ANNUAL MEETINGS
2022 | WASHINGTON DC
INTERNATIONAL MONETARY FUND
WORLD BANK GROUP

IMF SEMINARS

RECOMMENDED READING

Debt Restructuring: Why Too Little and Too Late

INTERNATIONAL MONETARY FUND

LIBRARY
Corporate Services and Facilities

ANNUAL MEETINGS
2022 | WASHINGTON DC
INTERNATIONAL MONETARY FUND
WORLD BANK GROUP

IMF SEMINARS

RECOMMENDED READING

LIBRARY
Corporate Services and Facilities

TUESDAY, October 11, 2022
2:00 PM - 3:00 PM, IMF HQ1, Atrium (HQ1-1-700)

Debt Restructuring: Why Too Little and Too Late

Sponsored by the IMF's Strategy, Policy, and Review Department

---

Government debt levels are climbing in emerging and developing economies. With rising interest rates, the strengthening of the US dollar, and weaker global growth, the risks of a systemic sovereign debt crisis are rising. The discussion draws on options for improving the functioning of debt restructuring mechanisms from a private sector perspective (a separate seminar looks at policy options and the G20 Common Framework).

Abbas, S. Ali, Alex Pienkowski, and Kenneth Rogoff. 2019.

[*Sovereign Debt: A Guide for Economists and Practitioners*]. Oxford University Press, 19 December 2019, online edition.

The last time global sovereign debt reached the level seen today was at the end of the Second World War, and this shaped a generation of economic policymaking. International institutions were transformed, country policies were often draconian and distortive, and many crises ensued. By the early 1970s, when debt fell back to pre-war levels, the world was radically different. It is likely that changes of a similar magnitude—for better or for worse—will play out over the coming decades. This book is an attempt to build some structure around the issues of sovereign debt to help guide economists, practitioners, and policymakers through this complicated, but not intractable, subject. The book brings together some of the world's leading researchers and specialists in sovereign debt.

Ams, Julianne, Reza Baqir, Anna Gelpern, Christoph Trebesch. 2019.

"Sovereign Default." *Sovereign Debt: A Guide for Economists and Practitioners*, 275–327. Oxford University Press.

This chapter begins by defining sovereign default. It proceeds to untangle several common forms of default, including unilateral and negotiated default, and default that results in principal haircuts and payment reprofiling, and offers a clear taxonomy of default, using real-world examples when needed. The chapter then explores the various costs of sovereign default, and the factors that influence them. It considers some of the weaknesses and distortions within the existing framework of crisis prevention and resolution, highlighting the role of official bailouts and moral hazard, and the causes of delayed and inadequate debt relief ("too little, too late"). The chapter concludes with recommendations for reducing the incidence and cost of default.

Arslanalp, Serkan, and Laura Sunder-Plassmann. 2022.

"Sovereign Debt Repatriation During Crises." Working Paper No. 2022/077, International Monetary Fund, Washington, DC.

We use a new, comprehensive data set on the sovereign debt investor base to document three novel empirical facts: (i) sovereign debt is repatriated - that is, shifted from external private to domestic investors - prior to sovereign defaults; (ii) not all crises are equal: evidence for repatriation during banking and currency crises is more limited; and (iii) the nature of defaults matters: external investors do not leave during preemptive debt restructurings. We further show that repatriation appears to be prevalent when defaults happen in large markets with low capital controls. The data set we use is uniquely suited to analyzing investor base dynamics during rare crises due to its large cross-section and time series, covering 180 countries from 1989 to 2020.

Buchheit, Lee, Guillaume Chabert, Chanda DeLong, and Jeromin Zettelmeyer. 2019.

"The Restructuring Process." *Sovereign Debt: A Guide for Economists and Practitioners*, 328–364. Oxford University Press.

This chapter goes into depth on the debt restructuring process itself, a topic which has not been covered in the literature in detail before. It gives a step-by-step outline of how restructurings take place, from deciding on the appropriate strategy, to determining which debt should be covered and in what way; to engagement with creditors in the negotiating process. It also covers one of the main structural problems in reaching an agreement with creditors—the collective action problem—and explores ways by which such problems can be overcome with both private creditors (collective action clauses, exit consents) and the official sector (the role of the Paris Club).

Cohen, Charles, S. M. Ali Abbas, Myrvin Anthony, Tom Best, Peter Breuer, Hui Miao, Alla Myrvoda, and Eriko Togo. 2022.

"The Role of State-Contingent Debt Instruments in Sovereign Debt Restructurings." Staff Discussion Notes No. 2020/006, International Monetary Fund, Washington, DC.

