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# ***The IMF's Dubious Proposal for a Universal Bankruptcy Law for Sovereign Debtors***

**by Anna J. Schwartz**

## **Executive Summary**

The International Monetary Fund has proposed a universal bankruptcy tribunal to deal with sovereign debt restructuring. But does the international financial system really need such a mechanism? There has been little demand by sovereign borrowers or their creditors for a universal bankruptcy law, and few countries have had to enter into debt restructuring procedures. The absence of such a law does not appear to have created chaotic conditions even in those cases.

Academic support for IMF's proposal is limited, and a diverse group of critics supports alternative, market-based solutions. One such solution includes the use of majority-action clauses in bank and bond debt instruments that would bind all creditors to a debt renegotiation agreement between the country and creditor represen-

tatives, thus eliminating the need for unanimity among creditors. Another proposal explains how capital market tools already exist and how they have been used to renegotiate outstanding debt in a short period of time. The crisis in Argentina shows that a centralized bureaucratic management of debt problems was not needed to initiate reduction of outstanding debt or organize the country's creditors.

Any of the proposals for dealing with sovereign debt problems may lead to reduced lending to emerging market economies. That may be a welcome change from the current culture of debt-based development and overborrowing, which the IMF has helped to encourage. A greater reliance on equity investment may help set countries on a more sustainable growth path.

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## **Introduction**

The idea that there is a “gaping hole” in the architecture of the international financial system that should be filled by a universal bankruptcy tribunal is not credible. For centuries, sovereign debt defaults have been resolved without the benefit of bankruptcy laws. When a financial crisis exposes a sovereign debtor’s bankruptcy, it seems wrong-headed to focus on resolving its dishonored obligations rather than expanding efforts on preventing debtors from accumulating excessive obligations.

Implicit in the bankruptcy approach is an assumption that the financial crises that have taken place in emerging markets have been made worse by the difficulties debtor governments have faced when trying to attenuate the commitments made to their creditors. But in each of the crises following the Mexican devaluation of 1994, the International Monetary Fund has bailed out creditors, and, to the extent that debt restructuring was involved, that restructuring was not stymied. There has been so much criticism of the moral hazard created by that policy that in the future the IMF may restrain its penchant for bailouts. But even if it does so, its continued sponsorship of a universal bankruptcy law should be questioned. Why would such a law be a higher priority for the IMF than more effective oversight of the economic policies of emerging markets?

The case for setting up an elaborate mechanism for sovereign debt restructuring is weakened to begin with by the IMF’s acknowledgment that such an instrument would not be activated often since many countries do not need debt restructuring. Moreover, it is not clear that the absence of a bankruptcy law has produced chaotic conditions in the few countries that have had to settle differences with their creditors. Finally, it is not at all obvious how a sovereign debt bankruptcy law, for which there is no precedent, would work or whose benefit it would serve. If the legislation was intended to serve both debtor nations and

their creditors, it is remarkable that the IMF did not consult with representatives of either of the parties to learn their wishes before issuing its proposals.<sup>1</sup>

In this paper, I begin by discussing two recent versions of the proposal for bankruptcy arrangements for sovereign debtors. I then ask if there is extensive demand for such arrangements from debtor countries, private investors, and disinterested observers and find it lacking. Next, I review the alternatives proposed by various opponents of sovereign bankruptcy legislation, the majority of whom prefer a market solution to bureaucratic management of debt-related problems. I conclude with some observations about the IMF’s role in the elusive quest for the development of emerging market countries by means of indebtedness.

## **A Proposal for a Bankruptcy Law for Sovereign Debtors**

In an address to a Washington audience in November 2001, Anne Krueger—the first deputy managing director of the IMF—presented a proposal for bankruptcy procedures for sovereign debtors to facilitate the orderly restructuring of their debt as if that were the holy grail long sought for the salvation of emerging market countries.<sup>2</sup> The proposal would enable governments to seek legal protection from their creditors by declaring bankruptcy, similar to the way in which Chapter 11 works for companies and Chapter 9 for municipalities under the U.S. Bankruptcy Code.<sup>3</sup>

