**IMF PAPER ON POLICY ANALYSIS AND ASSESSMENT**



PPAA/93/7

INTERNATIONAL MONETARY FUND

# Restructuring of Commercial Bank Debt by Developing Countries: Lessons from Recent Experience

Prepared by

Charles Collyns, Policy Development and Review Department

and

Mohamed A. El-Erian, Middle Eastern Department 1/

June 1993

Abstract

A number of developing countries, including some of the largest debtors, have recently completed comprehensive debt and debt service restructuring packages with their commercial bank creditors. The experience of these countries provides important lessons for other countries that are just embarking on discussions to normalize their external payments situation. Following a brief description of the framework of the international debt strategy, this paper discusses the main lessons, distinguishing between those that are relevant to the process of negotiation and those relevant to the structure of the package being negotiated.

JEL Classification Numbers:

F34, G15



1/ The authors are grateful for comments received from Mark Allen, Jack Boorman, Paul Chabrier, John Clark, Augusto de la Torre, Tom Leddy, Alessandro Leipold, Paul Mylonas, and Max Watson. The views expressed in the paper are the sole responsibility of the authors.

## Contents

## I. Introduction

A number of developing countries--including many of the largest debtors--have completed comprehensive commercial bank debt restructuring packages over the past few years. These packages differ from earlier reschedulings in their incorporation of officially supported debt and debt service reduction (DDSR) operations. At the same time, there remain other developing countries that are just embarking on discussions with bank creditors to normalize their external payments situation. This paper reviews the experience of the countries that have completed restructurings of their bank claims with a view to identifying some of the key issues to be considered by countries that are at an earlier stage in their bank debt negotiations. 1/

## II. The Framework

### 1. Developments up to 1989

The international debt crisis surfaced in 1982. In August of that year, after a period of heavy recourse to international lending, Mexico announced to its commercial bank creditors that it would no longer be able to meet fully its scheduled debt service obligations and sought a concerted rescheduling of principal amounts falling due. 2/ In the ensuing months, and with a sharp decline in the availability of new bank loans, several

---

1/ Detailed information on bank debt restructuring agreements is contained in the IMF's annual publication on "Private Market Financing for Developing Countries." See, for example, Leipold et al. (1991) and Collyns et al. (1992).

2/ An analysis of the Mexican experience in the context of developments in the international debt strategy is contained in El-Erian (1991) and van Wijnbergen (1991).

other developing countries followed suit. All told, the number of bank rescheduling agreements increased from an annual average of four in 1978-81 to 18 in 1983-84. 1/

The emerging debt crisis not only jeopardized debtors' growth and development prospects but also risked undermining the financial integrity of the international banking system. Recognition of the systemic nature of the problem led to the formulation of an international strategy that sought to combine debtor country adjustment and exceptional external financing. Its main elements included (i) the implementation of adjustment policies by debtor countries; (ii) the support of such policies by official bilateral and commercial bank creditors, including through the refinancing of debt obligations; (iii) the assistance of international financial institutions (IFIs) in designing adjustment programs, providing direct financial resources, and mobilizing financing from other sources; and (iv) fostering the steady growth of international demand and expanding market access to facilitate debtor country exports.

Initially, the commercial bank financing element of the strategy focussed on the liquidity aspects of developing countries' debt problems. Specifically, debtor countries' implementation of adjustment programs was supported by cash flow relief through the deferment of principal falling due and, in some cases, concerted new money loans which in effect refinanced a portion of the interest obligations. This approach was broadly successful in meeting developing countries' immediate financing requirements and in

1/ In all, a total of 40 countries concluded bank debt rescheduling agreements in 1983-88.

providing banks with time to strengthen their underlying balance sheet position. However, as the 1980s progressed and with only a slow recovery in debtor countries' growth performance, the approach proved increasingly difficult to implement, with banks' declining balance sheet vulnerability being accompanied by a growing reluctance to continue extending new money loans. 1/

Against this background, there was increasing recognition that many debtor countries faced deep-rooted problems that went beyond the immediate liquidity difficulties. The continuing growth in debt stocks--resulting from what was essentially a capitalization of interest--was seen to undermine private sector confidence by raising questions about the distribution of the benefits of increased investment between old and new contractual obligations. 2/ This discouraged investment activity and clouded economic prospects.

2. The 1989 modifications to the debt strategy 3/

These developments contributed to the modification of the debt strategy in March 1989 along lines proposed by U.S. Treasury Secretary Brady. The Brady proposals stressed four elements: (i) adoption of medium-term adjustment and reform programs in developing countries; (ii) market-related debt and debt service reduction, as a complement to new lending; (iii) use

---

1/ There was also growing evidence of banks' willingness to dispose of developing country claims, often at a substantial discount, through sales on the secondary market, debt-equity swaps, and other debt conversions such as the Mexico-Morgan discount exchange of 1988.

