Sovereign Debt Restructuring in Emerging and Developing Countries: Past, Present, Prospects, and Postscripts

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Past

Past: Brady (1989 -1998)

1. *A National Root Cause: The "Killer" Macro Mix*
2. *An External Shock*
3. *A Sovereign Domino: Mexico First*
4. *First International Reaction: Denial and Liquidity*
5. *Second International Reaction: Fear and Solvency*
6. *Core of Brady: Riskless Bonds for Defaulted Loans*
7. *Let Markets, not IMF, Decide Default and Relief*

Past: Brady (1989 -1998)

8. A Menu of Instrument for Creditors to Choose
9. COT Enforced by US Government
10. No COT across Debtors (list here)
11. No IMF DSA
12. It Took Lots of Time
13. It Was Also Costly to Creditors
14. And It Left Lasting Systems and Deep Scars

Past: HIPC (1996-on)

1. *Post-Colonial Africa Had Little or no Debt*
2. *Starting in 1980 to mid-1990s, It Went on a Borrowing Binge*
3. *Lenders Were the Colonial Bilaterals (and multilaterals they control)*
4. *By late 1980s, social cost of "Debt Overhang" causes unbearable domestic political pressure for the Creditors*
5. *Initial International Reaction: Liquidity through City-named Terms*
6. *By 1996, Second International Reaction: Solvency by Forgiveness*
7. *Core Idea: Everyone Down to a Common Factor*
8. *Only Two conditions: IDA-elegible, 3 years under "Country-led" PRSP*
9. *COT for Creditors: Self-driven Bilaterals; Multilaterals Excluded*

Past: HIPC (1996-on)

10. *COT for debtors: all debtors brought down to the same target—unfair?*
11. *Distances to target varied, NPV cut from 20% (Uganda) to 63% (Mozambique)*
12. *No DSA: IMF (debt calculations; no LIC DSF until 2005) and by WB (PRSP)*
13. *Phased Relief: from "Decision" to "Completion" points, supposedly 3 years*
14. *It took a lot of time: Uganda first (1996), Sudan and Eritrea still pending*
15. *37 out of 39 eligible LIC countries completed HIPC; $76b total nominal cut*
16. *Very Good and Very Bad Outcomes*

Past: MDRI (2005-on)

1. *By early 2000s, HIPC was (politically) not enough without multilaterals*
2. *In 2005, IMF, WB, AfDB and, later, IADB unilaterally forgave 100% of claims to HIPC completers*
3. *Multilaterals to be "made whole" by donors to protect lending capacity, but they did not quite*
4. *COT across creditors: all multilaterals forgave in the same proportion--100%!*
5. *COT across debtors: debtors that owned more to multilaterals, got more relief*
6. *Co-coordination was simple: technical teams in multilaterals worked under same owners*
7. *Timing: decided in 2005, launched in early 2006, implemented as HIPC completion points*
8. *Nominal value of forgiveness reached some US$50b (64% IDA; 14% each IMF & AfDB; 8% IDB)*
9. *IDA never got fully compensated, so forgiveness may have come at expense of future loans*
10. *Renewed emphasis on Public Debt Management (new trust funds from donors)*
11. *Together with HIPC, it may have further allowed for new borrowing binge (2010 onwards)*

Past: Two Contrasting Cases—Argentina (2001)

1. *The Killer Macro Mix, On Steroids.*
2. *An External Shock, Again (Brazil's Zamba).*
3. *Largest-ever Bond Default Becomes A Catastrophe, Economically, Socially, and Politically.*
4. *The Size and Complexity Was Mindboggling.*
5. *Four Years of Contentious Negotiations ("capacity" vs. "willingness")*
6. *In June 2005, a Bond Swap with 75% (world's average of 50%).*
7. *Menu of Instrument, Again: Three Options, all with two "innovative" features: GDP-linked warrant and "RUFO"*
8. *A portion of bondholders representing 25% of the bonded claims ($20b) refused the swap and began litigation.*
9. *No IMF program until September 2003 (for $12b), in a controversial, US-supported application of the LIA policy*
10. *But Argentina unilaterally pays off ($10b) the IMF in January 2006 (capacity to pay?)*
11. *Swap reopened in 2010, which reduced the hold-outs from 25% to 7%. The 7% continue litigate.*
12. *Argentina defaulted three more times since the 2005 restructuring: pari-passu plus RUFO, GDP-warrants, pandemic*
13. *Today, still in default with no market access and 1,000-plus spread (list of Argentina's 9 defaults here).*
14. *So, 23 years later the default of 2001 is not yet fully resolved; lost 2 decades!*

