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CONFIDENTIAL

August 19, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Bolivia - Debt Buyback Arrangement

Attached for the information of the Executive Directors is a paper on a debt buyback arrangement for Bolivia.

Mr. Flickenschild (ext. 8621) or Mr. Silard (ext. 7715) is available to answer technical or factual questions relating to this paper.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BOLIVIA

Debt Buyback Arrangements

Prepared by the Western Hemisphere Department and the Legal Department

(In consultation with the Exchange and Trade Relations, Research and the Treasurer's Departments)

Approved by S.T. Beza and Francois Gianviti

August 18, 1987

I. Expected Request

The Bolivian authorities are expected to request the Fund to establish and administer a voluntary contribution account pursuant to Article V, Section 2(b) in order to assist Bolivia to discharge a portion of its external debt to nonofficial lenders, which are mostly commercial banks, ("commercial banks"), through novel debt buyback arrangements. The buyback would operate by agreement between Bolivia and the commercial banks, and a feature of the arrangements is the principle that the use of Bolivia's own foreign exchange resources would be avoided. This memorandum provides background for the information of Executive Directors, and a basis for facilitating timely action on the request when it is made.

The resources would be contributed by other countries ("contributors") in the form of donations specifically designated for the buyback. Donations would be made directly to the account to be administered by the Fund, or indirectly through the Central Bank of Bolivia. Firmly pledged donations may be prefinanced by the Central Bank of Bolivia. Donations subject to conditions could be made also for this purpose if the conditions are disclosed to the commercial banks and are not found objectionable by a two-thirds majority of them on the grounds that the conditions make the prospect of receiving the donations too remote. Discussions have been taking place between Bolivia and the commercial banks about the possibility that concessional loans may qualify also, on terms to be determined, including the possibility of their prefinancing by the Central Bank of Bolivia.

The buyback would be governed by the 1987 Amendment to the 1981 Refinancing Agreement for Bolivia (see Annex for relevant provision). All but two commercial banks party to the Refinancing Agreement have signed the Amendment, which is expected to enter into effect when three conditions are met: (a) the remaining two banks sign (it is understood that their signature may be contingent on condition (c) having been met), (b) Bolivia approves the Amendment by a supreme decree, and (c) the Fund decides to perform the function of administering the account. Condition (c) was agreed in order to obtain the agreement of all banks to the Amendment.

The management supports the performance of this function by the Fund and a proposed decision with an instrument to establish the account, together with further explanatory material, would be circulated to the Executive Board when the arrangements are agreed and the Bolivian request is made. Upon entry into effect, the buyback would be subject to a time limit of four months for completion, as provided in the agreement between Bolivia and the commercial banks.

II. Purpose

The purpose of the contemplated debt buyback is to facilitate a significant improvement in Bolivia's external position through a reduction of its external indebtedness to commercial banks. Together with parallel arrangements that are envisaged for debt-equity swaps and a subsequent rescheduling of remaining debt to commercial banks, the buyback is expected to assist Bolivia in its efforts to reduce its debt burden and normalize its international payments position by eliminating arrears, and thereby contribute to a restoration of its international creditworthiness.

After experiencing several years of negative growth with hyper-inflation, in 1985 Bolivia undertook major economic reforms that were supported by a stand-by arrangement from the Fund that was in effect from June 19, 1986 to July 20, 1987 (EBS/86/120, Supplement 1, 6/27/86 and EBS/87/130, 6/15/87). As a low-income country, Bolivia is eligible for the Structural Adjustment Facility. A three-year structural adjustment arrangement and the first annual arrangement thereunder were approved for Bolivia on December 15, 1986 (EBS/86/263, Supplement 3, 12/22/86). Discussions are under way on a new program to be supported by the use of the Fund's general resources.

Outstanding external public debt of Bolivia at the end of 1986 was US$3.5 billion, or about 100 per cent of GDP, and debt service, before rescheduling, was 108 per cent of exports of goods and services. In mid-1986 Bolivia reached agreement with Paris Club creditors on the rescheduling of outstanding arrears and maturities falling due in the period July 1986-June 1987 (EBS/86/174, 8/4/86).

In April 1981 Bolivia and its foreign bank creditors agreed to refinance the bulk of some US$680 million owed to commercial banks. In September 1982 Bolivia began to fall behind on its obligations under the Refinancing Agreement and has not made any payments to the banks after March 1984. By mid-1987, more than 90 per cent of principal owed to the banks was in arrears. At that time, unpaid debt service to the banks is estimated to have amounted to US$0.9 billion. In recent months, Bolivia's debt to the commercial banks has traded reportedly in the secondary market at a discount of about 90 per cent.

In February 1987, Bolivia and the coordinating committee of its foreign commercial bank creditors agreed, subject to the agreement of all commercial banks, to amend the 1981 Refinancing Agreement for Bolivia to permit a two-step approach to resolving Bolivia's bank debt problem. As a first step, a portion of the outstanding principal and associated unpaid interest will be reduced by a debt buyback at a discount or through debt-equity conversions. As already noted, all but two of the commercial banks signed the Amendment in July 1987. Within a period of four months from the coming into effect of the Amendment, Bolivia will offer to buy back its debt at a price determined by the Bolivian authorities, using contributions from other countries for that purpose. Banks will then decide on the amount of debt they are willing to sell at that price, which will apply to all commercial banks. The buyback will take place directly between Bolivia and the commercial banks. A debt-equity conversion arrangement is also being offered as an alternative. As a second step, the remaining debt will be restructured on terms to be decided at that time. Some banks, while agreeing to permit a buyback, have indicated that they will not participate in it, and there is no obligation for banks to sell their claims on Bolivia. Bolivia is not expected to undertake any new borrowing from commercial banks in the next several years, other than possibly for trade financing.

