities with lockdowns and the post-COVID-19 situation combined with unprecedented measures

of national Governments were among the few grounds, which have allowed them to avoid a number of fresh bankruptcies. Crisis containment includes the short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak to prevent businesses from being systematically pushed into insolvency. The objective of the reforms implemented during this stage was to "flatten the curve" of insolvency cases and reduce the burden on the institutions.

Crisis recovery, the second stage, assesses actions taken by some countries during the COVID-19 crisis as well as during previous financial crises to address the medium-to long-term challenges of high levels of firm distress. The objectives of these second-stage reforms are generally to strengthen the institutional capacity and overall functioning of a country's insolvency regime, and to prevent a potential systemic banking crisis caused by elevated levels of non-performing loans.

By examining the outcomes of the two stages above and the lessons learned from past crises, we find that certain types of procedures might be particularly beneficial in the post-pandemic period when other insolvency tools could be useful if the economic recovery is muted and non-performing loans (NPLs) rapidly increase. Examination of crisis measures has promoted the understanding that when temporary emergency measures come to the end, countries will still need the appropriate insolvency and debt restructuring tools available to address debt overhang. Robust formal insolvency and reorganization procedures that may not be sufficient in times of crisis should always be the goal of systematic and continuous improvement and development.

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