The objectives of sovereign bankruptcy proceedings would be to (1) prevent creditors from disrupting negotiations by seeking repayment through domestic courts,<sup>4</sup> (2) require debtors to negotiate with creditors in good faith and to reform the policies that led to their bankruptcy, (3) encourage lenders to provide new money (known as debtor-in-possession financing) by guaranteeing that their claims would come before the claims of existing private creditors, and (4) persuade minor-

ity creditors to participate in restructuring arrangements.<sup>5</sup>

Krueger outlined the proposal again in a speech in Delhi, India, on December 20, 2001, and responded to objections that had been raised.<sup>6</sup> The IMF's executive board gave preliminary approval to the proposal, but at a two-day meeting in March 2002 there was no unanimity among the directors on how to proceed.<sup>7</sup> The subject was not formally on the agenda at the spring meeting. On April 1, 2002, Krueger answered questions at a press conference before giving another speech modifying the proposal.<sup>8</sup>

### The November 2001 Proposal

The November proposal would have authorized the IMF to grant a government, in response to its application for a temporary standstill on the repayment of its debt, the right to declare bankruptcy. The government would then negotiate a restructuring of its debt with its creditors, a majority of whom would decide the terms for all of them (a feature modeled on British bankruptcy laws). To prevent an outflow of private funds during the negotiations, the IMF would allow governments to impose temporary foreign exchange controls.

To restrict the ability of creditors to enforce their claims in national courts, it would be necessary to establish bankruptcy laws for sovereign debtors in each of the 183 member countries of the IMF. Otherwise creditors could attempt to enforce their claims in jurisdictions without such laws. Alternatively, an amendment to the Fund's articles—which requires the consent of 85 percent of the shareholders—could create an international law binding all nations and altering terms of all existing and future financial instruments. The IMF would then become the international bankruptcy tribunal, whose job would be to mimic bankruptcy proceedings in domestic corporate workouts. It would give sovereign debtors the benefit of a freeze on creditor lawsuits and the “cram-down” features (meaning compulsory acceptance of a restructuring plan by

dissident creditors) of a domestic bankruptcy proceeding. Disputes between a debtor government and its creditors would be adjudicated by an independent tribunal. A majority vote by creditors would bind dissident creditors just as if their bonds included collective action clauses.

### The April 2002 Proposal

In April 2002, Krueger modified the original proposal, mainly in response to criticism that the original version aggrandized the IMF's authority to resolve a debtor's negotiations with its creditors. The revised proposal removed the Fund from the restructuring process, leaving decisions on the matter to the debtor and a supermajority of the creditors. As before, an amendment to the IMF's articles would be required, this time to achieve a uniform legal arrangement for collective action. The definition of a supermajority was to be determined at a later date.

A second change from the original proposal was that the validation of the need for a stay or a standstill would be declared by the IMF only at the start of the process but would then be revalidated by a creditors' committee on its formation. A third change required a single supermajority for different creditor claims (bank loans, bonds, trade credits, interbank loans, and other claims), rather than each creditor class, to approve prolonging a stay beyond three months and a final restructuring agreement. If that agreement did not accord with the Fund's view of how much the debt burden needed to be reduced to be sustainable, the IMF could withhold further financing and additional restructuring would be expected.

## Who Favors Sovereign Bankruptcy Proceedings?

Neither sovereign countries nor private-sector investors have been clamoring for a sovereign country bankruptcy law. If anything, sovereign debtors have shunned previous plans—such as preapproved credit lines and

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contingency clauses in bonds stipulating steps to be taken in case of default—to signal to markets that their countries had responsible policies. Countries with emerging markets have regarded such devices as an indication of financial weakness and feared that adopting them would induce creditors to exact an interest premium on loans. Sovereign debtors might well have a similar reaction to the IMF's proposal. Nonetheless, the proposal has some support among academics.

Jeffrey Sachs, now at Columbia University, has long advocated a universal bankruptcy law.<sup>9</sup> In 1995 he made the case for giving insolvent countries the same protection from creditors as insolvent firms. His sympathies were with the sovereign debtors, not the creditors. Sachs's views were rejected in the report of an official working group issued after the Mexican crisis of 1994–95. That report, which received the endorsement of the major industrialized countries, favored debt workouts rather than massive official bailouts and stressed the importance of market discipline.<sup>10</sup>

In a paper that Sachs prepared for a Brookings conference in 2001 on debt restructuring, he relegated the bankruptcy court proposal to the periphery of his argument. He was more concerned with using grants and debt forgiveness to facilitate a greater flow of resources from richer countries to heavily indebted poorer countries.<sup>11</sup>

