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COPING WITH INFLATION: THE LAW AND PAYMENT OF DEBTS

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How does society cope with rampant inflation? For a number of years now Israel has suffered from an extremely high inflation rate which last year exceeded 50% and which apparently will be even higher this year. The complexities generated by a high inflation rate are many. The most complex inflation-generated problems are those which involve the legal process of collecting debts or damages.

Let us assume that a creditor was owed IL 50,000 which he should have received three years ago. However, the debtor refused to pay then, and, now, three years later, after successfully litigating a law suit the creditor finally receives his IL 50,000. Clearly, with the high rate of inflation of the past three years, the creditor will receive much less today, in real money, than he would have had he received the money when it was due. Similarly, imagine an automobile accident that took place three years ago and as to which, at the time, the damage to the plaintiff's automobile amounted to IL 10,000. Again, if he receives IL 10,000 three years later, he has received much less than he would have had he received the money at the time of the accident.

Even without problems of inflation, a creditor who receives money later than he should suffers a loss by the delay in that he is denied the use of the money during the period of delay. The remedy for that loss is the traditional one of awarding interest to the creditor. This remedy has been applied by Israeli courts for many years. However, in a period of high and rapid inflation, interest rates are not sufficient to compensate the creditor for the loss in real value of his money caused by the delay in its receipt.

In an inflationary period even small delays can be costly, but the damage is compounded if court congestion results in very long delays between the time that a court suit is filed and the time that the plaintiff finally recovers what is due him. Finally, the two elements of court delay and inflation are intertwined. Court delay increases the effects of inflation on the plaintiff's true recovery. This, in turn, induces creditors to use dilatory tactics in court; the later a creditor pays, the cheaper it is for him in real money terms. To complete the vicious circle, these

dilatory tactics in turn help cause court backlogs and thus increase the problem of court delay.

Faced with these problems, in recent years the Israeli legal system has acted on two fronts: to reduce court delay, and to directly attack the negative impact of inflation on a creditor's recovery in court in an attempt to insure that the creditor will recover the real money due him.

Reduction of court delay has been attempted through a variety of means. One is to reduce the number of complaints filed in court by changing the substantive law. This was done in the case of the recently enacted no-fault liability law for automobile accidents. The new law, while not free of problems, seems to have had the salutary effect of reducing the number of automobile accident cases filed in the courts.

Another method was the creation of a special small claims court so as to simplify and expedite the processing of small claims. Such a court was established on an experimental basis in Tel Aviv ten years ago for complaints filed by individuals, as distinguished from corporations, for sums of money not in excess of IL 5,000. While this experiment also has not been free of problems, it is generally viewed as having been successful and similar small claims courts will shortly be established in Haifa and Jerusalem.

There is increasing interest in a more general streamlining of the judicial system and, indeed, this may occur in the near future. Finally, it should be noted in this regard that in some areas the judges themselves have taken hold of the problem and have cut down on the court backlog by increasing their own productivity. In the Jerusalem District Court, for example, the average time that elapses between the filing of a complaint and the hearing of the case is now three to four months, as against over a year just a short time ago.

Even more interesting and far-reaching from a legal point of view, however, have been two recent changes in the law designed to deal directly with the effect of inflation on legal recoveries. The first of these was accomplished by the courts themselves. The generally accepted view in Israel, as in England and the United States, has been that in an action for damages to property or person, the monetary cost of the damages are determined as of the time of the occurrence of the damage. In order, however, to cope with the problem of the depreciation in the value of money in a highly inflationary period, the Israeli Supreme Court has determined in the past few years that this rule no longer applies, at least to property damage in tort cases. In such cases, the court has held that the value is to be determined at the time of the judgment or even at a later time, i.e., when the judgment is finally paid. Thus, to return to the second of our earlier examples, if the plaintiff's automobile was damaged three years ago and, at the time, it cost IL 10,000 to have it fixed, under the previous rule he would receive only IL 10,000, whenever the judgment was entered.

Under the new rule, however, if the cost of fixing the damage at the time of the judgment had risen to IL 25,000, a not unlikely occurrence, he would receive a judgment for IL 25,000, rather than IL 10,000.

This evaluation of the loss at the later time would have two salutary results. First, it would better compensate the plaintiff for his real loss. Clearly, if he did not undertake the repairs until he received the money, providing him with only IL 10,000 would not allow him to repair the damage. Even if he had the car repaired out of his own pocket three years ago at IL 10,000, he would still not be adequately compensated by "return" of the IL 10,000 now, since, if he had received the money three years ago when he should have, he could have invested the sum in such a way so that it would retain its real value and thus today be worth much more than IL 10,000. Moreover, by determining damages as of the date of judgment or payment of the judgment, this new rule also removes a major incentive for those liable for such damage, including insurance companies, to stall or otherwise resist payment.

In addition to this court-made law as to the determination of damages, which applies basically to tort, as distinguished from contract, actions, the Knesset recently passed a major amendment to the law concerning the awarding of interest in court proceedings. Until this new amendment, the courts were authorized to award interest on judgments according to rates that continuously rose and eventually reached 26%. Although 26% interest is a very high rate, as interest rates go, it still does not adequately compensate for the real loss of value of money since the inflation rates have been even higher. Thus, the creditor was not fully compensated for the loss in the value of the money caused by the debtor's delay in payment and the debtor had every reason to delay payment since he could invest his money and realize much more on it than the 26% interest he would ultimately have to pay to the creditor.

The Knesset legislation attempts to remedy this situation by authorizing courts to "link" the amount of judgment to the cost-of-living index, together with a low interest rate of up to 3%. In other words, to return to our first example, if a creditor should have received IL 50,000 three years ago, today he would receive a judgment for an amount equal to IL 50,000 multiplied by the inflation rate in that three-year period, plus the modest interest. In this way he would be put in the same position as if he had received the IL 50,000 at the proper time and, in order to preserve its value, had invested it, for example, in bonds or a savings plan linked to the cost-of-living index, as well as receiving a small interest payment of 3%, not linked, to compensate him for the ordinary loss involved in the delay in receipt of payment.

There are a number of difficulties surrounding this new "linkage" law, among them the fact that apparently the linkage amount is subject to income tax, whereas if the creditor had received the money when he should have and invested it in linked bonds or a linked savings account, he would not be required to pay

income tax on the amount he received as "linkage." However, this problem may be solved in the near future by adding a provision to the income tax regulations to exempt the linkage from tax. Other problems concern the retroactive application of the statute and the relationship of this new statutory provision for linkage to the judicial decisions concerning the evaluation of damages in tax actions, discussed above. Yet both these problems also appear capable of resolution. It would appear that the new law will realize its goal of protecting creditors from the effects of inflation and denying debtors this incentive to delay as long as possible the payment of their debts.