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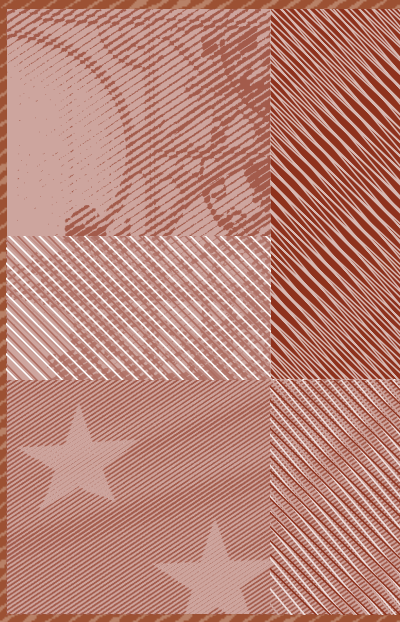

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Abstract

Sovereign debt restructurings do constitute a recurrent phenomenon in emerging and developing economies. Consequently, the international community has repeatedly explored options to increase the predictability and orderliness of debt workouts, of which the debate on the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the IMF in 2002 is the most recent example. Eventually, however, the most ambitious reform proposals have been systematically abandoned, thereby consolidating debt restructurings as market-led case-by-case processes. This paper reviews nine recent sovereign debt restructurings: Argentina (2001-2005), Belize (2006-2007), the Dominican Republic (2004-2005), Ecuador (1999-2000), Pakistan (1998-2001), the Russian Federation (1998-2001), Serbia (2000-2004), Ukraine (1998-2000) and Uruguay (2004).

Our case study analysis reveals the lack of a single model for sovereign debt restructurings. Indeed, we find significant variations in the roots of the crises, the size of the losses undergone by investors, the speed at which an agreement was reached with creditors, the proportion of creditors accepting the terms of that agreement, or the time needed to restore access to international financial markets. There also appears to be a lack of consistency in the role played by the IMF in the various crises. This is partly due to the lack of a policy specifically designed to deal with sovereign debt restructurings in the IMF's toolkit, which has provided the IMF with flexibility to adapt to each crisis on a case-by-case basis. However, it may have exacerbated the uncertainty that tends to characterize such disruptive episodes. This paper constitutes the basis of a broader effort to identify possible options for the IMF to endow itself with a policy to streamline and systematize its role during sovereign debt restructurings.

JEL codes: E65, F34, H63.

Keywords: IMF, sovereign debt, restructurings, default, solvency.

1 Introduction

Sovereign debt restructurings in emerging and developing economies do constitute a striking regularity in the world's economic history. Indeed, as pointed out by Reinhart et al. (2003), countries like Mexico and Venezuela were in a state of default or debt restructuring for 47% and 39% of the time respectively in between 1824 and 1999. On average, the group of serial defaulters considered in their analysis were renegotiating their international debt obligations for a quarter of that time span. In addition, such debt restructurings have tended to come in waves, often following periods of 'exuberance' in international financial markets reversed by unanticipated shocks to the world economy. For instance, the Latin American debt crisis was rooted in the combination of the recycling of petrodollars, via US and European banks, as cheap loans to developing countries in the 1970s, and the rising cost of that debt that followed a drastic tightening of macroeconomic policies in the US and other OECD countries in the early 1980s. Other more recent episodes, such as the wave of contagion that characterized the aftermath of the Asian and the Russian crises in the late nineties, followed a comparable pattern.

Another historical regularity is that, following waves of debt crises, more or less ambitious proposals have been put forward to increase the orderliness and predictability of sovereign debt restructurings. For instance, Eichengreen (1989) compares the policy discussions that took place during the debt crises of the 1930s and the 1980s, arguing that two similarly differentiated camps emerged in both episodes: those that favoured a case by case approach, and those that favoured '*global plans for fundamentally restructuring the terms of international lending and repayment*'. The same held true during the more recent discussions on the possible introduction of the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the IMF in 2002 [Kruger (2002)]. The proponents of the so-called 'statutory approach' argued in favour of the SDRM on the grounds that the problems characterizing sovereign debt restructurings called for the establishment of some sort of supranational body modelled along the lines of domestic bankruptcy courts. Instead, the proponents of the 'contractual approach' argued that the market failures that stand in the way of orderly debt restructurings can be overcome by means of the generalization of collective action clauses (CACs) in bond issues, and especially in those under New York law. As in previous similar episodes, the international community shelved this debate in 2003, dismissing the SDRM proposal and opting instead for the 'contractual approach', which effectively consolidated sovereign debt restructurings as case by case market-led processes.

The present paper reviews 9 recent sovereign debt restructurings, revealing the lack of a single model. Indeed, we find important differences in the roots of the debt crises, the size of the 'haircuts' undergone by private creditors, or the speed at which access to international financial markets was resumed after the debt workout. A crucial factor shaping debt restructurings appears to have been whether the sovereign remained current on debt servicing while negotiating with private creditors or whether, instead, the sovereign defaulted on its obligations. The first of these two scenarios corresponds to pre-emptive restructurings, which tended to be concluded more quickly and in more cooperative terms, with a larger proportion of creditors accepting the government's offer, and with a faster resumption of access to international financial markets. On the other hand, sovereigns in the second scenario secured larger debt relief from private creditors, pointing at the shift in bargaining power from private investors to governments that may be associated with the act of

defaulting. Another distinguishing factor is the degree of comprehensiveness of the various debt restructurings. It was often the case that the authorities tried to ring-fence more or less specific categories of debt from the restructuring. This was particularly true at the early stage of the debt crises, often in an attempt to bridge liquidity needs while avoiding the disruptions expected from a broader default or restructuring. We also find that some of these attempts at restructuring selectively failed, sometimes signalling a 'gambling for resurrection' strategy which tended to aggravate the impact of the crises. Domestic agents do constitute an important group of creditors, not only because of the rise in the share of sovereign debt issued or held domestically, but also for the implications of the restructuring of that category of debt on the domestic economy. Contrary to conventional assumptions in the literature on debt restructurings, we find that under some circumstances the sovereign may have an incentive to discriminate against domestic creditors, again especially at an early stage of the crisis. Indeed, domestic sources of finance may be sought by the authorities in order to substitute for a loss of access to international financial markets.