Initially, Kenneth Rogoff, formerly of Princeton and Harvard universities, offered a skeptical perspective on sovereign bankruptcy proceedings.<sup>12</sup> He differentiated between a domestic bankruptcy court, which can seize physical assets and fire a company's board of directors, and an international bankruptcy court, which is unlikely to enter a debtor country and seize physical assets, much less fire the country's government. For Rogoff, municipal government bankruptcies, in which outside boards run the city's day-to-day finances, are no more convincing examples for sovereign government bankruptcies. Federal governments, in his view, would not tolerate a comparable level of outside interference. Rogoff concluded that the main

problem with an international bankruptcy court is that it could not enforce its decrees in debtor countries. Moreover, in the event of a default, if lenders could not turn to national courts, which would be superseded by an international court, the volume of lending would diminish.

When Rogoff was appointed director of research at the IMF, his position on a bankruptcy law for sovereign debtors changed. In his June 28, 2002, remarks on the Joseph Stiglitz book, *Globalization and Its Discontents*, Rogoff reversed himself. He stated, "there is a need for a dramatic change in how we handle situations where countries go bankrupt." He saluted Krueger for having "forcefully advocated a far-reaching IMF proposal." He taunted Stiglitz for having first sharply "criticized the whole idea" at a Davos panel in February and later taken credit "as having been the one to strongly advance it first."<sup>13</sup>

Michelle White of the University of California at San Diego believes that a bankruptcy court or some equivalent may be needed to rein in rogue creditors, provide private sector financing that has seniority over earlier claims against countries during debt restructuring, and compel dissenting groups of creditors to accept a restructuring plan.<sup>14</sup> She cautions, however, that such a procedure may "dry up the sovereign bond market completely."<sup>15</sup>

## **Who Opposes Sovereign Bankruptcy Procedures?**

The opponents of the IMF's proposal include former as well as present government officials and academics. Their criticisms and alternative recommendations vary. In the concluding section, I note the opposition of spokesmen for international investors and debtor countries.

Edwin Truman, a former Federal Reserve and Treasury Department official, is entirely opposed to bankruptcy proceedings, as he made clear in a speech in New York on December 10, 2001.<sup>16</sup> He believes that there is no consensus among policymakers and com-

mentators to make a sovereign bankruptcy proceeding politically feasible.<sup>17</sup> He faults payments standstills, which, in his view, are likely to worsen crises. Instead of focusing on debtor insolvency, as does a sovereign bankruptcy procedure, he favors the provision of adequate liquidity to the world financial system. He proposes a new fund for the IMF to be raised by an annual fee of 0.1 percent on international investment until it reached a value of, say, \$300 billion. Countries in financial difficulties could draw on the fund. In effect, Truman's approach is a better financed continuation of the IMF's previous response to financial crises, possibly including bailouts.

In opposition to the tax that Truman advocates, Charles Dallara, managing director of the Institute of International Finance, which represents international banks and other investors, disputes the need to raise more resources for the IMF.<sup>18</sup>

The U.S. Treasury Department's response to the IMF's proposal was negative. John Taylor, Treasury undersecretary for international affairs, told the congressional Joint Economic Committee that a decentralized approach that relies on collective action clauses would be superior to the proposal.<sup>19</sup> He elaborated on that approach in a subsequent speech.<sup>20</sup> It would involve adoption by sovereign debtors and their creditors of a majority-action clause to bind all creditors to an agreement between the country and the creditor representatives. A second clause on procedures would stipulate that each class of creditors would have its own representative and would require the debtor to provide the creditor representatives with necessary data. Each creditor representative on instruction by a specified fraction of creditors would have the exclusive right to initiate litigation. A third clause would allow deferral of debt payments and bar litigation for long enough to permit creditors to choose their representative. The three clauses would be included in bank and bond debt instruments. Any country seeking an IMF loan would have to include those clauses in its debt instru-

ments.<sup>21</sup> The IMF could also promote use of the clauses by lowering the charge for its loans for countries that did so.<sup>22</sup>

The Joint Economic Committee of the U.S. Congress also rejected a new role for the IMF in supervising sovereign bankruptcies. One explanation for the launch of the bankruptcy court proposal has been offered by Chairman Jim Saxton (R-N.J.), who said, "I can't help thinking that its default supervision proposal would have the effect of compensating the IMF for the reduction in its influence arising from a more restricted policy toward international bailouts."<sup>23</sup> The JEC instead supported Taylor's decentralized approach. It also released a study further documenting how the private sector can resolve bankruptcy without a formal court.<sup>24</sup>

The study shows how the absence of majority action clauses in outstanding debt can easily be remedied. Exchange offers containing majority action clauses could be swapped for old debt. To execute those offers, the study's authors advocate a series of auctions. To encourage participation in the exchange offers, exit consent amendments could be used. Those amendments added to the terms of old instruments destroy the value of any instruments held by holdouts. When a bond issue includes the amendment, voted by a supermajority of holders, it becomes binding on the remaining holders.