The COVID-19 crisis may lead to a series of costly and inefficient sovereign debt restructurings. Any such restructurings will likely take place during a period of great economic uncertainty, which may lead to protracted negotiations between creditors and debtors over recovery values, and potentially even relapses into default post-restructuring. State-contingent debt instruments (SCDIs) could play an important role in improving the outcomes of these restructurings.

de Soyres, Constance, Reina Kawai, and Mengxue Wang. 2022.

"[Public Debt and Real GDP: Revisiting the Impact](#)." Working Paper No. 2022/076, International Monetary Fund, Washington, DC.

This paper provides new empirical evidence of the impact of an unanticipated change in public debt on real GDP. Using public debt forecast errors, we identify exogenous changes in public debt to assess the impact of a change in the debt to GDP ratio on real GDP. By analyzing data on gross public debt for 178 countries over 1995-2020, we find that the impact of an unanticipated increase in public debt on the real GDP level is generally negative and varies depending on other fundamental characteristics. Specifically, an unanticipated increase in the public debt to GDP ratio hurts real GDP level for countries that have (i) a high initial debt level or (ii) a rising debt trajectory over the five preceding years. On the contrary, an unanticipated increase in public debt boosts real GDP for countries that have (iii) a low-income level or (iv) completed the HIPC debt relief initiative.

Hatchondo, Juan Carlos, Leonardo Martinez, Kursat Onder, and Francisco Roch. 2022.

"Sovereign Cocos." Working Paper No. 2022/078, International Monetary Fund, Washington, DC.

We study a model of equilibrium sovereign default in which the government issues cocos (contingent convertible bonds) that stipulate a suspension of debt payments when the government faces liquidity shocks in the form of an increase of the bondholders' risk aversion. We find that in spite of reducing the frequency of defaults triggered by liquidity shocks, introducing cocos increases the overall default frequency. By mitigating concerns about liquidity, cocos make indebtedness and default risk more attractive for the government. In contrast, cocos that stipulate debt forgiveness when the government faces the shock, achieve larger welfare gains by reducing default risk.

International Monetary Fund, and World Bank. 2022.

"Making Debt Work For Development and Macroeconomic Stability." Policy Paper No. 2022/019, International Monetary Fund, Washington, DC.

The coronavirus crisis has stiffened debt and development-related headwinds that had become strong even before 2020. Sustaining development while maintaining debt sustainability has been made harder by the protracted effects of the pandemic on public finances, earnings and employment, and human capital accumulation of vulnerable populations. The fiscal support programs financed by public debt provided relief and saved lives and livelihoods. But debt-induced uncertainty can now dampen investment and growth, especially given rising global interest rates.

International Monetary Fund. 2022.

"Poverty Reduction and Growth Trust—Guidance Note on New Enhanced Safeguards for Debt Sustainability and Capacity to Repay." Policy Paper No. 2022/028, International Monetary Fund, Washington, DC.

International Monetary Fund. 2022.

"Reviews of the Fund's Sovereign ARREARS Policies and Perimeter." Policy Paper No. 2022/023, International Monetary Fund, Washington, DC.

This paper undertakes a comprehensive review of the Fund's sovereign arrears policies. Staff assesses that the Fund's Lending into Arrears to Private Creditors (LIA) policy (established in 1989 and last reviewed in 2002) remains broadly appropriate, while recommending some improvements given the experience gained over the last 20 years. Staff also sees merit in codifying the existing practice guiding the Fund in preemptive debt restructurings into a Fund policy, together with an amendment focusing on debt transparency. Given limited experience with the application of the LIOA policy (established in 2015), staff does not propose any amendments but only one restatement confirming current practice. Given recent developments in the international creditor community, staff proposes refining the Fund's arrears policies with respect to multilateral creditors. Finally, recent developments raise questions about the perimeter between official bilateral and private claims, with significant implications for the Fund's arrears policies.

International Monetary Fund. 2022.

"Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for Market Access Countries." Policy Paper No. 2022/039, International Monetary Fund, Washington, DC.

This note provides operational guidance for the use of the Sovereign Risk and Debt Sustainability Framework (SRDSF), which replaces the Debt Sustainability Framework for Market Access Countries. The SRDSF introduces improvements in organization, methodology, transparency, and communication when

analyzing public debt issues in countries that mainly finance themselves with market-based debt. After its phased adoption beginning [June 2022], it will become the Fund's principal tool for assessing public debt sustainability.

International Monetary Fund. 2021.

"Issues in Restructuring of Sovereign Domestic Debt." Policy Paper No. 2021/071, International Monetary Fund, Washington, DC.