This paper places a special focus on the role played by the IMF in each of these episodes. Apart from committing the IMF to promote the inclusion of CACs in sovereign bond contracts, the closure of the SDRM debate left the role of International Financial Institutions in coping with sovereign debt restructurings essentially unchanged. But, what exactly is that role? We find that the IMF can play a significant role during sovereign debt restructurings along a number of dimensions: it provides financial assistance in a context in which the sovereign is most likely to have lost all meaningful access to international financial markets; it contributes to set a medium-term adjustment path which can anchor negotiations between the sovereign and its private creditors; it provides 'independent' information at a time of heightened uncertainty; it can provide incentives to the parts involved in the debt restructuring. We do find, however, a lack of consistency in the IMF's interventions in sovereign debt restructurings. This is particularly clear regarding the role of the IMF as a provider of financial assistance and of information, where the widest variations are found among the cases analyzed in this paper.

An explanation for this lack of consistency is the fact that the IMF's toolkit lacks an instrument or policy specifically designed to cope with sovereign debt restructurings as such. Only when sovereigns fall into arrears on the servicing of their external debt does the Policy of Lending Into Arrears (LIA) come into effect [IMF (1999)]. However, the LIA policy in its current form fails to specify what the specific contribution of IMF-supported programs should be in the context of sovereign debt restructurings. It simply introduces loose procedural requirements that are absent in non-LIA programs, and which are aimed at encouraging sovereigns and their creditors to engage in constructive negotiations (the so-called 'good faith' criterion) and to safeguard the IMF's own resources (financing assurances reviews). The lack of a policy on sovereign debt restructurings is likely to have provided the IMF with flexibility to adapt to potentially very different types of debt crises. On the other hand, this case by case approach may have contributed to exacerbate the uncertainties and informational asymmetries that characterized sovereign debt restructurings. In this context, a relevant question is whether the IMF and the international financial system would gain from specifying *ex ante* the dimensions along which the institution should aim at influencing the outcomes of debt workouts. This paper is precisely at the basis of an effort to explore policy options for the IMF to endow itself with a new and broader instrument to address sovereign debt restructurings. This is a relevant question in view of the forthcoming reform of the IMF's Policy of Lending Into Arrears, a specific item for reconsideration under the ongoing strategic review. Our departing hypothesis, which is further explored in Díaz-Cassou et al. (2008),

a companion paper, is that such an instrument is needed to streamline and systematize the IMF's intervention in a situation which has proven to be especially harmful for its member states and for the international financial system at large.

Our sample includes Argentina (2001-2005), Belize (2006-2007), the Dominican Republic (2004-2005), Ecuador (1999-2000), Pakistan (1998-2001), the Russian Federation (1998-2001), Serbia (2000-2004), Ukraine (1998-2000) and Uruguay (2004). With the exception of Belize, the IMF was involved in all these debt restructurings through a financial program. We have included Belize in our sample because, although no program was approved to back that country's crisis resolution strategy, the IMF did play a substantial role as a provider of 'independent' information and technical assistance. In addition, the Belizean experience stands out in particular because, following the adoption of the aforementioned 'contractual approach', this was the first instance in which collective action clauses were used as a meaningful component of the restructuring. Section 2 presents the different case studies. All of them are analyzed following the same structure. First, the roots of the crisis are explored. A detailed description of the debt restructuring process follows. We then move on to depict the role played by the IMF in each restructuring episode and to describe the exit from the crisis in terms of macroeconomic stabilization and recovery of access to international financial markets. Finally, Section 3 summarizes the main results of the analysis and presents some policy conclusions.

2 Case Studies

2.1 Argentina

The Argentine crisis constitutes one of the most traumatic recent episodes in international finance. Among the cases analyzed here, a number of specific features of the Argentine debt restructuring stand out in particular. First of all, its scale was unprecedented, involving a default on approximately US$66 billion of bonded debt in December 2001, later to rise to almost US$100 billion as a result of an extension of the scope of the default and of past-due interest. Second, this debt was extraordinarily complex, involving 152 bond series issued under 8 governing laws, denominated in 6 different currencies and held by thousands of heterogeneous creditors dispersed in numerous constituencies. Third, the Argentine case was marked by the authorities' uncooperative stance and the ensuing contentious climate of the negotiating process. Fourth, the losses imposed on investors were also unprecedented, on the range of 71-75% in NPV terms. Fifth, the role of the IMF in this debt restructuring was greatly constrained by a number of factors such as the Fund's position as Argentina's largest single creditor at the time of the default or by its tight involvement in the policy-making during the years that led to the crisis.

2.1.1 THE DEBT CRISIS

The roots of the Argentine crisis can be traced back to the early 1990s, a period of far-reaching economic reforms during which the *Convertibility regime* (a currency board establishing a one-to-one parity between the peso and the US$) was adopted to combat hyper-inflation and to stabilize the economy. This macro-economic framework was initially successful, and Argentina recorded an impressive economic performance during most of the decade (see Appendix 1, graph 1.1). However, in the late 1990s the underlying weaknesses of the Argentine economy emerged as a result of a combination of external and domestic factors, which ultimately resulted in the 2001 collapse.

On the external side, Argentina was affected by a series of adverse shocks such as the Asian, Russian or Brazilian crises, which substantially worsened emerging economies' access to international financial markets (see graph 1.8). In addition, this was a period of declining commodity prices and an appreciating dollar, which contributed to erode Argentina's external competitiveness vis-à-vis its main trade partners. This was compounded by the fact that, in the context of the Convertibility regime, the authorities had little room for manoeuvre, having relinquished control over monetary policy and being banned from devaluating the currency.