As Carnegie Mellon University's Adam Lerrick and Allan Meltzer note, the market is familiar with exchange offers. In the period before Argentina defaulted in December 2001, it made extensive use of exchange offers to fulfill a condition the IMF attached to the \$40 billion loan Argentina obtained in 2000 from a consortium of donors including the IMF. The condition was to implement a voluntary, market-based operation to improve the country's debt profile. The technique Argentina adopted was an exchange offer of debt instruments for existing maturing bonds, without the use of exit consent agreements. The new debt instruments provided for longer maturities and higher interest rates than did the original bonds. In 2000

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and 2001, Argentina made exchange offers to foreign bondholders, presumably after consultation with investment advisers on what the market would accept. However reluctantly, Argentina's bondholders accepted the exchange. Nominally the exchange offer improved the terms of existing bonds, but the market rating of the bonds imposed substantial losses on the bondholders.<sup>25</sup>

Lerrick and Meltzer show how debt contracts can replicate the protections of a sovereign bankruptcy court. A trust indenture, for example, provides for a trustee to control all action against the sovereign on behalf of all bondholders. In order to continue debt service in a liquidity crisis, the equivalent of debtor-in-possession financing can be arranged by subordinating outstanding claims to interim lenders. The authors dispute the IMF's contentions that it is difficult to coordinate increasing numbers of anonymous creditors holding a great variety of debt instruments and that holdout creditors are likely to sue a country.<sup>26</sup> As they note, a creditors' committee was formed in November 2001 before Argentina defaulted, which indicates that it is not so difficult to access a broad spectrum of investors in such situations. Lerrick and Meltzer also argue that their recommendation for exchange offers and exit consent agreements preclude the ability to sue and extract preferential treatment by holdouts.<sup>27</sup>

Peter Kenen of Princeton University dissents from the IMF proposals and the Taylor position on the ground that they

fall short of resolving the problem encountered during the Asian crisis, which involved the liquidation of short-term foreign claims on Asian banks and firms, rather than claims on Asian governments. . . . Suspension of payments and stays of litigation may be required by *all* debt-related crises, not merely those requiring restructurings of sovereign debt.<sup>28</sup>

Kenen would reinforce Taylor's proposals by

two further measures: he would include collective-action clauses in all standardized debt contracts of both the private sector and governments and a 90-day rollover option in all standardized debt contracts. He would require debtors to exercise that option if a country's government made a formal finding that the country faced a financial emergency. Coverage of private sector debt would be limited to debts denominated in foreign currency.

The advantage of including private debt, according to Kenen, is that it might obviate the need to impose exchange controls. Under the IMF plan, if a government imposed exchange controls, the private sector might have to suspend debt payments, but the IMF would sanction a stay of litigation against private sector debtors only if a country faced a sovereign debt problem. Kenen believes that his plan avoids this problem but admits that private sector suspension of debt payments, not backed by exchange controls, might motivate debtors to buy foreign currency before the end of the 90-day rollover period to provide the means to resume debt payments after the end of the period.

Because it will take years to amend the Fund's articles of agreement and the proposal is apt to provoke opposition from the private sector, lacks Treasury support, and may be opposed by some emerging market countries, Kenen favors his own comprehensive contractual approach as "the most expeditious second-best way to go."<sup>29</sup>

Stanford University's Jeremy Bulow sets the right priorities for dealing with the problem of sovereign debt: first, control the extent of borrowing by sovereigns, and, second, downgrade the need for bankruptcy procedures.<sup>30</sup> Bulow regards emerging market economies as being prone to create budget deficits owing to corruption by many of their policymakers and their willingness to borrow for socially inefficient projects. The sovereign has an incentive to default not because of an inability to pay but because of an unwillingness to pay. Bulow would limit borrowing by sovereigns to their own legal jurisdictions rather than allow them to issue debt in major

foreign centers. The problem with a bankruptcy court, Bulow contends, is that it would facilitate default and debt restructuring. However, the capital market for loans to emerging market economies would shrink as a result. In Bulow's view, that is a desirable outcome.