2/ See Dooley et al. (1990). The linkage between domestic and foreign indicators of country risk is discussed in Khor and Rojas-Suarez (1991).

3/ A broader overview of recent changes in the debt strategy (including modalities for restructuring of official bilateral debt) is contained in Clark and Kalter (1992).

of the IFIs' resources to facilitate such operations; and (iv) continued creditor government support through official bilateral debt reschedulings and new export credits. 1/

While bank debt restructurings have differed in their specifics (as detailed below), they have involved the same basic principle: debtor countries obtaining banks' legal agreement to reduce debt service obligations and stretch out the payments on the residual claims. For their part, banks agreed to such modifications in exchange for higher expected debt service payments on the residual claims, based on a combination of: (i) up-front debtor payments, including principal prepayments (such as in the case of cash buybacks or debt-swaps) and downpayments on outstanding arrears; (ii) the debtor providing secure collateral for part of the future payment stream (typically principal plus a specified period of interest payments) on the restructured debt in the form of cash deposits/risk-free securities ("enhancements"); and (iii) improved prospects for payments of the uncollateralized obligations related to the fact that the remaining bank debt would be exchanged for marketable securities (including in bearer form) that would be more difficult to reschedule in the future, as well as the expected beneficial impact of a reduction in the debt overhang on the debtor's economic prospects.

Before going into the details of these operations, two aspects are worth emphasizing. First, debt management policy has to be fully integrated and consistent with the country's overall macroeconomic strategy, including through a careful assessment of medium-term prospects and the implications

---

1/ See Mulford (1989).

for other economic and financial policies. In this context, experience has shown that DDSR operations are not appropriate for all debtors. A number of developing countries that had high debt ratios in 1982 were able to maintain an exemplary record of debt servicing throughout the period following the onset of the debt crisis and to retain access to international capital market flows (e.g., Hungary and Indonesia). Looking back over the past decade, the "orthodox strategy"--involving early economic adjustment to emerging problems combined with a determination to maintain normal relations with creditors--that was followed by a number of such countries has been rewarded in terms of economic performance and continued availability of voluntary external inflows.

Second, seeking a single comprehensive DDSR settlement is not the only approach to debt reduction. A group of countries (including Chile, Honduras and Paraguay) have followed a different approach concentrating on a series of market-related operations with individual banks--including debt-equity operations 1/ and buybacks. With Chile, the debt conversions reduced bank debt in half over a period of five years, with success depending in great part on the careful design of the debt conversion program and the strength of the country's fiscal position. In some other cases, the approach was facilitated by the fact that a substantial part of the debt had been initially contracted on a bilateral rather than on a syndicated basis, and therefore did not involve legal constraints in the form of sharing clauses and other features.

---

1/ The advantages and disadvantages of debt-equity swaps are discussed in United Nations Center on Transnational Corporations (1990).

3. <u>Recent bank debt restructuring packages and their impact</u>

To date, 13 countries have completed market-related restructurings of their bank debt, covering US$116 billion of claims (Table 1). Of these, the agreements with seven countries--Argentina, Costa Rica, Mexico, Nigeria, the Philippines, Uruguay and Venezuela--have taken the form of complex menus of DDSR options, while Chile completed two small cash buybacks concurrent with its debt equity program. The other five cases--Bolivia, Guyana, Mozambique, Niger, and Uganda--have involved low-income countries essentially buying back their debt at steep discounts. In addition, Brazil has reached an agreement with bank creditors on a menu of options that would restructure a further US$50 billion of debt. In all, including Brazil, some 90 percent of developing country debt to commercial banks that was rescheduled in the 1980s has been restructured in the process.

The packages completed to date have served to lower the gross present value of the stream of debt service obligations payable by the debtor country to commercial banks by about US$50 billion (44 percent of total eligible debt). This amount takes account of (i) the reduction in principal obtained through cash buybacks and discount exchanges; 1/ (ii) the lower present value of future interest payments resulting from a shift to sub-market interest rates following par exchanges; 2/ and (iii) effective pre-payments on future obligations implied by the setting aside of

---

1/ Under a discount bond exchange, the creditor receives a partially collateralized security with a lower face value bearing a market interest rate (typically, LIBOR plus a spread).