Past: Two Contrasting Cases—Uruguay (2002)

1. *Massive contagion from Argentine 2001 crisis*
2. *A banking crisis becomes a BOP (K outflow) and debt crisis*
3. *Immediate IMF arrangement*
4. *Government calls for voluntary rescheduling of external bonds in March 2003 for $5b*
5. *Two months later, a rescheduling through a "bond exchange" is completed.*
6. *No cut in principal or coupon; maturities extended 5 years; cut in PV 13% ex-post*
7. *Menu: longer-maturity (same face and coupons) or even longer but "benchmark size"*
8. *Participation rate by bondholders was 98%.*
9. *Restructuring was government led, with support from IMF to reassure creditors.*
10. *From call for debt exchange to settlement, Uruguay took 45 days.*
11. *Uruguay, which never technically defaulted, began its economic recovery in 2004*
12. *By 2004, it had recovered market access.*
13. *Today, it is investment grade and its spread over US T-bills is less than 100 bps.*

Selected Past Restructurings in EMDE: Summary

Initiative/Country	Menu			Approx. NPV Cut (%) of treated debt	Approx. Dollar Value of Haircut (US billion)
Brady	Discount	Par	Cash	35-50	60
HIPC	Debt forgiven until Debt/Export 150% or Debt/Fiscal Revenue 250%, whichever is most binding			20-63	76
MDRI	All debts forgiven (after HIPC completion)			100	50
Argentina	Discount	Par	Quasi-Par	75	58
Uruguay	Extension	Benchmark		13	0

Present

Present: A Mess under the Common Framework (CF)

- Context: the Pandemic (March 2020) and the G20's pressure to help—no private sector
- Initial Reaction Was Liquidity: in April 2020, DSSI, a PV-neutral deferral of official service till December for 73 IDA clients
- Followed by Solvency: in November 2020, the "CF for Debt Treatments Beyond the DSSI"
- Non-enforceable Commitment—no directives, diverging incentives.
- Poor Outcome: Only four takers, long-dragged, unclear debt sustainability at exit

Present: Why has the CF underdelivered? Eight Reasons:

1. Perverse Signaling – Better be last
2. Fragmentations of Agents – "Tragedy of the Commons" over capacity to pay
3. Missing Data – Some by practice of the lender, some by logistical
4. Dispute over assumptions behind DSA – Rooted in incentives
5. Cancelation by multilaterals: An issue of capital and voting power?
6. Comparability across Creditors: disputes over methodology, coverage of and, critically, on enforcement
7. Comparability across Borrowers: no common target for relief; case-by-case according to IMF's DSA
8. Financing Assurances: timing and unknown loss, logistics of coordination, power of LIOA if borrower wants to pay

