REINVENTING INSOLVENCY LAW IN EMERGING ECONOMIES

This book explains how and why insolvency law in emerging economies needs to be reinvented. It starts by examining the importance of insolvency law for the promotion of economic growth as well as the similarities and divergences in the design of insolvency law around the world. The central thesis of the book is that insolvency law in emerging economies fails to serve as a catalyst for growth. It is argued that this failure is mainly due to the design of an insolvency legislation that is not tailored to the market and institutional environment generally existing in emerging economies. The book also provides a critical analysis of the design of insolvency law in many advanced economies where the insolvency system has proven to be unattractive for debtors, creditors, or both. Therefore, in addition to suggesting a new insolvency framework for emerging economies, this book ultimately invites readers to rethink insolvency law.

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To my parents

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PREFACE

Insolvency law plays an essential role in the real economy. On the one hand, it facilitates the reorganization of viable companies, the maximization of the returns to creditors and the reallocation of resources of nonviable firms towards more productive activities. On the other hand, an attractive insolvency regime for debtors and creditors can foster entrepreneurship, innovation, and access to finance. Therefore, insolvency law can ultimately serve as a catalyst for growth.

Unfortunately, many countries have an insolvency system that has proven to be unattractive to debtors, creditors, or both. And while this problem can also be observed in some advanced economies, two aspects make the lack of an attractive insolvency framework particularly worrisome in emerging economies. First, emerging markets and developing economies represent about 85 percent of the world's population and almost 60 percent of the global gross domestic product ("GDP"). Second, many emerging economies suffer from significant problems of poverty and access to finance. Therefore, insolvency law is failing in countries where it is most needed.

In many cases, the absence of an attractive insolvency framework is due to the lack of political incentives to embark on legal and institutional reforms whose benefits will only be shown in the long run. In other situations, these reforms might not occur as a result of the lack of awareness about the importance of insolvency law for the promotion of economic growth. In the past decades, however, many emerging economies have implemented major insolvency reforms. Yet, those reforms have not delivered the expected outcome. This book argues that the failure of insolvency law in many emerging economies is mainly due to the design of an insolvency legislation that is not tailored to the market and institutional environment generally existing in emerging economies. Therefore, insolvency law in emerging economies needs to be reinvented.

The book is structured into four parts. Part I comprises an introductory chapter (Chapter 1) that starts by reviewing the economic functions

and strategies of insolvency law as well as a variety of country-specific and firm-specific factors that may affect the optimal design of insolvency law. Part II includes two chapters (Chapters 2 and 3). The first one (Chapter 2) analyzes the market and institutional environment generally existing in emerging economies. The following chapter (Chapter 3) provides an overview of insolvency and restructuring laws around the world, emphasizing the primary features, similarities, and divergences generally found across jurisdictions. Part III comprises five chapters (Chapters 4–8) that develop the primary pillars that this book suggests for the design of an efficient insolvency framework in emerging economies. These pillars include the promotion of workouts and hybrid procedures (Chapter 4), the design of directors' duties in the zone of insolvency tailored to emerging economies (Chapter 5), the adoption of simplified insolvency proceedings for micro and small enterprises (Chapter 6), the need to redesign formal insolvency proceedings for medium and large enterprises (Chapter 7), and the desirability of allowing companies to choose their insolvency forum (Chapter 8). Part IV comprises a final chapter (Chapter 9) that explains why insolvency law has also failed in many advanced economies. Therefore, the book concludes by pointing out that insolvency law might need to be reinvented beyond emerging economies.

This book has been motivated by several factors. First, a primary driver for embarking on this project has been the strong belief that insolvency law can serve as a catalyst for growth. Therefore, if having an efficient insolvency framework is essential for any country, it becomes even more urgent for emerging economies due to their greater financial needs. Second, while it is generally accepted that an insolvency legislation should be tailored to the particular features of a country, the specific factors that should affect the design of insolvency law (and how) have not been clearly identified in the literature. This book seeks to fill that gap by providing a theoretical framework that can contribute to the design of insolvency law in different contexts. Finally, another motivation for conducting this project has been the surprising fact that, even though emerging markets and developing economies represent the majority of countries in the world, most studies on insolvency law have traditionally focused on advanced economies or, at most, in a few emerging markets such as Brazil, India and China. Therefore, I hope this book can encourage other colleagues and insolvency enthusiasts to join the fascinating and much needed debate on how emerging economies can design more attractive insolvency systems that can help them reduce poverty and foster growth.

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This book would not have been possible without the enriching experience that I had gathering and analyzing information from insolvency laws around the world for the development of a new global insolvency index that I have built with the purpose of assessing the attractiveness of reorganization procedures from the perspective of debtors, secured creditors, and unsecured creditors. Therefore, my sincere gratitude to the colleagues and students who have been directly or indirectly involved in this project. Likewise, I would like to thank the institutions that kindly helped me fund many of the research projects on insolvency law that I have conducted in the past few years. These institutions include the Singapore Ministry of Law – through the generous support provided for the launch of the SGRI – and the Lee Kong Chian Fellowship obtained from Singapore Management University. I would also like to thank the University of Chicago's Becker-Friedman Institute for Economics for the financial support kindly provided during my visit to Chicago, where I had the opportunity to present a preliminary version of my global insolvency index.

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