2/ Under a par bond exchange, the creditor receives a partially collateralized security carrying the same face value but a sub-market interest rate (usually fixed).

collateral on these obligations. The total cost of the operations--in terms of resources for enhancements and cash payments--has amounted to some US$18 billion. The operations have implied a net reduction in annual interest due in the public budget equivalent to 1/2-1 1/2 percent of GDP depending on the case. Moreover, payments on the remaining obligations have generally been spread over a 30-year period, and a significant proportion of interest payments on these claims have been converted from floating rate to fixed rate basis.

An important feature of these restructurings has been that they have been market related. 1/ By this is meant that the operations have involved a reduction in bank claims at a price broadly in line with that prevailing in the secondary market (Table 2). Subsequently, the holders of the debt being restructured have generally experienced an appreciation in the value of the restructured claims (Chart 1). This appreciation has reflected improving perceptions of country risk on the remaining uncollateralized claims. 2/ Where has the "surplus" come from that has benefitted both sides of the transaction? From the real economic gains that are realized as the debt overhang and related uncertainty about the division of the fruits of future economic growth are reduced.

---

1/ This assessment is based on the estimated buyback equivalent price implied by the debt operation. This price is defined as the ratio of the total cost of the operation in terms of enhancements and cash payments to the gross reduction in claims payable to banks, and can be compared to the price prevailing in the secondary market. For a discussion of the general approach, see Clark (1990).

2/ The increase in price has been leveraged by the reduced amount of uncollateralized claims, implying that an improvement in payments prospects is shared among a smaller base.

The turnaround in economic performance in the context of debt restructurings by countries such as Argentina, Chile, and Mexico has been impressive. A permanent gain for the debtor has been the contractual debt servicing savings as a result of the new terms on the debt. But that gain has been relatively small in most cases; for countries such as Argentina where interest payments before the restructuring had only been partial, there has in fact been an increase in cash payments upon finalization of the debt deal. The more substantial gain seems to have come from the reduction in the debt overhang and a normalization of creditor relations, in the context of appropriate domestic economic policies. These have allowed many of the countries that completed debt restructurings as well as sustaining sound domestic polices to regain access to spontaneous financing from the international capital markets. 1/

Notwithstanding these rewards, there are also important risks involved if the debt restructuring is not appropriately designed and implemented. Specifically, the restructuring process implies a certain loss of flexibility in future debt and liquidity management to the extent that (i) debtors borrow from multilateral sources to finance the enhancements used in the DDSR operations, thereby substituting "senior" debt for "junior" debt; (ii) debtors tie up their own reserves by using them to finance the enhancements; and (iii) the new securitized claims are more difficult to

---

1/ For recent information, see Collyns et al. (1992). Discussion of the early phase of Latin American countries' market re-entry is contained in El-Erian (1992), while a discussion of the factors behind capital reflows is contained in Calvo, Leiderman, and Reinhart (1992).

reschedule in the future as the debt instruments are held by a significantly broader group of creditors/investors.

## III. Lesson from Experience to Date

The experience of those countries that have completed negotiations of bank packages contains a number of important lessons for countries that are now at earlier stages in the process. For convenience, these lessons are divided between those relevant to the process of negotiations and those relevant to the structure of the package being negotiated.

### 1. Process of negotiations

Having determined the necessity for a restructuring of debt obligations, the typical process has included five main steps. 1/ First, broad agreement with commercial bank representatives (the "bank advisory committee") on the general approach to the debt workout and, in the case of interest payments arrears, on the treatment of existing and prospective arrears pending agreement on a comprehensive debt restructuring package. Second, reaching agreement with the advisory committee on the menu options to be included in the debt restructuring package as reflected in the "term sheet." Third, marketing the term sheet to the universe of creditors, with requests for acceptance by a specified deadline. In some cases, early acceptance has been sought by offering "early bird" participation bonuses. Fourth, signing of the package once the bulk of the eligible claim holders have agreed to participate in the proposed package. The required level of positive responses has depended, inter alia, on terms specified in prior

1/ For an illustration, see El-Erian (1990).

syndications/restructurings, including conditions governing amendments to sharing, negative pledge, and prepayment clauses. The final stage involves the exchange of financial instruments. 1/

A key hurdle in the initial phase of negotiations facing countries with arrears on bank debt has been reaching a satisfactory accommodation on the payments to be made to banks during the period before a comprehensive restructuring package is completed. This issue has taken increasing prominence as the bulk of countries still to negotiate bank debt deals are in arrears to banks and most have made little or no cash payments for a period of time. With middle-income countries, banks have generally been unwilling to proceed far in negotiations until at least some payments, albeit partial, are made on amounts falling due. Banks' insistence on this point in individual cases has been reinforced by moral hazard concerns about setting precedents for other countries. 2/ At the same time, countries have often been reluctant to resume payments, even where the external financing constraints have been eased by more prudent domestic policies. Such reluctance may reflect concerns for the possible impact of renewed payments on secondary market prices (and hence the terms of a market-based debt restructuring); for the need to accumulate a reserve cushion for use in debt reduction; and for the domestic political implications if payments to

---

1/ In some cases, the exchange date has been delayed until significantly after the signing date by the need to reconcile claims between debtor and creditor. Reconciliation can be a time-consuming process, particularly where arrears have accumulated over a number of years and a substantial part of the debt has been sold in the secondary market.