As emerging and developing economies accumulate more domestic sovereign debt, it is likely to play a larger role in the resolution of future sovereign debt crises. This paper analyzes when and how to restructure sovereign domestic debt in unsustainable debt cases while minimizing economic and financial disruptions. Key to determining whether or not domestic debt should be part of a sovereign restructuring is weighing the benefits of the lower debt burden against the fiscal and broader economic costs of achieving that debt relief. The fiscal costs may have to be incurred in the context of restructuring because of the need to maintain financial stability, to ensure the functioning of the central bank, or to replenish pension savings. A sovereign domestic debt restructuring should be designed to anticipate, minimize, and manage its impact on the domestic economy and financial system.

International Monetary Fund. 2020.

"The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options." Policy Paper No. 2020/043, International Monetary Fund, Washington, DC.

There have been significant developments in sovereign debt restructuring involving private-sector creditors since the IMF's last stocktaking in 2014. While the current contractual approach has been largely effective in resolving sovereign debt cases since 2014, it has gaps that could pose challenges in future restructurings. Given these challenges, the note lays out several reform options for strengthening the resolution toolkit going forward. The IMF has a rich work program on sovereign debt that will include a review of its key policies on sovereign debt.

International Monetary Fund. 2013.

"Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework." Policy Papers, International Monetary Fund, Washington, DC.

This paper reviews the recent application of the Fund's policies and practices on sovereign debt restructuring. Specifically, the paper: recaps in a holistic manner the various policies and practices that underpin the Fund's legal and policy framework for sovereign debt restructuring, including on debt sustainability, market access, financing assurances, arrears, private sector involvement (PSI), official sector involvement (OSI), and the use of legal instruments; reviews how this framework has been applied in the context of Fund-supported programs and highlights the issues that have emerged in light of recent experience with debt restructuring; and describes recent initiatives in various fora aimed at promoting orderly sovereign debt restructuring, highlighting differences with the Fund's existing framework.

Isgut, Alberto. 2022.

"Addressing Sovereign Debt Challenges in the Era of COVID-19 and Beyond: The Role of the United Nations." *Asia-Pacific Sustainable Development Journal* 28 (2): 149 – 194.

Traditionally, sovereign debt problems of developing countries have been discussed mostly at institutions representing the creditors, such as the Paris Club, and at the International Monetary Fund, but they have also been addressed by the United Nations, mostly in the context of its international conferences on financing for development. Although the views of the United Nations on debt are not widely known, they are highly relevant in the post-COVID-19 context, as inflationary pressures could lead to tightened global financial conditions and exacerbate debt vulnerabilities in developing countries. The present paper provides an overview of sovereign debt restructurings from the 1980s, a summary of the debt situation of Asia and the Pacific as a case study and a review of the views of United Nations on debt issues. It also offers suggestions to improve the global debt architecture based on such views by highlighting the importance of linking debt sustainability with sustainable development in debt restructuring workouts and through a hub-and-spoke institutional arrangement to disseminate prudential debt management practices and promote transparency.

Jalles, João Tovar, and Paulo A Meda. 2022.

"Economic Growth After Debt Surges." Working Paper No. 2022/159, International Monetary Fund, Washington, DC.

Debt levels, both private and public, were already at record highs before the Covid-19 pandemic, and surged further in 2020. The high indebteness raises concerns whether it will undermine future growth prospects. This paper contributes to the ongoing debate by examining what happens to economic growth after debt surges. We apply a local projection method to a new dataset of debt surges in 190 countries between 1970 and 2020. Our results show that the relationship between debt surges and economic growth are complex. Debt surges tend to be followed by weaker economic growth and persistently lower output. However, this negative relationship does not always hold. Surges in public debt tend to have the most negative impact on future growth prospects. This is particularly the case if the economy is already operating with a large positive output gap. Debt surges also tend to be followed by weaker economic growth if the initial debt levels are high, especially for private debt surges. Our results also show how debt surges impact future growth.

Lee, Nancy. 2020.

"Restructuring Sovereign Debt to Private Creditors in Poor Countries: What's Broken?" CGD Notes August 2020, Center for Global Development, Washington, D.C.

Two out of five low-income countries (LICs) were in the grips of, or moving rapidly toward, unsustainable debt levels before the global pandemic. But the economic, financial, and fiscal effects of the pandemic have brought the day of reckoning for many countries much closer. The need for massive countercyclical spending and additional health and other social spending is now layered on top of huge finance needs for the Sustainable Development Goals (SDGs), which for LICs had been estimated by the IMF to average 15 percentage points of GDP. Such spending is no less essential in poor countries than in middle- and high-income countries given the dire effects of the pandemic on poor populations.

Martinez, Leonardo, Francisco Roch, Francisco Roldán, and Jeromin Zettelmeyer. 2022.

"Sovereign Debt." Working Paper No. 2022/122, International Monetary Fund, Washington, DC.