Present: The Common Framework – A Comparison with HIPC

Issue	HIPC	Common Framework
Market Signaling	Limited concern about credit rating and market access. Borrowers had an incentive to apply, and apply first.	Credit ratings and market access a major concern. Borrowers had an incentive to delay, and wait for others to apply.
Fragmentation of Creditors	Multilaterals and Paris-Club creditors played the dominant role.	Other types of lenders were added, notably non-Paris Club creditors and private bondholders—and now play a dominant role.
Fragmentation of Borrowers	The borrower was almost exclusively the central government.	Borrowing has been done by central governments but also by subnationals, SOEs, guaranteed projects, etc.
Missing Data	The necessary loan information was available in the World Bank's DRS.	For a large portion of the total debt, information has not been compiled or made public. Some restructurings may have already happened.
Link between Reforms and Haircut	Creditors accepted reforms listed in home-grown Poverty Reduction Strategy Papers—emphasis on preserving social expenditures.	Creditors have an incentive to delay and elicit more government effort, especially on the fiscal side.
Exclusion of Multilaterals	No problem for bilaterals. Multilaterals joined almost a decade later through MDRI.	Bilaterals now debating whether to exclude multilaterals and accept a larger haircut, or include multilaterals and then recapitalize them.
Comparability of Treatment across Creditors	Negotiations were joint and simultaneous. The Paris Club used one of three indicators to assess the relief by each creditor.	Negotiations are neither joint nor simultaneous. Not clear whether the indicators of the Paris Club will be used to compute relief and, if so, which.
Comparability of Treatment across Borrowers	All borrowers were brought down to the same indicator of debt sustainability (same ratio of debt service to exports or to fiscal revenues).	Each borrower will be granted relief on a case-by-case basis until debt is judged sustainable. Relief can range from 100 percent to zero.
Timing of Financing Assurances to the IMF	Not an issue. The IMF and Paris Club creditors were working hand-in-hand.	A chicken-and-egg situation. Creditors may use their assurances to leverage concessions from debtors. Individual creditors are asked to give assurances not knowing how much loss each will suffer. Logistics of creditor coordination also a problem.
Domestic Debt	A lesser issue. Low-income countries had not yet started developing their domestic capital markets.	External creditors need to know how domestic debt will be addressed without inflationary spikes or major currency depreciations. Foreigners may hold domestically-issued debt.
Non-concessional Borrowing Limits	Applied and accepted. IDA was the predominant financier of low-income countries.	Unclear for how long, and whether under IDA new Sustainable Development Financing Policy or imposed by IMF programs. IDA no longer the predominant financier of low-income countries.

Prospects

Prospects: What Is Likely to Happen?

1. *Discontent with MAC SRDSF and the LIC DSF will be modified (the Review is on-going).*
2. *Zambia's important (non)precedent — how much, who is in/out, creditor classes, PDI*
3. *Contingencies will abound and will cause all kinds of problems*
4. *Non-financial clauses in new exchange bonds (a la Zambia) will also be common*
5. *More use of payment Suspension Clauses*
6. *Debt for Development Swaps — many attempts, not the solution, not for everyone*
7. *Post Restructuring I: TA for PDM*
8. *Post Restructuing II: Fiscal Risk and Debt Crisis Simulations Exercises*
9. *Post Restructuring III: How will going back to the market look like if IMF unpaid?*

Prospects: Will There Be a Wave of HIPC-like Debt Distress?

1. *IMF said in 2023 AMs: “Maybe Not”; World Bank disagreed. Some selected countries are in worse or equal position compared to HIPC, but the creditor landscape is more complicated. See graphs.*

2. *Limited political pressure: for now, not like HIPC; France trying to change that (France hosted the "Summit for a New Global Financial Pact" on June 22-23, 2023 and helped Zambia)*

3. *But domestic debt and climate risk (and its associated fiscal cost and difficulties to restructure with that risk present) may make things worse fast in the near future. Maybe World Bank should be the conditionality institution for climate expenditures after restructuring (especially adaptation).*

4. *Long-term solution is Fiscal Consolidation: it reduces debt/GDP ratios, but only if done through expenditures, with accompanying structural reforms and better institutions. (IMF WEO of April 2023 chapter 3)*

But Remember: the Social Cost of Sovereign Default Is Huge…

According to Farah-Yacub et. al., using 131 sovereign defaults since 1900 (see list of contemporary defaults here):

- *In the first two years, on average GDP growth loses 3.6 and 2.4 percentage points compared to counterfactual*
- *After a decade, GDP per capita is, on average, 17 percent lower than counterfactual*
- *Within a year of default, poverty headcounts rises 30 percent on average—and stays higher years after. (1 in 6 in Russia 1998; 1 in 5 in Argentina 2001)*
- *After a decade, infant mortality is 13 percent higher on average—and life expectancy is 1.5 percent lower than counterfactual*

Postscripts

A Variety of Proposals

1. *"Brady-like" with WB Bonds (Buchheit and Lerrick)*
2. *"Brady-like" with G20-guaranteed bonds under a "New Common Framework" (BU's GDPC)*
3. *No More External Sovereign Bonds—that's it.*
4. *Many, many Ideas to Enforce "Duty to Cooperate"*
5. *Borrower Commitments—if they can be credible*
6. *A Supra-National SDRM and/or a Global Debt Register*
7. *A Debtor "Cartel"*

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THANK YOU!