Crucial to the credibility of the Argentine monetary scheme was the maintenance of a sound fiscal framework. The authorities, however, tended to implement pro-cyclical policies all through the 90's (see graph 1.2). While this fiscal profligacy could be somewhat masked during periods of fast growth, when the Argentine economy lost steam in the later years of the decade, the accumulation of debt at both the central and provincial government levels became increasingly apparent and difficult to roll-over (see graph 1.5 and 1.6). Successive finance ministers tried to mount fiscal adjustment packages to stabilize the debt situation and preserve the convertibility regime. However, social unrest and a lack of political capital derailed all these attempts, further fuelling investors' concerns and setting the stage for a self-fulfilling crisis. An aggravating problem was the accumulation of widespread currency mismatches in the Argentine financial system during the Convertibility years. Indeed, given the

large amounts of dollar debts held by non-dollar earners, abandoning the peg to the dollar and devaluating the currency posed obvious risks for the financial system and was politically unacceptable (see graph 1.3). In this context, the Argentine government disorderly 'gambled for resurrection' with the implementation of a series of measures such as the introduction of a dual exchange rate system and a financial transaction tax, financial engineering operations like the 'mega-swap', moral suasion to place debt domestically (the 'Patriotic' bond), the freezing of bank accounts (the so-called 'Corralito') or the semi-coerced restructuring of domestic debt. Eventually, all these late attempts to save the Convertibility regime failed, and on December 2001 the authorities were forced to default and float the peso. The desperate measures adopted in the weeks leading to the default proved to be not only ineffective, but also markedly harmful given their amplifying effect on the economic dislocation caused by the crisis.

2.1.2 THE RESTRUCTURING

Prior to defaulting on its international bonds in December 2001, the Argentine government went at great length to mobilize domestic sources of finance in order to substitute for the gradual loss of access to external sources of credit. This included the exertion of moral suasion on domestic banks, pension funds and large firms to acquire government paper[1] and financial engineering operations aimed at alleviating short term liquidity pressures[2]. The most heavy-handed measure to involve domestic creditors in this crisis resolution effort, however, was the November 2001 'voluntary' exchange of bonds held by residents for 'guaranteed' loans, which marked the beginning of the Argentine debt restructuring process.

Originally, the government's strategy was structured in two stages in order to differentiate between domestic and external creditors. During phase I of the restructuring, the government would exchange debt held by residents introducing some guarantee on the resources needed to honour the new debt, and during phase II it would restructure the debt held by non-residents, presumably without such an explicit guarantee. Following that plan, in November 2001 domestic federal debt with a face value of approximately US$ 41 billion (and an additional US$ 10 billion provincial debt) was exchanged for loans collateralized with revenues from the financial transaction tax. This operation reduced interest payments while expanding maturities, implying an NPV loss of around 26%[3]. The November exchange was backed by various incentives such as the tax collateral, the possibility for banks and pension funds to value the new debt at par rather than marked to market or the option of claiming back the original bonds in the event of a modification in the conditions attached to the guaranteed loans. Eventually, however, the exchange was largely subscribed because of the implicit threat of coercively restructuring holdout creditors' debt in worse terms. In fact, some observers interpreted the November exchange as a technical default on domestic debt.

Ultimately, the Argentine authorities could not complete phase II of the restructuring as originally envisaged. Indeed, the December 2001 political upheaval precipitated events, and the authorities comprehensively defaulted on their non-official external obligations soon after completing phase I of the restructuring. At that time, the volume of debt in default

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1. Including the notorious 'patriotic' bonds issued in April 2001 for an amount of US$2 billion.

2. In June 2001 the Argentine authorities completed a 'mega-swap' involving US$29.5 billion of old bonds for new instruments. This operation involved a relief of about US$15 billion in undiscounted cash payments for the period 2001-2005. However, it increased debt repayments after 2006 by approximately US$65 billion. Overall, this operation carried an NPV gain which has been estimated by the IMF to be in the range of 2 to 28%.

3. On top of the NPV loss, the exchange carried a liquidity loss because there was no secondary market for the new debt instruments.

amounted to US$66 billion, barely affecting residents. In March 2002, however, the government 'pesoized' guaranteed loans at a rate of 1.4 pesos to the dollar (the peso/dollar rate was close to 1.9 at that time), and many domestic creditors exerted their right to claim back the original bonds following a modification of the conditions of the guaranteed loans[4]. In some cases, however, this re-swap was quasi-compulsory. This was especially the case for pension funds, which loudly resisted the 'pesoization' and, in retaliation, were forced to re-absorb the old bonds in default. As a result of such actions, the volume of defaulted debt held by residents rose by approximately US$21 billion, most of which was in the hands of pension funds (approx US$17 billion). Adding up past due interests, when the exchange was launched the volume of debt in default had risen to close to US$99.5 billion.

Table 1: Debt stock by the time of default (2001) (US$ billion)

Total public sector debt	**143.8**
External	***87.5***
Official multilateral	31.6
Official Bilateral	4.5
Commercial debt	0.6
Bonds	50.8
Domestic	***56.3***

Source: De Bolle, Rother and Hakobyan.

As mentioned above, one of the crucial characteristics of the Argentine debt restructuring was the protraction of the negotiating process. This was primarily due to the un-cooperative stance of the authorities, the complexity of the debt structure and the heterogeneity and number of involved creditors. In fact, no offer was launched by the authorities until September 2003, coinciding with the IMF-World Bank annual meetings in Dubai, almost 21 months after the default. The so-called "Dubai terms" offered a draconian 75% nominal haircut with no recognition of past-due interests, which would have entailed an NPV loss for investors of close to 90%. After a series of meetings with international investment banks and other representative bondholders' groupings, the terms of the debt exchange offer were somewhat softened and past-due interest partially recognized. Eventually, a final offer was launched in January 2005 giving bondholders three options:

(i) A par option, under which old bonds would be exchanged at par for a new bond with a 3.2% coupon and 35 years maturity.