2/ I.e., some countries could be tempted to cut back on payments to banks as they enter into the negotiations.

banks commence without a "quid pro quo" in the way of concessions from the creditor side.

A way forward in some cases has been for the banks and the country to reach agreement on a general framework for the negotiations, in the context of which the country would undertake to commence regular monthly or quarterly payments. The agreed framework could cover the type of instruments to be included in the menu, special features (such as treatment of arrears and short-term debt), and an indicative timetable for negotiations, without necessarily going into detailed terms. The agreement may include banks' acquiescence--de facto or de jure--to a roll-over of amounts in arrears and principal falling due, which would reduce the risk of asset seizure by individual banks. The impact on the secondary market may be limited by signals about the likely shape of the package.

There is no simple rule about what level of partial payments would be appropriate. Rather, this is the outcome of the negotiation process. In cases to date, levels of partial payments have typically been in the range of 20-30 percent of interest obligations falling due. Banks are obviously looking for a significant level of payments that demonstrates the debtor's seriousness in seeking a normalization of relations with creditors. From the country's point of view, it is important that the payments start at a level that can be sustained over time, as a subsequent interruption would potentially undermine progress in discussions on a restructuring package.

In approaching the negotiations, it is important to recognize that the process is likely to be complex and time-consuming. In all cases, the time from preliminary agreement on terms to the exchange date has been at least six months, and where arrears are involved, it has exceeded a year. Moreover, in many cases the period of negotiations before preliminary agreement is reached can also be lengthy. This process can tie up precious human resources, and prove a distraction for policy makers facing a heavy agenda on the domestic front. For this reason, many countries have chosen to name a chief debt negotiator to head discussions with banks, thus allowing the most senior officials to avoid being entangled in the negotiations.

A factor affecting the length of time needed to complete a package is the complexity of the menu of options included. From the debtor's perspective, there are advantages in seeking a simple package with a limited number of menu options that can be more easily negotiated. Seeking innovations and precedents, while potentially allowing a package to be better tailored to a country's circumstances, can also complicate and prolong the negotiations. In the first place, creditor banks may be wary about an unfamiliar approach and may need time to investigate the full financial, tax and regulatory implications. Some complex innovations--such as the phased delivery of enhancements negotiated by Brazil--may be possible only for the large cases where stakes are high and extra legal costs are smaller in relation to the size of the deal. Moreover, creditors may be reluctant to make a concession in one negotiation--even if they see a strong case--if they fear that it will set a precedent that may be used in other cases with less justification or could jeopardize the completion of other packages still in their final stages.

A second factor affecting the difficulty of negotiations is the degree of homogeneity of the creditor group. A heterogeneous group can lead to complications, such as interest in special features (e.g., interest capitalization) and pressures for a range of currency options, as well as having a variety of tax and regulatory concerns. Over time, creditor composition has changed, as many banks have sold out their positions, with an increasing proportion of claims now being held by traders. For example, in the case of Ecuador, about half of the eligible debt is now estimated to be held by traders. This latter development is relevant as traders may have different attitudes and motives from bankers--as a rule, they seem to focus more on achieving trading profits in a particular deal and to be less concerned with implications for other cases. 1/

From the country's perspective, care needs to be taken to track the changing composition of the ownership group, and to understand the motives and concerns of the different nationalities and creditor groups that hold the claims. It is important to have a bank advisory committee with which to negotiate that is broadly representative of the interests of the holders of the claims, taking into account regional considerations. However, this has become more difficult to achieve as the balance between banks and traders has shifted over time. For example, with Ecuador, the banks directly represented in the steering committee now hold only about 25 percent of the total, and a significant part of this is held in separate traders' departments. In some cases, such as Nigeria and Panama, even the chair bank

---

1/ An example of specific issues that can arise when a substantial proportion of claims is held by traders occurred with the Argentina package. In this case, the initial menu allocation was heavily concentrated in the par bond option and Argentina asked that creditors reallocate their claims toward the discount bond option. It proved particularly difficult to persuade traders to adjust their choices, in part because many had already sold forward the par bonds on a "when issued" basis.