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Annexes

Country List for Brady Plan

Argentina, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Ivory Coast (Cote d'Ivoire), Jordan, Mexico, Nigeria, Panama, Peru, the Philippines, Poland, Russia, Uruguay, Venezuela and Vietnam.

Countries that Reached HIPC Completion Point (Pending: Eritrea and Sudan)

- Afghanistan
- Benin
- Bolivia
- Burkina Faso
- Burundi
- Cameroon
- Central African Republic
- Chad
- Comoros
- Republic of Congo
- Democratic Republic of the Congo
- The Gambia
- Ghana
- Guinea
- Guinea-Bissau
- Guyana
- Haiti
- Honduras
- Liberia
- Madagascar
- Malawi
- Mali
- Mauritania
- Mozambique
- Myanmar
- Nepal
- Nicaragua
- Niger
- Rwanda
- São Tomé and Príncipe
- Senegal
- Sierra Leone
- Solomon Islands
- Somalia
- Tanzania
- Togo
- Uganda
- Zambia

Non-exhaustive List of Contemporary Sovereign Debt Defaults

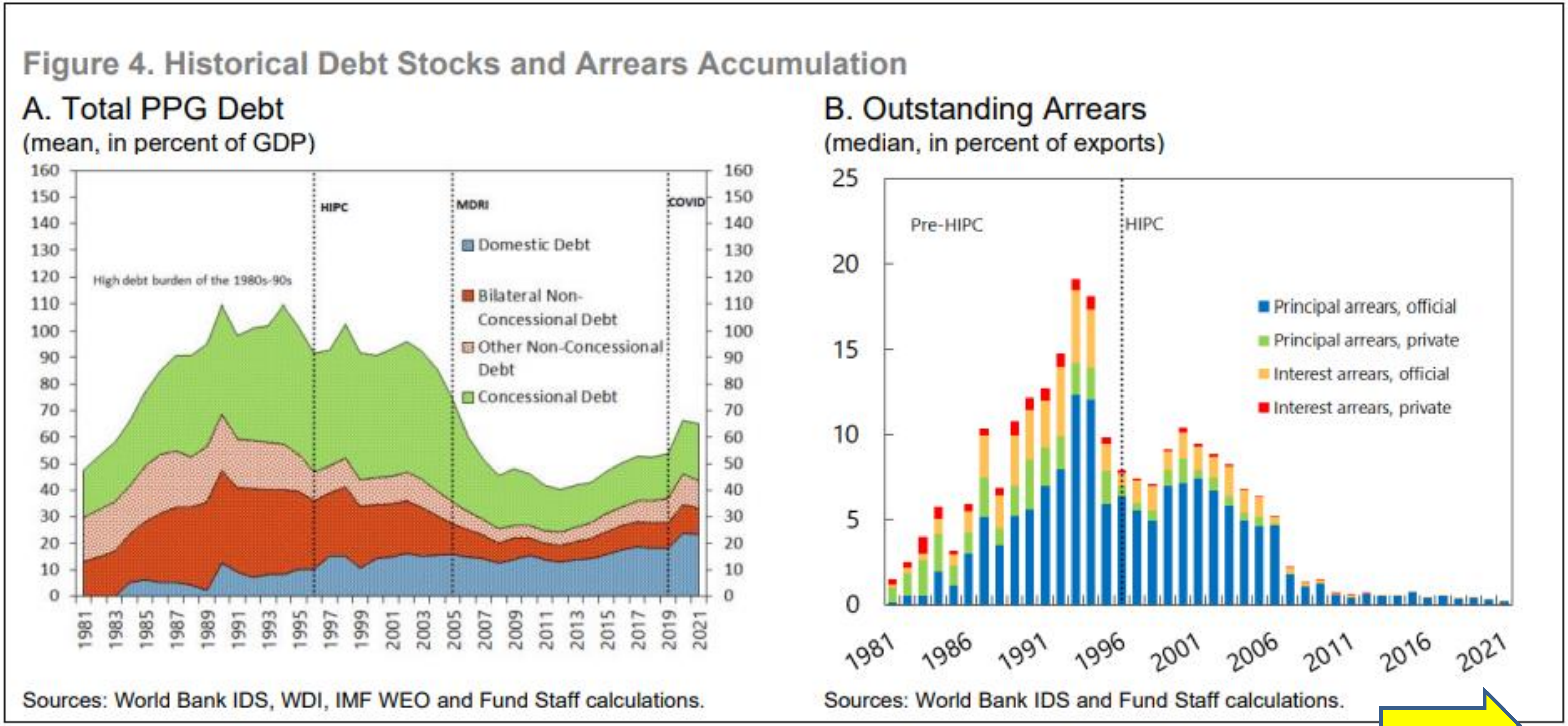
1980s	1990s	2000s	2010s	2020s
Bolivia 1980	Iraq 1990	Ukraine 2000	Ivory Coast 2011	Argentina 2020
