Chapter II

The Proposal for a Statutory Sovereign Debt Restructuring Mechanism

A statutory approach, as suggested by the IMF, could provide a sustainable solution that would also cover existing debt.¹ The intellectual origins of the IMF’s Sovereign Debt Restructuring Mechanism (SDRM) can be traced back to the U.S. Bankruptcy Code, in particular Chapters 9² and 11 thereof.³ While Chapter 9 deals with the reorganisation of insolvent municipalities, Chapter 11 addresses the reorganisation of corporations.

The proposal to use the U.S. Bankruptcy Code as a model for sovereign debt reorganisation was first advocated in 1981 by Oechsli, who argued in favour of an analogy with Chapter 11.⁴ Several other authors followed his approach,⁵ but some shifted the focus from Chapter 11 to Chapter 9.⁶

---

Similarly, Krueger stressed in her proposal that Chapter 9 is, in many respects, of greater relevance for a reorganisation system for sovereign debt than corporate rehabilitation laws such as Chapter 11.7 Those parallels result specifically from the differences arising from the sovereign status of states and municipalities. For instance, Chapter 9 reorganisation cases for municipal debtors cannot be converted into a liquidation process. In the same way, it has been reiterated that “companies may go down, but governments must not”.8 Hence, there is no question that the liquidation and distribution of a state’s elected government is excluded. The reason most advocates of a statutory approach focus on Chapter 11 as the conceptual basis might be that Chapter 9 in essence incorporates Chapter 11 by reference9 and is said to add little to the other chapters10 that is not already obvious11 on account of the municipal status.

Notwithstanding the major differences in these proposals, they all proceed from a triple premise:12 First of all, they agree that the current ‘Ad hocery’ in responding to sovereign debt reorganisations leads to significant inefficiencies in the allocation of resources. This aspect is generally correlated to the issue of the current inadequacy of incentive structures, which favour lending and borrowing that should not occur. Secondly, as the constant repetition of financial crises indicates, a change in the international financial structure appears overly due. Finally, only a set of rules, binding on the actors (i.e. emerging markets’ governments as debtors, creditor governments, international financial institutions, such as the IMF or the World Bank and private entities, in particular banks) can realign governmental and public behaviour to improve efficiency, equity and accountability.

In order to provide an overview of the statutory approach, the relevant provisions of the U.S. Bankruptcy Code shall be highlighted and their applicability in the sovereign context briefly illustrated.13

---

7 Krueger, supra n. 1, p. 12.
10 Schwarcz, supra n. 5, p. 970.
11 Ibid.
13 For an analysis of the substance of those proposals see the discussion in Part C, Chapter II, 5.2.