This paper surveys the literature on sovereign debt from the perspective of understanding how sovereign debt differs from privately issue debt, and why sovereign debt is deemed safe in some countries but risky in others. The answers relate to the unique power of the sovereign. One the one hand, a sovereign has the power to tax, making debt relatively safe; on the other, it also has control over its territory and most of its assets, making debt enforcement difficult. The paper discusses debt contracts and the sovereign debt market, sovereign debt restructurings, and the empirical and theoretical literatures on the costs and causes of defaults. It describes the adverse impact of sovereign default risk on the issuing countries and what explains this impact. The survey concludes with a discussion of policy options to reduce sovereign risk, including fiscal frameworks that act as commitment devices, state-contingent debt, and independent and credible monetary policy.

Meyer, Josefin, Carmen M. Reinhart, and Christoph Trebesch. 2022.

"Sovereign Bonds Since Waterloo." *The Quarterly Journal of Economics* 137 (3): 1615–1680,

This article studies external sovereign bonds as an asset class. We compile a new database of 266,000 monthly prices of foreign-currency government bonds traded in London and New York between 1815 (the Battle of Waterloo) and 2016, covering up to 91 countries. Our main insight is that, as in equity markets, the returns on external sovereign bonds have been sufficiently high to compensate for risk. Real ex post returns average more than 6% annually across two centuries, including default episodes, major wars, and global crises. This represents an excess return of 3%–4% above US or UK government bonds, which is comparable to stocks and outperforms corporate bonds. Central to this finding are the high average coupons offered on external sovereign bonds. The observed returns are hard to reconcile with canonical theoretical models and the degree of credit risk in this market, as measured by historical default and recovery rates. Based on our archive of more than 300 sovereign debt restructurings since 1815, we show that full repudiation is rare; the median creditor loss (haircut) is below 50%.

Porter, Nathan, Camilo E. Tovar Mora, Juan P Trevino, Johannes Eugster, and Theofanis Papamichalis. 2022.

"The Systemic Impact of Debt Default in a Multilayered Global Network Model." Working Paper No. 2022/171, International Monetary Fund,

Washington, DC.

The world has become more interconnected over the past few decades. Against this backdrop, economic and financial contagion following adverse shocks can have a severe impact on the global economy. How systemic can the effects of contagion be? What specific transmission channels are involved? What is their relative importance? We address these questions using a multilayered global network model of contagion that simulates the impact of sovereign debt default on the global economy. We also develop a measure of global systemic risk and use bank stress testing techniques to quantify the systemic impact of the shock and the extent of contagion on the global economy. Our model shows that economic and financial contagion are highly non-linear, and many bystander economies can experience significant negative effects as the initial default is spread through the network. This suggests that many economies might be systemically more important than what conventional measures of size or openness might suggest.

Schlegl, Matthias, Christoph Trebesch, and Mark L.J. Wright. 2019.

"The Seniority Structure of Sovereign Debt." Working Paper 25793, National Bureau of Economic Research, Cambridge.

Sovereign governments owe debt to many foreign creditors and can choose which creditors to favor when making payments. This paper documents the de facto seniority structure of sovereign debt using new data on defaults (missed payments or arrears) and creditor losses in debt restructuring (haircuts). We overturn conventional wisdom by showing that official bilateral (government-to-government) debt is junior, or at least not senior, to private sovereign debt such as bank loans and bonds. Private creditors are typically paid first and lose less than bilateral official creditors. We confirm that multilateral institutions such as the IMF and World Bank are senior creditors.

Schumacher, Julian, Christoph Trebesch, and Chuck Fang. 2020.

"Restructuring Sovereign Bonds: Holdouts, Haircuts and the Effectiveness of CACs." Working Paper Series No. 2366 / January 2020, European Central Bank, Frankfurt.

Sovereign debt crises are difficult to solve. This paper studies the "holdout problem", meaning the risk that creditors refuse to participate in a debt restructuring. We document a large variation in holdout rates, based on a comprehensive new dataset of 23 bond restructurings with external creditors since 1994. We then study the determinants of holdouts and find that the size of creditor losses (haircuts) is among the best predictors at the bond level. In a restructuring, bonds with higher haircuts see higher holdout rates, and the same is true for small bonds and those issued under foreign law. Collective action clauses (CACs) are effective in reducing holdout risks. However, classic CACs, with bond-by-bond voting, are not sufficient to assure high participation rates. Only the strongest form of CACs, with single-limb aggregate voting, minimizes the holdout problem according to our simulations. The results help to inform theory as well as current policy initiatives on reforming sovereign bond markets.

MEDIA PARTNERS

LIBRARY
Corporate Services and Facilities