Poland 1981	Nicaragua 1990	Ivory Coast 2000	Greece 2012	Lebanon 2020
Argentina 1982	Algeria 1991	Argentina 2001	Belize 2012	Ecuador 2020
Costa Rica 1982	Angola 1992	Nigeria 2001	Argentina 2014	Suriname 2020
Dom. Rep. 1982	Venezuela 1998	Suriname 2001	Ukraine 2015	Zambia 2020
Guatemala 1982	Russia 1998	Moldova 2002	Suriname 2016	Belize 2021
Mexico 1982	Ukraine 1998	Madagascar 2002	Mozambique 2017	Ethiopia 2021
Romania 1982	Ecuador 1999	Uruguay 2003	Puerto Rico 2017	Russia 2002
Turkey 1982	Gabon 1999	Nigeria 2004	Venezuela 2017	Ghana 2023
Venezuela 1982	Pakistan 1999	Dom. Rep. 2005		Sri Lanka 2023
Brazil 1983		Belize 2006		
Chile 1983		Ecuador 2008		
Jamaica 1983		Seychelles 2008		
Philippines 1983				
Uruguay 1983				
Zambia 1983				
Ecuador 1984				
Serbia 1984				
Egypt 1984				
Peru 1984				
Morocco 1983				
Sudan 1984				
Guyana 1985				
Liberia 1985				
Bolivia 1986				
Nicaragua 1986				
Zaire (DRC) 1986				
Cameroon 1987				
Ivory Cost 1988				