## Conclusion

The opposition to the IMF's original and modified proposals is varied and substantive. Even apart from the chorus of dissent, there is reason to believe that the IMF will not succeed in enacting its unwieldy and overly complex program. It would take years for the membership to adopt the changes set forth in the program or for the Fund to be in a position to amend its articles. It is doubtful that the Fund will be able to convince the U.S. Treasury to vote for an amendment, which requires the consent of 85 percent of the Fund's shareholders.<sup>31</sup> The U.S. vote is more than 17 percent of the total.

There are serious challenges to at least three of the premises on which the proposal for a bankruptcy court is based:

1. *It is difficult to assemble committees of creditors who hold bearer bonds of various maturities.* Today, all bonds are registered, so there is no problem in identifying holders and organizing committees of homogeneous claimants.
2. *A rogue creditor poses a threat to the successful conclusion of a restructuring.* As Nouriel Roubini has remarked: "Rogue creditors do not jeopardize the completion of an exchange offer; their incentive to start litigation is triggered by a successful offer, not a failed one. Only after a majority of creditors have accepted a deal does a rogue have the incentive to obtain a full claim."<sup>32</sup>
3. *Official intervention is needed to facilitate restructuring.* Market solutions already exist and have been used to renegotiate the outstanding debt of troubled

emerging sovereign debtors. IMF intervention is a solution to a problem that does not exist.

At stake if the IMF proposal for a sovereign bankruptcy procedure or any of its variants is implemented is that investors will view the new conditions with a jaundiced eye and retreat from lending to emerging market countries. Indeed, the borrowers are well aware of this pitfall. That is the message that both creditors and debtors have expressed in response. Charles Dallara, a spokesman for international banks and other investors, contends that various types of contractual provisions for international bonds will enable orderly restructuring to proceed without the need for the IMF to oversee a country's debt restructuring.

At recent IMF-World Bank meetings former Brazilian finance minister Pedro Malan said that he was unconvinced that the benefits of statutory debt restructuring would be greater than the potential costs. Mexico has expressed similar doubts. The costs to which Malan referred are higher interest rates that lenders will require if either the contractual or the statutory approaches ever materialized.<sup>33</sup>

That might not be such a deplorable result. Lenders have not exercised due diligence in extending loans to those countries, and the IMF has fostered a culture that encourages borrowing, not only from creditors in the world capital market but from the international financial institutions as well. Although the objective of such institutions has been to promote development, looking back on what that culture has achieved over the past 50 years, one has to conclude that their record is unimpressive. Perhaps the time has come to abandon debt-based development; to encourage the conversion of debt to equity; to set countries on a different path than one that leads to unsustainable debt, crises, and debt restructuring; and to rely on equity investment for development.

## Notes

1. It is noteworthy that the first reference to consultation with market participants in an

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International Monetary Fund document on sovereign debt restructuring appears in the November 27, 2002, paper for a meeting April 2003 to consider an initial draft of the text of the amendment to the Fund's articles. See IMF, "The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations," prepared by the Legal and Policy Development and Review Departments, p. 3.

2. Anne Krueger, "International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring," address to the American Enterprise Institute, November 26, 2001, [www.imf.org/external/np/speeches/2001/112601.htm](http://www.imf.org/external/np/speeches/2001/112601.htm).

3. Chapter 11 allows companies to continue operating and to repay creditors' claims from future earnings rather than from the proceeds of liquidating their assets. There is a stay on litigation against the company that was initiated before bankruptcy filing and on litigation after the filing. Companies may obtain new loans—debtor-in possession financing—that are senior to all claims that existed before the filing. For four months after the filing managers have an exclusive right to propose a reorganization plan that specifies how the claims of each class of creditors will be settled. If the bankruptcy judge ends the 'period for the managers' proposal, creditors may then offer their own reorganization plan. Each class of creditors must approve the final plan by two-thirds of the amount involved and a majority of the number of claims. When no reorganization plan is adopted, the judge may order liquidation of the company under Chapter 7. Otherwise, the judge may adopt the failed reorganization plan under the procedure known as "cram down." Chapter 9 applies only to cities and other entities that are state creations. A city may file for bankruptcy only after obtaining permission from the state. It must be insolvent and unable to pay ongoing debts. Public officials may not be replaced, as managers may be under Chapter 11. The former have the exclusive right to offer a reorganization plan but a committee of creditors may negotiate with public officials. In theory the judge may offer his own restructuring plan, but that has never happened. The voting procedure on a plan is similar to that in Chapter 11. See Michelle J. White, "Sovereigns in Distress: Do They Need Bankruptcy?" *Brookings Papers on Economic Activity* 1 (2002): 293–97. Chapter 7 permits consumers and businesses to be freed of most of their unsecured debts. Chapter 13 requires debtors to propose a plan to pay off at least some debt over three to five years.