on the committee has been known to liquidate its position, which can reduce its incentive to take an active role in the negotiations. While the debtor country can encourage informally a change in composition of the committee or of the chairmanship, these are the prerogative of the creditors. In some instances, ways have needed to be found to involve a broader group of creditors in the decision process, as occurred for example in the closing stages of the Argentine operation. 1/

2. Structure of debt packages

In approaching any negotiation, it is obviously critical to have a clear idea of the objectives. With debt restructuring, the country needs to establish two key aspects at the outset. First, it needs to assess the potential resources available to finance DDSR operations, including through existing reserves and borrowings. Second, it needs to establish what path of cash payments to banks would be consistent with the country's medium-term external prospects. With these two parameters in mind, it will be possible to make a judgment about the appropriate balance to seek in the package between up-front cash flow support through new money or front-loaded interest relief and menu options providing a permanent reduction of debt and debt service due. Particular proposals can be analyzed relative to how far they address the country's basic financing constraints.

In considering a package, the first instinct for the debtor country is often to maximize the coverage of the cash buy back, the component which

---

1/ Agreement on reallocation between the options described in the preceding footnote was facilitated by close consultation with traders. However, it is unlikely that traders would formally join a bank steering committee as in doing so they would forego their ability to trade their position in view of their access to privileged information.

promises the greatest degree of debt reduction. However, except for countries with relatively small amounts of debt and where the secondary market discount is high, a buyback of the bulk of the debt is likely to be prohibitively expensive. Moreover, experience suggests that debt reduction may in some cases be achieved at a somewhat lower cost through debt exchanges (see Table 2). This may be for a number of reasons. First, debt exchanges are more flexible and can be more easily tailored to banks' tax and regulatory situations. In particular, the par exchange option allows banks to recognize losses gradually over time rather than up-front. 1/ Second, and perhaps more importantly, with an exchange the creditor has the potential of future capital gains on the uncollateralized part of the new instrument, thus compensating for a lower price on the claims being relinquished.

Debt exchanges also have other advantages over buybacks. One relevant consideration is that the balance between upfront cash-flow relief and long-term debt reduction can be more precisely calibrated with an exchange. 2/ Moreover, the country may benefit economically from retaining a longer-term relationship with international banks. Finally, debt exchanges may facilitate access to resources from the IFIs. 3/

---

1/ The tax and regulatory treatment of debt and debt service reduction is discussed in Allen et al. (1990) and Hay and Paul (1991).

2/ This is particularly so for a par exchange where the cash flow relief depends on the agreed interest rate path on the new instrument relative to the expected path of future interest rates.

3/ Under the current guidelines on use of IMF resources, "augmentation" resources may be used for purchase of principal or interest collateral of par bonds or interest collateral of discount bonds. "Set-asides" may be used to finance operations involving principal reduction, including buybacks and discount exchanges. The World Bank has similar guidelines on the use of its resources.

In seeking a debt package that achieves the debtor's objectives, a problem has been that of ensuring appropriate balance in banks' responses to the menu of options. In the packages completed to date, there has been fairly broad variation in the allocations of claims among the menu options (Table 3). Voluntary bank choices cannot be entirely predictable, and even an initially well-calibrated package can be thrown off kilter if there are shifts in interest rates subsequent to agreement on terms that change significantly the relative attractiveness of alternative options. The attraction of the par bond option is particularly sensitive to interest rate shifts as the implied debt service reduction attained depends critically on present and expected future rates. 1/

A country may seek to influence the allocation among the menu options of a voluntary package, consistent with the requirements of medium-term external viability and the availability of financing, by building in incentives for banks to select a certain menu option. For example, in Costa Rica, a minimum of 60 percent debt reduction was targeted by providing preferential treatment to the residual claims of banks tendering at least 60 percent of their exposure to the buyback option. However, in general banks have resisted features that constrain their choices, seeking to safeguard their flexibility in matching their participation to their particular interests. In most cases, obtaining a desired balance has depended on working closely with the advisory committee to agree on options

---

1/ In a period of uncertainty about prospective trends in market interest rates, consideration might be given to mechanisms that limit the implications of interest rate fluctuations for the amount of debt relief. For example, the interest rate path on a par bond could be negotiated as a discount vis-à-vis LIBOR.

that can be expected to yield appropriate results and to allow some shifting in choice if the expected outcome is not forthcoming. 1/

A broad strategic issue is whether to seek a single comprehensive operation or a phased approach in which debt operations are implemented as the financing becomes available. A "one-shot" approach is generally preferable, as the benefits of debt reduction may be slow in coming where the restructuring is phased, given residual uncertainty about the terms of future operations and whether the necessary financing will in fact become available. Where financing constraints make a phased approach unavoidable, it would seem desirable from the debtor's perspective at least to reach agreement with banks on terms for the operation in its entirety to reduce this area of uncertainty. Such an approach is now being followed with Brazil, although banks had previously resisted the idea in other cases where less was at stake.