Argentina's Nine Sovereign Debt Defaults – A World Record?*

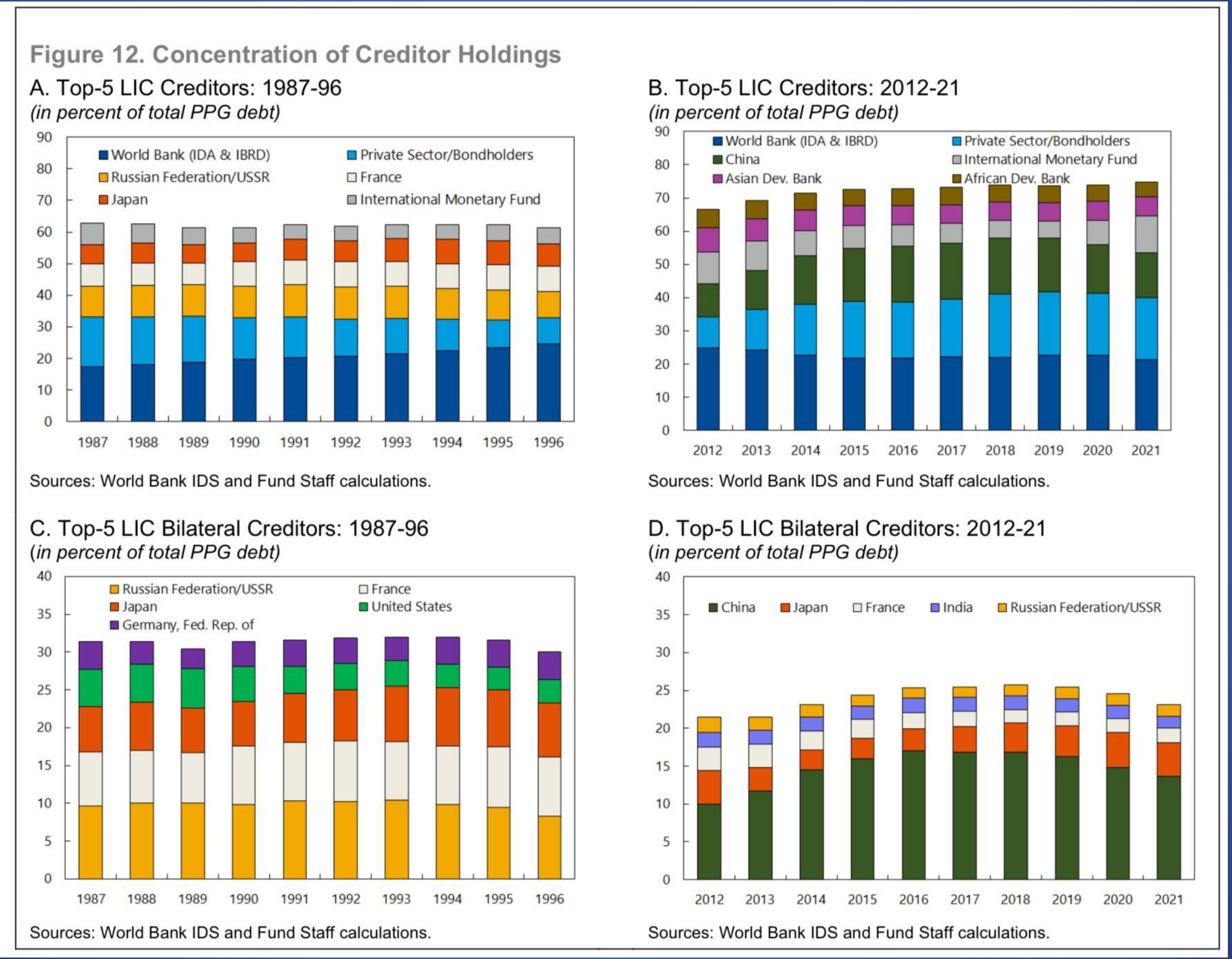
1. 1827 - Argentina defaults on its external debt for the first time shortly after declaring independence from Spain.
2. 1890 - Argentina defaults on external debt due to a sharp drop in wheat prices and political instability.
3. 1951 - Argentina defaults on external debt following a dispute with the United Kingdom.
4. 1956 - Argentina defaults on external debt after the military government repudiates the debt incurred by its predecessor
5. 1982 - Argentina defaults on external debt in the midst of an economic crisis and a military dictatorship.
6. 1989 - Argentina defaults on external debt after the government ends a hyperinflation by pegging the peso to the US dollar.
7. 2001 - Argentina defaults on external debt after a severe economic crisis.
8. 2014 - Argentina defaults on some of its external debt after a dispute with holdout creditors from previous debt restructurings.
9. 2020 - Argentina defaults on a $65 billion restructuring of its sovereign debt.

*Some of these defaults were partial or selective defaults, while others were more comprehensive.