4. Litigation has been a feature of sovereign defaults for centuries, but there is no evidence that restructuring has been delayed or disrupted as a result.

5. A voluntary market-based way of achieving this end is described below.

6. Anne Krueger, "A New Approach to Sovereign Debt Restructuring," address to the Indian Council for Research on International Economic Relations, Delhi, India, December 20, 2001, [www.imf.org/external/np/speeches/2001/122001.htm](http://www.imf.org/external/np/speeches/2001/122001.htm).

7. Anne Krueger, "Transcript of a Teleconference on Sovereign Debt Restructuring Mechanism with Washington-based Journalists and First Deputy Managing Director, Anne Krueger," International Monetary Fund, April 1, 2002, [imf.org/external/np/tr/2002/tr020401.htm](http://imf.org/external/np/tr/2002/tr020401.htm).

8. Anne Krueger, "New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking," address to the Institute for International Economics, April 1, 2002, [www.imf.org/external/np/speeches/2002/040102.htm](http://www.imf.org/external/np/speeches/2002/040102.htm), and Anne Krueger, *A New Approach to Sovereign Debt Restructuring* (Washington: International Monetary Fund, 2002).

9. Jeffrey Sachs, "Do We Need an International Lender of Last Resort?" The Frank D. Graham Lecture delivered at Princeton University, 1995.

10. Group of 10, "The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors," International Monetary Fund, 1996.

11. See Jeffrey D. Sachs, "Resolving the Debt Crisis of Low-Income Countries," *Brookings Papers on Economic Activity* 1 (2002): 257–86.

12. Kenneth Rogoff, "International Institutions for Reducing Financial Instability," National Bureau of Economic Research Working Paper no. 7265, July 1999.

13. Kenneth Rogoff, "Introductory Remarks to Discussion with Joseph Stiglitz on *Globalization and its Discontents*," International Monetary Fund, June 28, 2002.

14. Michelle J. White, "Sovereigns in Distress: Do They Need Bankruptcy?" *Brookings Papers on Economic Activity* 1 (2002): 287–316.

15. *Ibid.*, p. 316.

16. Ed Crooks, "IMF 'Needs a Cash Fund' for Rescuing Crisis-hit Countries," *Financial Times*, December 12, 2001.

17. See Edwin M. Truman, "Debt Restructuring: Evolution or Revolution," *Brookings Papers on Economic Activity* 1 (2002): 341–46. In discussing the three papers presented at the Brookings 2001 con-



ference on an international bankruptcy court, Truman reiterates his view that it is not now feasible “because the intellectual and political foundations have not yet been laid” (p. 342). The reasons are (1) no consensus exists on whether such an institution should seek to maximize the return to creditors or give debtors a fresh start and (2) the world is not ready to give a supranational body the right to make such judgments.

18. Ed Crooks.

19. John B. Taylor, “Grants and Sovereign Debt Restructuring: Two Key Elements of a Reform Agenda for the International Financial Institutions,” Testimony before the Joint Economic Committee of Congress, February 14, 2002, [www.house.gov/jec/hearings/taylor.pdf](http://www.house.gov/jec/hearings/taylor.pdf).

20. John B. Taylor, “Sovereign Debt Restructuring: A U.S. Perspective,” address to the Institute for International Economics, April 2, 2002, [www.treas.gov/press/releases/po2056.htm](http://www.treas.gov/press/releases/po2056.htm).

21. The legal framework outlined by Taylor was endorsed by the finance ministers of the Group of Seven industrial countries at a meeting in Washington at the end of September 2002. See Edmund L. Andrews, “World Financial Officials Back New Debt Framework,” *New York Times*, September 29, 2002. Earlier that month Treasury presented the plan to a gathering of senior economic officials from the Group of Seven, large private investors, and representatives from several nonindustrial countries. See Michael M. Phillips, “U.S. Presses Bid for Escape Clause in Some Bonds,” *Wall Street Journal*, September 26, 2002.