Another relevant consideration in putting together a package is that not all types of debt to banks should necessarily be treated in an equivalent fashion. Indeed, differential treatment of debt may constitute an important element of a country's debt strategy. For instance, in some cases priority has been given to normalizing short-term credits as a means of enhancing the availability of financing that underpins normal trade activities. The underlying issue here has been debtors' provision of

1/ In early cases, this post-selection shifting in choice occurred through informal consultation between the country and creditor banks. With Argentina and Brazil, however, such rebalancing has involved use of more formal mechanisms, in part reflecting the broadening of the creditor base beyond the banking community.

seniority to certain debt either through payments or through more favorable treatment in the restructuring.

Banks may also push strongly for preferential treatment of certain types of claims, for example "new money" or past due interest, given moral hazard type concerns. 1/ Debtors have typically accepted such preferential treatment, while seeking offsetting concessions elsewhere so that the overall package is consistent with the country's objectives. Where countries have taken a less flexible approach, this has sometimes soured the atmosphere of negotiations with creditors, which may have complicated subsequent efforts to regain access to new capital flows. However, it has to be recognized that where interest arrears are a substantial share of the total debt, it may be difficult to achieve the targeted degree of debt reduction unless some mechanism can be found to restructure at least part of the arrears. 2/

On a similar point, banks have tended to push for certain clauses in a debt agreement which, while seemingly insignificant on their own, can be quite costly to countries when taken together. These clauses include

---

1/ Typically, in packages completed for countries that have had outstanding interest arrears, these arrears have either been cleared before the signing (e.g., Nigeria) or rescheduled (without debt reduction) after a downpayment (e.g., Argentina and Brazil). The exception has been Costa Rica, where past-due interest associated with debt tendered to the buyback option was also extinguished at a discount in the buyback with the remaining interest arrears rescheduled. The Dominican Republic is now following a similar approach.

2/ Care must be taken in assessing the secondary market price of bank claims when interest arrears are present. For many countries the price is quoted per unit of principal, but including associated interest arrears without additional payment. In this case, the average price per unit of claim may be substantially less than the quoted price.

debt-equity, multiple currency options, 1/ interest retiming in the interim period, and value recovery options. These so-called "bells and whistles" may not be central elements of the debt agreements, but in combination can be costly to the debtor, as well as adding significantly to the complexity of the negotiations.

## IV. Concluding Remarks

The experience of developing countries that have recently concluded comprehensive restructurings of their commercial bank debt provides important lessons for other countries that are just embarking on discussions with bank creditors to normalize their external payments situation. In particular, from the countries' point of view, there is a need to consider the range of trade-offs that arises in negotiations with banks. This includes the trade-off between potentially rapid completion based on a simple and well-tried menu structure and slower negotiations on complex and innovative menu options that seek to mold more closely the financing package to the debtor country's circumstances. Second, the trade-off between obtaining deep and lasting bank debt reduction and focussing on short-term cash-flow benefits. And third, the trade-off between the potentially better

---

1/ A multiple currency option allows banks to retain the currency of denomination of the original loan rather than switching all claims into a single currency, typically U.S. dollars. Usually, an attempt is made to ensure equivalent restructuring treatment of similar types of debt denominated in different currencies. Establishing such equivalence can, however, be a complex financial exercise, particularly where the interest yield curves in the currencies are very different from each other. This issue is discussed in Clark (1992).

terms that may be obtained from a tough negotiating stance and the possibly adverse implications for creditor relations and longer-term access to new voluntary sources of international financing.

In considering these trade-offs, it is important to take account of the preferences and constraints affecting the different parties in the restructuring process. This will be particularly relevant for some countries now embarking on negotiations where the more difficult external situation (and lower secondary market price) points to a need for terms going beyond those obtained in other recent cases. This process may, however, be complicated, inter alia by the growing role of traders, a group which tends to have rather different concerns than banks.

Finally, in assessing a package, it is essential to focus on its overall impact rather than only on each of its components. A negotiating party's insistence on certain aspects may be accommodated by seeking compensating adjustments elsewhere such that the overall package is consistent with the fundamental objectives of debt restructuring.