(ii) A discount option, which offered an exchange of old bonds at a nominal discount of 66% with an 8.28% coupon and 30 years maturity.

4. Adding up the impact of this forced 'pesoization' to that of the November 2001 debt swap, the NPV loss assumed by domestic creditors would have reached close to 60%.

(iii) A quasi-par option, under which old bonds would be exchanged for consumer price indexed Argentine peso denominated bonds, implying a 31% nominal cut due to pesoization, with a 3.31% coupon and 42 years maturity.

Regarding the currency denomination, under options (i) and (ii) bondholders were allowed to choose between CPI-indexed pesos, US$, euro and yen. An interesting novelty of the Argentine exchange was that a small strip of GDP-linked securities was attached to each bond in order to increase coupon payments should Argentine growth exceed some predefined thresholds. In addition, various legal features were included to discourage holdout creditors such as a "most preferred creditor status" clause stipulating that any future improvement in the conditions of the swap would have to be extended to all of the other participants in the exchange. In an attempt to signal the Government's resolve not to pay hold-outs in full, a debt exchange law was issued in order to raise the bar for reopening the exchange or settling with hold-outs on the side.

The exchange was formally opened in February 2005 and completed by April of that same year. In total, the volume of debt eligible for the exchange amounted to US$82 billion[5]. Eventually, the overall participation rate reached 76%. Although this participation rate is much lower than that of other similar debt workouts, the government considered it sufficient to claim a successful debt exchange. In fact, given the harsh conditions attached to the Argentina offer (the average haircuts in NPV terms have been estimated at 71-75%), this participation rate exceeded expectations. A crucial factor to explain this unexpected participation in the exchange was the mobilization of resident bondholders, close to 96% of which tendered their bonds. The exchange resulted in the issuance of US$35.3 billion of restructured debt: US$15 billion in par bonds, US$11.9 billion in discount bonds and Arg$24.3 billion (about US$8.3 billion) in quasi par bonds. It entailed a substantial simplification of the structure of Argentine debt: from 152 to 11 bond series; from 8 to 4 governing laws; from 6 to 4 currency denominations.

As a result of the exchange, the ratio of federal debt to GDP fell from 148% in December 2002 to 72% in April 2005. This figure, however, does not take into account the post-restructuring arrears stemming from holdout bondholders. These post-restructuring arrears amounted to close to US$20 billion in July 2005. In addition, the partial recognition of past due interests generated interest arrears of approximately US$6 billion. These post-restructuring arrears are still unresolved. In addition, partly as a result of the Argentine move to disengage from the Fund, and given that the authorities did not reach a restructuring agreement with its bilateral creditors when an IMF-supported program was in place in 2003 and 2004, arrears with the Paris Club have not been settled yet[6] . At the current juncture, and given the Argentine government's rhetoric, the prospects of Argentina signing an IMF supported program, a pre-condition for a Paris Club treatment, are unclear.

2.1.3 IMF INVOLVEMENT

The Argentine case illustrates the potential conflict of interests that a large financial exposure to a country that defaults on its sovereign debt can generate for the IMF. Indeed, because there was a real risk of Argentina defaulting on its large obligations to international financial institutions, the Fund's leverage to influence the outcome of the private debt restructuring was much weakened all through the post-default phase

5. The difference with the aforementioned US$99.5 billion was due to the fact that past due interest were only partially recognized.

6. Total obligations to the Paris Club amount to US$6.3 billion.

of the crisis. This materialized in pressures to roll-over Argentina's obligations to the Fund, the setting of relatively soft conditions in successive programs and a certain leniency as regards the vigilance over the fulfilment of these conditions. In addition, since investors interpreted the IMF as being 'hostage' to the Argentine authorities and primarily concerned with the preservation of its preferred creditor status, the Institution was placed in an awkward position to provide independent analysis or mediate between Argentina and its private creditors.

As shown in Table 2, the IMF had been continuously involved in Argentina since 1991. Furthermore, the Fund's financial exposure to that country exhibited a rising trend, especially at the turn of the century. In retrospect, these successive programs have been heavily criticized primarily for the weak enforcement of fiscal conditionality and for their insufficient structural content. Indeed, quantitative deficit targets were frequently missed since 1994, in spite of which waivers were consistently granted. As a result, the IMF somewhat emerged from the Argentine meltdown as co-responsible for the policy inadequacies that resulted in the crisis, which tended to de-legitimize the Institution as a crisis resolution agent during the restructuring process.

The IMF-supported program in place at the time of the December 2001 default was a 2000 SBA originally approved for an amount of US$ 7.2 billion (SDR 5.4 billion) and duration of three years. This program was originally intended to be treated as precautionary, its main objectives being to support the government's fiscal adjustment effort and to buttress investors' confidence. However, by end-2000 it was already clear that this program had failed as Argentina showed no sign of controlling its debt problem and had effectively lost access to international financial markets. This set the stage for the most contentious decisions regarding the IMF's involvement in the Argentine crisis: the 2001 augmentations, which consolidated the Fund as Argentina's largest single creditor, almost tripling its financial exposure to that country. It has often been argued that these augmentations had the effect of delaying the inevitable, postponing the default and amplifying the dislocation caused by the crisis.

Table 2: IMF programs in Argentina

	Approval	**Expiration**	**Amount**	**% of quota**
SBA	Jul 91	March 92	SDR 789mn	70.1
EFF	March 92	March 96	SDR 4020mn	361.2
SBA	April 96	Jan 98	SDR 720mn	46.8
EFF	Feb 98	March 00	SDR 2080mn	135.3
SBA	March 00	Jan 03	SDR 16937mn	800
of which SRF	Jan 01	Jan 02	SDR 6087mn	287.5

Source: IMF.