22. An observer might have concluded that Treasury opposition to the Krueger proposal effectively ended its prospects. Such a conclusion was spiked by a statement made by U.S. Secretary Paul O’Neill at the International Monetary and Financial Committee meeting of the IMF on September 28, 2002: “The United States strongly welcomes the significant progress being made on the contractual approach to sovereign debtor restructuring. We are particularly encouraged by the broad support expressed by both borrowers and creditors for the implementation of this approach. In addition, we strongly support the continued pursuit of the statutory approach.” The contractual approach to which O’Neill referred is the one that Taylor offered. The statutory approach is the one Krueger offered. Does Treasury favor both approaches? More dubious is O’Neill’s claim that both borrowers and creditors have given broad support for these approaches. See contrary statements by these parties in the conclusion.

23. Joint Economic Committee, Congress of the United States, “IMF Sovereign Bankruptcy Super-

vision Is Unnecessary: New Analysis Rejects More IMF Mission Creep,” press release, Washington, D.C., April 19, 2002.

24. Adam Lerrick and Allan H. Meltzer, “Sovereign Default: The Private Sector Can Resolve Bankruptcy without a Formal Court,” *Quarterly International Economics Report*, Carnegie Mellon Gailliot Center for Public Policy, April 2002.

25. Before the default, further exchange offers were expected in 2002 but were never made. Two suits have been filed against Argentina—one by German investors, the other by Americans seeking class action certification. Four other suits have been filed for small amounts. Argentina is defending all.

26. The reason that there is no obstacle to organizing creditors is that these days all bonds are registered. The debtor or fiscal agent who distributes interest can distribute a note to creditors stating that they are all invited to a meeting that will be held on a designated date. In the same way, creditors can organize themselves either in a corporate or a sovereign context.

27. In a 2001 paper, Lerrick and Meltzer proposed an approach to debt restructuring quite different from their 2002 proposal. The earlier approach required a debtor to declare default that would prompt the IMF to provide a stand-by line of credit. The line of credit would allow any creditor to sell its defaulted claim for a fixed cash price that the IMF would set—an official floor of support—significantly below the debt’s anticipated restructured value during a brief time period. During this period, the country would offer to restructure its debt through an exchange for new bonds, fixing a maximum write-down. Negotiations between the debtor and creditors during the restructuring period would presumably set the final restructured value above the official floor of support. See Adam Lerrick and Allan H. Meltzer, “Beyond IMF Bailouts: Default without Disruption,” Carnegie-Mellon Gailliot Center for Public Policy, 2001.

28. Peter B. Kenen, “The International Financial Architecture: Old Issues and New Initiatives,” *International Finance* 5, no. 1 (Spring 2002): 38–39. Emphasis in original.

29. *Ibid.*, p. 42.

30. Jeremy Bulow, “First World Governments and Third World Debt,” *Brookings Papers on Economic Activity* 2002(1), 229–55.

31. This may be wishful thinking. The Treasury apparently has retreated from Taylor’s disavow-

al of the Krueger proposal. At its meeting with the executive board at the end of September 2002, it was expected that the IMF would be asked to prepare a detailed account by March 2003 (subsequently changed to April 2003; see note 1 above) of how a bankruptcy system for countries could be put into practice. See "Doubts Inside the Barricades," *The Economist*, September 28, 2002, p. 65.

32. Nouriel Roubini, "Do We Need a New Bankruptcy Regime?" *Brookings Papers on Economic Activity* 1 (2002): 329. Incidentally, I fail to see why rogue creditors who, after all, demand only fulfill-

ment of the terms of a contract, are excoriated in the literature.

33. Michael M. Phillips, "Developing Nations Are Reading the Fine Print," *New York Times*, April 29, 2002; Michael M. Phillips, "U.S. Presses Bid for Escape Clause in Some Bonds," *New York Times*, September 26, 2002; Edmund L. Andrews, "Big Banks Step Up Efforts against I.M.F. Debt-Relief Plan," *New York Times*, December 19, 2002; Michael M. Phillips, "Support Builds for Plan to Ease Debt Loads of Developing Nations," *New York Times*, September 17, 2002.

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