Table 1. Commercial Bank Debt and Debt Service Reduction Operations, 1987-May 1993 1/

(In millions of U.S. dollars)

| | | Debt and Debt-Service Reduction 2/ | | | | | | Total Debt and Debt Service Reduction/ Debt Restructured | Cost of Debt Reduction 5/ |
|---|---|---|---|---|---|---|---|---|---|
| | Debt Restructured Under DDSR Operation 3/ | Debt Reduction | | Debt-Service Reduction | | Prepayments through Collateral-ization | Total | | |
| | | Buyback | Discount Exchange 4/ | Principal Collateralized Par bond 4/ | Other Par bond 4/ | | | | |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7)=(2)+..+(6) | (7)/(1) | |
| Argentina (1992) | 28,066 | -- | 2,420 | 4,995 | -- | 2,417 | 9,832 | 35.0 | 3,047 |
| Bolivia | 644 | 331 | 232 | 29 | -- | 21 | 613 | 95.2 | 61 |
| (1987) | 473 | 253 | 182 | -- | -- | 7 | 442 | 93.5 | 35 |
| (1993) | 171 | 78 | 50 | 29 | -- | 14 | 171 | 100.0 | 26 |
| Chile (1988) | 439 | 439 | -- | -- | -- | -- | 439 | 100.0 | 248 |
| Costa Rica (1989) | 1,599 | 991 | -- | -- | 101 | 36 | 1,128 | 70.5 | 196 |
| Guyana (1992) | 93 | 93 | -- | -- | -- | -- | 93 | 100.0 | 10 |
| Mexico | 51,902 | -- | 8,306 | 7,130 | -- | 7,737 | 23,173 | 44.6 | 7,677 |
| (1988) | 3,671 | -- | 1,115 | -- | -- | 555 | 1,670 | 45.5 | 555 |
| (1989) | 48,231 | -- | 7,191 | 7,130 | -- | 7,182 | 21,503 | 44.6 | 7,122 |
| Mozambique (1991) | 124 | 124 | -- | -- | -- | -- | 124 | 100.0 | 12 |
| Niger (1991) | 111 | 111 | -- | -- | -- | -- | 111 | 100.0 | 23 |
| Nigeria (1991) | 5,811 | 3,390 | -- | 651 | -- | 352 | 4,393 | 75.6 | 1,708 |
| The Philippines | 5,812 | 2,602 | -- | 569 | 121 | 409 | 3,701 | 63.7 | 1,795 |
| (1989) | 1,339 | 1,339 | -- | -- | -- | -- | 1,339 | 100.0 | 670 |
| (1992) | 4,473 | 1,263 | -- | 569 | 121 | 409 | 2,362 | 52.8 | 1,125 |
| Uganda (1993) | 152 | 152 | -- | -- | -- | -- | 152 | 100.0 | 18 |
| Uruguay (1991) | 1,608 | 633 | -- | 160 | -- | 95 | 888 | 55.2 | 463 |
| Venezuela (1989) | 19,700 | 1,411 | 543 | 2,195 | 488 | 1,739 | 6,376 | 32.4 | 2,585 |
| Total | 116,062 | 10,277 | 11,501 | 15,729 | 710 | 12,806 | 51,023 | 44.0 | 17,843 |

Sources: IMF staff estimates.

1/ Debt and debt service reduction is estimated by comparing the present value of the old debt with the present value of the new claim, and adjusting for pre-payments made by the debtor. The methodology is described in detail in Annex I of Collyns (1992). The amounts of debt reduction contained in this table exclude debt extinguished through debt conversions.

2/ The figure for debt service reduction represents the expected present value of the reduction in future interest payments arising from the below-market fixed interest rate path on the new instruments relative to expected future market rates. The calculation is based on the estimated term structure of interest rates at the time of agreement in principle.

3/ Includes past due interest and debt restructured under new money options for Mexico (1989), Uruguay (1991), Venezuela (1989), and Philippines (1992); the Philippines' (1989) new money option was not tied to a specific value of existing debt.

4/ Excludes prepayment of principal and interest through guarantees.

5/ Cost at the time of operation's closing. Includes principal and interest guarantee, buy-back costs, and for Venezuela resources used to provide comparable collateral for bonds issued prior to 1990. Excludes cash downpayments related to PDI.

Table 2. Buy-back Equivalent Prices in Debt and Debt-Service Reduction Operations 1/

(In percent of face value)

| | Debt Reduction | | Debt Service Reduction | | | Secondary Market Price at Time of Agreement in Principle |
|---|---|---|---|---|---|---|
| | Buyback | Discount Exchange | Principal Collate-ralized Par Exchange | Other Par Exchanges | Overall Package | |
| Argentina | -- | 26 | 30 | -- | 29 | 39 |
| Costa Rica 2/ | 16 | -- | -- | 29 3/ | 19 | 19 |
| Mexico 2/ | -- | 31 | 37 | -- | 34 | 44 |
| Nigeria 2/ | 40 | -- | 36 | -- | 38 | 40 |
| Philippines (1989) | 50 | -- | -- | -- | 50 | 50 |
| Philippines (1992) | 52 | -- | 45 | 28 | 43 | 53 |
| Uruguay 2/ | 56 | -- | 42 | -- | 50 | 54 |
| Venezuela 2/ | 45 | 35 | 37 | 26 | 40 | 46 |
| Total 4/ | 42 | 30 | 35 | 26 | 35 | 43 |

Source: IMF staff estimates.