The first augmentation, approved in January 2001, brought the total amount of resources committed by the IMF up to US$13.7 billion (SDR10.6 bn), of which one fifth

was provided under the SRF[7]. This was combined with commitments from other IFIs and the government of Spain. In addition, Argentina was allowed to purchase the un-drawn amount under the SBA, and conditionality was revised with a focus on the acceleration of growth and the reinforcement of medium term fiscal discipline. At the time, the bet was that Argentina could grow out of its debt problem and that an exceptional injection of official finance combined with a re-invigorated adjustment effort could still restore access to international financial markets. Again, this strategy failed, partly as a result of the authorities' inability to implement a credible adjustment package and to meet the program's fiscal targets. However, in spite of the weak implementation of the revised program, and for fear of precipitating events, the IMF did not suspend disbursements and the successive program reviews were approved, implicitly bringing support to the government's increasingly heavy-handed measures to save the convertibility regime and avoid default. The final act in this 'gamble for resurrection' was the September augmentation which brought total commitments under the IMF program up to US$22 billion (SDR 17.5 billion). This augmentation coincided with the fourth program review, which already considered the possibility of using the Fund's resources to support a sovereign debt restructuring. Eventually, however, in the face of obvious policy slippages, the fifth review was never completed. Soon after the suspension of the Fund's financial support Argentina defaulted and abandoned the convertibility regime, giving way to a new phase of the crisis.

After the December 2001 events, the relationship between Argentina and the IMF entered a limbo. Throughout 2002 the program was de-facto suspended and re-purchase expectations were extended in order to avoid an Argentine default on its obligations to the IMF. In the meanwhile, the Argentine authorities justified the protraction in the initiation of the restructuring process by the lack of an on-track IMF program.

Eventually, in January 2003, a 'transitory' 7 month program was approved for an amount of SDR 2174.5mn (US$ 2980 mn or 103% of quota). Again, this program was primarily aimed at avoiding an Argentine default on its IMF loan: combined with a further extension of repurchase expectations, it covered Argentina's payment obligations to the Fund until August 2003. Together, these measures constituted a de facto roll-over of SDR 4.94bn (US$6.78bn) in payment obligations. The program's conditionality was soft, setting quantitative performance criteria only for the first two months of its implementation, contemplating a primary surplus of 2.5% of GDP and some limited but well-targeted structural measures such as the preparation of draft legislation for a fiscal reform, regulatory actions targeted at the banking system and the appointment of an external advisor to carry out the debt restructuring. Given that the transitory program was approved under the policy of Lending Into Arrears, IMF disbursements were supposedly made conditional upon the authorities' good faith vis-à-vis its private creditors. However, although the first relevant contacts between the government and its bond-holders coincided with the implementation of the transitory program, few measures were taken to advance with the restructuring process. In fact, the Argentine authorities continued arguing at the time that this program was insufficient to set the parameters for a normal offer-counteroffer process.

As mentioned above, the first formal restructuring offer was launched in September 2003 with the so-called Dubai terms. This coincided with the approval of a new IMF-supported program: a three year SBA giving access to US$12.55 billion (SDR8.98 billion or 424% of quota). Again, this move left the Fund's exposure to Argentina essentially

7. The relatively low proportion of resources committed under the SRF was aimed at easing the terms of the Fund's financial support.

unchanged and, thereby, constituted a de facto rollover of Argentine obligations to the IMF. The program established a primary surplus floor target of 3% of GDP for 2004, leaving it to be determined for years 2005 and 2006. In addition, the 2003 SBA envisaged monetary policy to be focused on price stability, with the central bank moving towards an inflation targeting framework by end-2004. On the structural front, the program contemplated a fiscal reform and the modernization of the tax administration, the establishment of an intergovernmental revenue sharing system, the phasing out of distortionary taxes and the introduction of a fiscal responsibility law. Regarding the banking system, the program envisaged the compensation to banks for the effects of the asymmetric pesoization of their assets and liabilities. Finally, the Argentine authorities committed to establish a sound regulatory framework for the utility sector as well as the re-negotiation of contracts with concessionaries.

A central feature of the 2003 SBA which differentiates this case from most of the other restructurings analyzed here was that the program's macroeconomic framework restrained from specifying a domestic adjustment path. Indeed, it only included a short-term fiscal target for 2004 which was interpreted as a minimum threshold rather than as an objective in its own right[8]. In fact, Argentina recorded in 2004 a primary surplus of 5.1% of GDP, much larger than the 3% target contemplated in the program. As a result of this lack of a medium-term macroeconomic framework, the program provided no guidance about the Fund's views on the desirable outcome of the restructuring. The burden distribution between domestic adjustment and private sector involvement, therefore, was entirely left to be determined by the negotiations between the Argentine government and its private creditors.

The implementation of the 2003 program was, again, rather weak. On the macroeconomic side, monetary policy became a contentious issue as the Central Bank carried out a series of unsterilized interventions in the foreign exchange market which resulted in inflationary pressures. In addition, progress was slow in the implementation of the program's structural agenda, especially with regard to fiscal reform and with the renegotiation of contracts with utility firms. However, the first two reviews of the program were completed.