Are We Really Heading to a HIPC-situation: The IMF has doubts

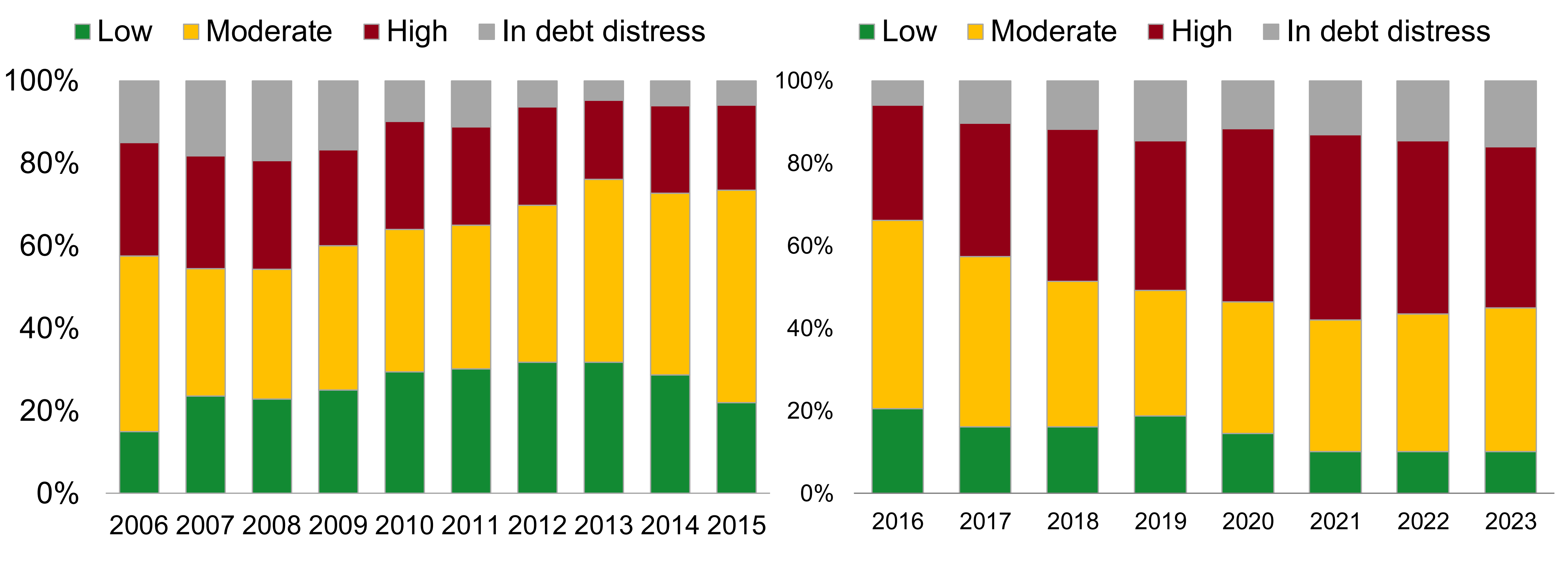


Change in Creditor Landscape – Top 5 Creditors to LICs: pre-HIPC, pre-CF (Chuku e.t., 2023)



Evolution of risk of external debt distress

(share of LIC DSA countries, as of March 2023)



Source: Federico Gil Sander (World Bank)

Basic Definitions

Relief: a roll-over of upcoming service or a moratorium (even NPV neutral) or a reduction in NPV of debt (and thus in NPV debt/GDP)

Reprofiling: change in terms (grace, interest, amortization calendar) without reduction in NPV of debt

Rescheduling: reprofiling through amortization calendar

Restructuring: a reduction in NPV of debt through cut in principal and/or change in interest or maturity

INTERNATIONAL PRACTICE:
World Bank LIC DSF – DEBT INDICATOR AND THRESHOLDS

- LIC DSF debt indicators are projected under various scenarios:

Solvency

- Present value (PV) of the public and publicly guaranteed (PPG) total debt-to-GDP ratio
- PV of the PPG external debt-to-GDP ratio
- PV of the PPG external debt-to-exports ratio

Liquidity

- PPG external debt service-to-exports ratio
- PPG external debt service-to-revenues ratio

- LIC DSF thresholds depend on a country's debt carrying capacity (strong, medium, weak):

	Strong	Medium	Weak
PV of PPG total debt-to-GDP	70%	55%	35%
PV of PPG external debt-to-GDP	55%	40%	30%
PV of PPG external debt-to-exports	240%	180%	140%
PPG external debt service-to-exports	21%	15%	10%
PPG external debt service-to-revenues	23%	18%	14%

INTERNATIONAL PRACTICE:
LIC DSF – DEBT DISTRESS RISK RATING

LIC DSF assigns a debt-distress risk rating for the **public external debt** where a country is rated as having:

- **Low risk** if none of the indicators breach their respective thresholds under the baseline scenario or the most extreme stress-test scenario
- **Moderate risk** if none of the indicators breach their respective thresholds under the baseline scenario, but at least one indicator breaches its threshold under the most extreme stress-tests scenario
- **High risk** if any of the five indicators breach their corresponding thresholds under the baseline scenario
- In **public external debt distress** when specific conditions are observed (e.g., arrears to official creditors, nonvoluntary debt negotiations) regardless of any comparison between indicators and thresholds