1/ The buy-back equivalent price for a debt exchange is the total value of enhancements as a proportion of the total reduction in claims payable to banks, including effective prepayments through collateralization, evaluated at prevailing interest rates at time of agreement in principle. This is the price at which the debt reduction achieved through a debt exchange is equivalent to the debt reduction under a buy-back at this price.

2/ The calculations include estimates of value recovery clauses.

3/ Weighted average of the buyback equivalent price of the series A par bond (33 cents), the series B par bond (0 cents), and the series A PDI bond (119 cents).

4/ Weighted average.

Table 3. Bank Menu Choices in Debt Restructuring Packages

(In percent of total eligible bank debt)

| Country | Debt Reduction: Buy-back | Debt Reduction: Discount Exchange | Debt-Service Reduction: Principal Collate-ralized Par Exchange | Debt-Service Reduction: Other Par Exchanges | New Money |
|---|---|---|---|---|---|
| Argentina | -- | 34 | 66 | -- | -- |
| Costa Rica | 63 | -- | -- | 37 | -- |
| Mexico | -- | 43 | 47 | -- | 11 |
| Nigeria | 62 | -- | 38 | -- | -- |
| Philippines (1989) 1/ | 100 | -- | -- | -- | -- |
| Philippines (1992) | 29 | -- | 42 | 18 | 11 |
| Uruguay | 39 | -- | 33 | -- | 28 |
| Venezuela | 7 | 9 | 38 | 15 | 31 |
| Total 2/ | 9 | 29 | 46 | 4 | 12 |

Source: National authorities; and IMF staff estimates.

1/ The agreement included new money but it was not tied to a specific amount of eligible debt.
2/ Weighted average.

## References

Allen, M., et al. (1990), International Capital Markets: Developments and Prospects, World Economic and Financial Surveys series, April.

Calvo G.A., L. Leiderman and C.M. Reinhart (1992), "Capital Flows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors," IMF Working paper, WP/92/62, August.

Clark, J. (1990). "Evaluation of Debt Exchanges," IMF Working Paper, WP/90/9, February.

Clark, J. and E. Kalter (1992), "Recent Innovations in Debt Restructuring," Finance and Development, September.

Clark J. (1992), "Debt Reduction Equivalencies Across Different Currencies", (unpublished).

Collyns, C. et al. (1992), Private Market Financing for Developing Countries, World Economic and Financial Surveys series, December.

Dooley, M. et al. (1990), Debt Reduction and Economic Activity, IMF Occasional Paper No. 68.

El-Erian, M.A. (1990), "Mexico's Commercial Bank Financing Package," Finance and Development, September.

El-Erian, M.A. (1991), "Mexico's External Debt and the Return to Voluntary Capital Market Financing," IMF Working Paper, WP/91/83, August.

El-Erian, M.A. (1992), "Restoration of Access to Voluntary Capital Market Financing: The Recent Latin American Experience, Staff Papers, Vol. 39, March.

Griffith-Jones, S. (ed.) (1989), Third World Debt: Managing the Consequences, IFR books.

Griffith-Jones, S. (1992), "The Return of Private Capital to Latin American Countries: The Facts, an Analytical Framework and Some Policy Issues," in Teunissen (ed.).

Hay, J. and N. Paul (1991), Regulation and Taxation of Commercial Banks During the International Debt Crisis, World Bank Technical Paper No. 158.

Khor, H. and L. Rojas-Suarez (1991), "Interest Rates in Mexico: The Role of Exchange Rate Expectations and International Creditworthiness," Staff Papers, Vol. 38, December.

Leipold, A. et al. (1991), Private Market Financing for Developing Countries, IMF World Economic and Financial Surveys series, December.

Mulford, D. (1989), "The Brady Plan: Strengthening the Current International Debt Strategy," in Griffith-Jones (ed.).

Teunissen, J. (ed.) (1992), Fragile Financing: Rethinking the International Monetary System, FONDAD.

van Wijnbergen, S. (1991), "Mexico and the Brady Plan, " Economic Policy: A European Forum, Vol 6, April.

United Nations Center on Transnational Corporations (1990), Debt Equity Conversions, United Nations.