Regarding the IMF's role as a provider of information, a debt sustainability analysis was published in December 2003 when negotiations with private creditors were still ongoing. The baseline scenario of this DSA assumed, i.a., a constant primary surplus of 3% for the period 2004-2010, the maintenance of IFIs' exposure to Argentina, and a rollover of obligations to Paris Club and other creditors. Under these assumptions, it predicted large financing gaps: 6% of GDP during 2004-2006, and 3.5% in the following years. This was due to the fact that debt service would consume 3.3% of GDP in 2005-2006 (the last two years of the program) and would rise to 4% in the following years (until 2010). Therefore a primary surplus of 3% of GDP was deemed insufficient to cover payments after 2004. This baseline scenario was especially sensitive to reductions in rates of GDP growth, depreciation of the exchange rate or higher interest rates. Notwithstanding these sensitivities, primary surpluses seemed to be the most influential variable, and the analysis shed doubts on the capacity to service debt on a sustained basis without a re-invigorated fiscal effort or a broader debt restructuring.

8. Some observers argued that this fiscal target was only set to secure the resources needed for Argentina to honour its obligations to the IMF.

In August 2004, the IMF agreed with the Argentine authorities to suspend the program and to resume negotiations for its third review only after the completion of the restructuring. This was primarily a consequence of the increasing reluctance by the IMF to approve the program's reviews given the substantial delays in the implementation of its structural agenda. In addition, there was enough ground at the time to argue that Argentina was not negotiating "in good faith" with its private creditors. However, to some extent the suspension of the program was also brought about by Argentina's reluctance to define a medium-term fiscal framework so as to specify a path for domestic adjustment. Indeed, the Argentine authorities began to view the IMF's pressure to define such an adjustment path as potentially getting in the way of bondholders' acceptance of its restructuring offer. In this context, the best solution for the authorities was to obtain the roll-over of its obligations to the IMF under a suspended program. This was obtained with two successive extensions of repurchase expectations: in September 2004, the IMF approved a one year extension of repurchase expectations for SDR 779 million (US$ 1.1 billion) and another one-year extension of Argentina's repayment expectation to the IMF arising between May 05 and April 06 for SDR 1.68 billion (about US$ 2.5 billion) was approved in May 2005. These extensions were conceded partly because of the veiled Argentine threat of defaulting on its multilateral obligations should it be forced to repay prior to the completion of the restructuring, illustrating the Fund's limited leverage at that time of the crisis.

Although in June 2005 the IMF announced that it was ready to negotiate a new program, Argentina opted not to renew the arrangement. Instead, in January 2006 the authorities anticipated the cancellation of the 2003 SBA and repurchased the entire stock of IMF credit (about US$ 9.9 billion). This was made possible by a marked improvement of Argentina's external position brought about by the depreciation of the peso, a boom in commodity prices and the ensuing improvement in terms of trade. Various other factors contribute to explain Argentin's decision of not using a transitory program to soften its exit from the Fund's financial support. First of all, this decision is likely to have been politically motivated, given the government's anti-IMF rhetoric at the time. Second, the authorities made clear that certain structural requirements would not be accepted, without which it would have been difficult for the IMF to concede a new program. Finally, given the presence of post-restructuring external arrears, the new program would have been approved in the context of the policy of Lending Into Arrears. However, the government made it clear during the restructuring process that it would not settle with holdout creditors and, in fact, a law was passed specifically for that purpose. As a result, it was clear that, should a new program be approved, Argentina would have continuously been in breach of the 'good faith' criterion.

2.1.4 RECOVERY FROM THE CRISIS

In the years following the default, Argentina has experienced a robust economic recovery with yearly GDP growth exceeding 9% between 2002 and 2005. In fact, by the end of 2005 real output reached its pre-crisis levels. To a large extent, this recovery has been favoured by developments in the external sector such as a marked improvement in Argentina's terms of trade (around 10% between 2002 and 2004), buoyant liquidity conditions in international financial markets, historically high commodity prices and strong economic activity in some of Argentina's main trading partners. After year 2001 the current account changed sign and exhibited significant surpluses: 8.5% of GDP in 2002 and 5.8% of GDP in 2003 (see graph 1.5). The turnaround in Argentina's balance of payments position has allowed the central bank to accumulate foreign exchange reserves on a significant scale: from around US$15 billion in 2002 to US$28 billion in 2005. Another factor that has contributed to the Argentine recovery has been the behaviour of the domestic financial system.

Indeed, after 2003 both domestic credit to the private sector and the level of deposits stabilized and have shown signs of recovery thereafter (see graph 1.7).

Another positive development after the 2001 default has been the behaviour of public finances. Argentina has consistently registered substantial primary surpluses in recent years with a record of 5.1% of GDP in 2004, and 4.4% of GDP in 2005. Together with the effects of the debt restructuring, this has contributed to the positive dynamics of sovereign debt: the stock of federal debt has fallen from 148% of GDP in December 2002 to 72% of GDP in April 2005 (see graph 1.3). Along with the 2006 Article IV consultation, the IMF published a debt sustainability analysis for Argentina which presented a scenario in which the Argentine economy experiences a soft landing in the short-term and sustained growth in the medium term[9]. Under such a scenario, debt dynamics would prove to be sustainable, and the stock of federal debt would fall to 42% of GDP by year 2010. In addition, the DSA carried out a series of sensitivity tests showing that as a result of the long average maturity of the post-restructuring debt, shocks affecting market borrowing costs would have a relatively minor impact on the underlying debt dynamics.

On the negative side, there has been a slow progress with the implementation of structural and institutional policies, raising doubts about the medium-term sustainability of the robust growth path registered in recent years. In addition, monetary policy has been heavily criticized (among others by the IMF) for being too accommodative. In spite of the depreciation of the currency by almost 300%, inflation was kept under control in years 2003 and 2004. However, more recently, inflation has become the main current challenge to Argentina's macro-stability, having reached 10% in 2005 and 8% in 2006. Finally, another challenge in the medium-term is the lack of discernible efforts on the part of the Argentine authorities to reach a collaborative agreement with holdout creditors. As a result, a substantial stock of debt still remains in default, which could stand on the way of a full normalization of Argentina's standing in the international financial community.