An effort by Bolivia to obtain resources for the buyback is under way.

III. Role of the Fund

A role for the Fund is envisaged in two respects:

(a) The Fund would administer the account in such a way as to maintain the anonymity of the contributors if they so request. The Fund would provide for a certification procedure, involving contacts by the staff both with Bolivia and the contributors, under which the commercial banks would obtain confirmation that all resources used for the buyback are specifically obtained for this purpose from official sources. This element of the arrangements is to assure the banks that the buyback would not diminish Bolivia's own resources available for the service of the remaining obligations to be rescheduled (except for concessional loans, if these are agreed). The total amount available for the buyback would not have to be disclosed by the Fund. Disbursement of resources in the account would be made, at Bolivia's instruction, and through a coordinating agent, to the commercial banks agreeing to sell their claims on Bolivia.

(b) The Fund would need to be satisfied that the financing and the modalities of the buyback are consistent with Bolivia's economic and financial program in support of which Bolivia expects to request the use of the Fund's general resources.

IV. Legal Authority for Fund

Article V, Section 2(b) provides the Fund with authority to perform financial and technical services, and, in that connection, to administer contributions for the benefit of a member. Article V, Section 2(b) reads as follows:

> "If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund. Operations involved in the performance of such financial services shall not be on the account of the Fund. Services under this subsection shall not impose any obligation on a member without its consent."

The establishment of the account would be a service for Bolivia and would provide the member with an opportunity to normalize its international payments position in a way consistent with the Fund's purposes. This would be accomplished in the context of financial support from the Fund for Bolivia's economic and financial policies in accordance with the Fund's policies on the use of its general resources.

Accordingly, the Fund would have authority to accede to Bolivia's expected request to establish the account and to decide upon arrangements under which resources would be transferred to the account for administration and disbursement for the purchase by Bolivia of claims constituting its external debt to commercial banks.

No charge would be levied by the Fund for these services. It is not expected that the operation of the account would give rise to any losses. In any event, the assets and property of the account will be kept separate from the assets and property of all other accounts of, or administered by, the Fund. The assets and property held in such other accounts will not be used to discharge or meet any liabilities, obligations or losses of the Fund that may be incurred in the administration of the account; nor will the assets and property of the account be used to discharge or meet any liabilities, obligations or losses that may be incurred by the Fund in the administration of such other accounts.

Annex

<u>Amendment to Refinancing Agreement Dated as of April 29, 1981 and Other Agreements among La Republica de Bolivia, Banco Central de Bolivia, The Original Obligors and Banks Named Herein and Bank of America National Trust and Savings Association, as Coordinating Agent for the Banks, Dated as of February 17, 1987.</u>

The provision dealing with purchase of debt, Section 12.19, provides:

> "The Republic or Banco Central may utilize Foreign Currency to make voluntary purchases of External Indebtedness (defined as if clause (iii) were not included in the definition thereof) owed or guaranteed by the Republic, Banco Central or any other Governmental Agency, from lenders of record under bank credit agreements or instruments (including this Agreement and any Governing Instrument) during the period ending on the date four months after the effectiveness of the Amendment to this Agreement dated as of February 17, 1987, subject to the conditions that (i) each offer in respect of any such purchase shall be made to all the Banks on identical terms, (ii) each Bank shall be entitled to accept or reject such offer in respect of all or any portion of its debt in its sole discretion, (iii) the Republic and Banco Central shall represent and warrant to the Banks at the time of such offer and at the time of each such purchase that they have obtained irrevocable legal, valid and binding agreements from other countries to provide funds to the Republic or Banco Central (with no resulting obligation or indebtedness of the Republic or Banco Central or any other Governmental Agency) for the exclusive purpose of making such purchases in an amount sufficient to reimburse them in full for all purchases pursuant to this Section 12.19, (iv) the Republic and Banco Central shall represent and warrant to the Banks at the time of such offer that no conditions have been imposed by the donor countries on the availability of the funds referred to in clause (iii) above other than as specified in the offer, and (v) Majority Banks shall not have sent written objections, within 30 days after receipt of such offer (during which period no such purchases shall be made), to the Coordinating Agent to such offer, on the grounds that the conditions referred to in clause (iv) above make the prospect of receiving such funds from the donor countries too remote. No purchase pursuant to the terms of this Section 12.19 shall be deemed a violation of Sections 5.01, 5.03, 9.01(d) or 9.02(d), or require any action under Section 5.04. All purchases pursuant to the terms of this Section 12.19 shall be made at the same price for each Bank, and, in the event there are insufficient funds to purchase all the debt agreed to be sold, purchases shall be made <u>pro rata</u> in accordance with the amounts agreed to be sold by each Bank. The Republic authorizes the IMF to release information to the Coordinating Agent on the amount of Foreign Currency funds received from donor countries for the purpose of making such purchases during each calendar quarter without disclosing the identities of the donor countries."