Regarding the restoration of market access, the evolution of the EMBI shows that Argentine spreads remained well above 1000 bp until the restructuring was completed in April 2005. After that date, however, spreads fell dramatically and, in a matter of days, reached their pre-crisis level (see graph 1.8). Argentina placed its first international bond one year after the closure of its debt exchange. All in all, this would suggest that Argentina has managed to restore its perceived creditworthiness in international financial markets.

2.2 Belize

On February 2007 Belize completed the restructuring of its private external debt. In total, various instruments with a face value of US$571 million were exchanged for a single bond, significantly improving the servicing profile of Belize's debt at no nominal cost for investors. This case study is of relevance to our analysis for various reasons. First of all, for the first time ever, collective action clauses (CACs) were used to facilitate the restructuring of a bond governed under New York law. Second, as opposed to all of the other cases covered here, the IMF played a relatively minor role in this debt workout. Indeed, the Belizean authorities opted not to request the Fund's financial assistance to back the restructuring, although the IMF did play a role as a provider of information and technical assistance. In spite of this

9. This is under assumptions of fiscal and monetary tightening (primary surpluses between 3-4% in the 2004-2010 period, and average real interest rate shifting from negative 3.1 to positive 2.1) combined with some appreciation of the currency and good progress in structural reforms. In this scenario, growth performs a gradual slowdown and so does inflation.

marginal IMF involvement, all in all Belize's debt restructuring can be considered a success given its market-friendly approach, the almost universal participation of creditors in the exchange, and the substantial alleviation of liquidity pressures that it entailed. However, concerns remain about the medium-term sustainability of Belize's debt, rating agencies having barely upgraded Belize's international bonds and still warning about a high risk of default. In addition, this debt restructuring has to be assessed against a background of unusual buoyancy in international financial markets, which substantially facilitated the process.

2.2.1 THE DEBT CRISIS

As a result of a reconstruction effort following a series of hurricanes and of an attempt to revitalize the economy through public spending, Belize's stock of external public sector debt almost quadrupled since the late 90's and the launching of the debt exchange: from US$ 260 million (about 40% of GDP) in 1998 it jumped to close to US$1.000 million (about 100% of GDP) in 2005 (see Appendix 1, graphs 2.2, and 2.3). As rating agencies successively downgraded Belize, the cost of refinancing this debt rose substantially, and prior to the debt workout the average effective interest rate stood at 11.25%. In addition, this debt's amortization profile was highly uneven with sharp spikes in the period between 2005 and 2015, and especially in 2007 and 2012. By 2005, and in spite of the government's effort to tighten fiscal policy (the deficit was brought down from 8% of GDP to about 3% of GDP), interest payments were absorbing 30% of Belize's fiscal revenues, and close to 50% of its foreign currency earnings (see graph 2.4).

This fiscal expansion was sided by a massive widening of the current account deficit, which exceeded 15% of GDP a year between 2000 and 2003 (see graph 2.5). As the stock of foreign exchange reserves fell to dangerous levels, it became increasingly clear that the fiscal problem could degenerate into a currency crisis potentially forcing Belize to abandon the fixed exchange rate regime which has constituted a cornerstone of its macroeconomic policy since independence in 1981.

2.2.2 THE RESTRUCTURING

In August 2006 the Belizean authorities announced their intention to seek a cooperative agreement with external creditors to restructure sovereign debt. At that time, Belize's stock of official debt stood at close to US$1.1 billion, 90% of which was external. Leaving aside bilateral and multilateral official creditors (US$364 million), the debt instruments eligible for the restructuring (6 international bonds with maturities ranging from 2008 and 2015, and various loans and suppliers' credits) had a face value of US$ 571million.

The Belizean restructuring was primarily motivated by a concentration of debt servicing obligations in early 2007. Although the restructuring was a preventive one and the authorities managed to avoid a broad-based default, some arrears were accumulated on specific debt instruments. Indeed, in September 2006, the authorities missed a payment on two special purpose vehicles which were part of an issuance of insured bonds. In addition, coinciding with the launching of the formal debt exchange offer in December 2006, the government temporarily suspended debt service payments until the time of the official closure of the exchange. In return, it offered to pay accrued interest and principal payments up to the closing date of the exchange as a "participation fee" to participating creditors.

Table 3: Debt stock at end-2005 (US$ million)

Total public sector debt	**1109.7**
External	***970***
Bilateral Bonds	163.4
Bonds	491.75
Commercial Banks	106.95
Multilateral	207.2
Suppliers credit	0.7
Domestic	***139.7***

Source: Central Bank of Belize.

After various consultations with external creditors, on December 18, 2006 the government launched its exchange offer: a new single bond with a 22 years maturity for all existing debt instruments held by external private creditors. Principal repayments on the new bond would be made in equal semi-annual instalments beginning in 2019 and finishing at maturity in 2029. The new bond would carry a step-up interest rate structured as follows: 4.25% in years 1-3; 6% payable in years 4-5; 8.5% payable from year 6 to maturity.

The tender period was to close officially on January 2007, although it was eventually extended until February in order to allow 'late' creditors to take part in the exchange. Ultimately, holders of 97% of Belize's debt voluntarily tendered their claims. In addition, the authorities used the collective action clause in order to apply the terms of the restructuring to the un-tendered notes in one of the debt instruments[10] as a result of which over 98% of Belize's debt could be exchanged. The high participation rate in Belize's debt exchange was facilitated by various factors: the substitution of various instruments for a single one improved liquidity conditions for investors; Belize's debt instruments were trading at deep discount and the exchange carried only moderate NPV losses, being primarily aimed at bridging amortization spikes in 2007, 2012 and 2015[11]; buoyant liquidity conditions in international financial markets encouraged participation; the government's transparent and cooperative stance, together with a tradition of strong credit culture favoured the success of the exchange; a timely communiqué from the Belize Creditor's Committee from Trinidad and Tobago announcing their full participation in the exchange encouraged other investors to follow suit.

In the case of Belize, the authorities did not seek to restructure bilateral debt. In fact, although bilateral obligations vis-à-vis countries such as Taiwan and Venezuela were significant, Paris Club debt was marginal, amounting to only US$15 million at the time of

10. The CAC was used on a 9.75% note due in 2015 with a face value of US$100 million.

11. We have calculated the overall NPV loss imposed by the restructuring on 6 international bonds with a face value of close to US$333 million (58% of total restructured debt). According to our calculations, the NPV loss associated with Belize's debt restructuring ranges between 1% if we use a discount rate of 5%, and 28% if we use a discount rate of 10%.

the crisis. In addition, the authorities discriminated in favour of domestic creditors, which were spared from the restructuring.

2.2.3 IMF INVOLVEMENT

No IMF-supported program was approved to back Belize's debt restructuring. From the outset, the authorities were reluctant to signing an adjustment program, partly because of the stigma that could have been attached to it, and partly because of the fear of being pressed to abandon the peg to the US dollar. However, Belize did involve the IMF in its roles of advisor, provider of technical assistance and provider of 'independent' information. Indeed, the second round of consultations with private creditors was launched right after the publication of Belize's Article IV in October 2006. At that time, the government disclosed various possible debt restructuring scenarios (equivalent to a DSA), which were constructed upon the macroeconomic scenarios envisaged by the IMF in the Article IV report. In addition, the IMF's Managing Director issued a letter of comfort to international investors supporting participation in Belize's debt exchange.

Part of the reason why Belize's government did not request the Fund's financial assistance was that it managed to secure financing from other official sources, namely the Inter-American Development Bank and the Caribbean Development Bank (US$25 million each), and other bilateral sources (ROC/Taiwan US$30 million and Venezuela US$50 million). This financial assistance was instrumental for the government to honour its external obligations and to rebuild the stock of international reserves.

2.2.4 RECOVERY FROM THE CRISIS

The Belizean debt exchange can be considered a success given that it eliminated the repayment peaks which were to occur between 2005 and 2015. Indeed, as a result of the restructuring, foreign exchange outflows stemming from the servicing of external debt are projected to fall by an average of US$48mn (US$431 cumulative) in between 2006 and 2015. However, the macroeconomic outlook for 2007 and beyond remains a source of concern. While the debt servicing relief achieved with the restructuring can only have a positive impact, significant challenges are still to be addressed in order to ensure a stable medium-term macroeconomic environment, all the more so given Belize's vulnerability to natural disasters and terms-of-trade shocks. In this light, the IMF's 2006 Article IV consultation report argues that a sustainable medium-term framework should not only build upon the debt relief which has already been secured, but also upon a combination of fiscal discipline, continued monetary tightening, bilateral and multilateral financing and the implementation of a set of structural reforms.

Concerns about the sustainability of Belize's post-restructuring debt have also been expressed by other market participants. For instance, Moody's 2007 annual report argues that, in spite of the liquidity relief provided by the restructuring, there is still a high risk of Belize defaulting on its international obligations. The report stresses the little room for manoeuvre enjoyed by the government to implement counter-cyclical fiscal policies in response to the frequent shocks undergone by the Belizean economy.

As the time series for Belize's EMBI do not begin until March 2007, we can not assess the impact of the restructuring on that country's spreads. Nor can we assess movements on the EMBI after the latest issue, which took place in late February 2007. Graph 2.8 in Appendix 1 shows the evolution of the EMBI since March 2007, highlighting the date in which the aforementioned Moody's report was made available. As we can see,

this report did not result in any significant move in the EMBI, which could be interpreted as an indication that the market was already aware of Belize's weaknesses. There has been a steady rise in the EMBI since July 2007. However, it is difficult to disentangle the factors behind that trend. It may be that the unleashing of a global financial turmoil following the sub-prime crisis had an impact in that respect.

2.3 Dominican Republic

In between April 2004 and October 2005 the Dominican Republic successively renegotiated the terms of its bilateral official debt (Paris Club), two series of international bonds, and its commercial debt (London Club). This comprehensive restructuring enabled the government to bridge intense liquidity pressures and set the stage for a recovery from the severe financial crisis that had erupted in 2002. Various factors contributed to the success of the Dominican restructuring. First of all, the authorities' market-based, transparent and cooperative stance, together with the moderate losses associated with the restructuring, contributed to gather the support of international creditors, conscious of the risk of a costly sovereign default. In addition, the restructuring was facilitated by a well established institutional framework articulated around an IMF-supported program and two Paris Club treatments, which somewhat legitimized the private debt workout while establishing the parameters of the agreement eventually reached with private creditors.

2.3.1 THE DEBT CRISIS

After a decade of impressive economic growth, the Dominican Republic underwent a severe recession in 2002-2005 (see Appendix 1, graph 3.1). The situation started to deteriorate in the aftermath of the September 11 attacks with a fall in tourism and exports receipts. However, the Dominican crisis was primarily rooted in the mishandling of a banking crisis. Problems began when the second largest private bank (Baninter) experienced liquidity needs in 2002, to which the Central Bank responded with the provision of LOLR support on a significant scale. In 2003 the situation worsened when fraud and extensive accounting malpractices were unearthed in that same bank, further feeding deposit withdrawals (see graph 3.7). Although the authorities tried to contain the crisis by intervening Baninter and bailing out its depositors, the situation got out of control when the run on deposits extended to other banks, forcing the monetary authority to continue pumping liquidity into the system.

A central problem with the management of the crisis was that the liquidity support extended to the troubled banking system was not sterilized, thus generating intense inflationary pressures (see graph 3.1). Together with the financial panic, this deteriorating macroeconomic environment triggered capital flight, depleting the stock of foreign exchange reserves and setting the stage for an attack on the Dominican peso which depreciated by 66% in 2003 and by 37% in 2004 (see graph 3.5). The twin banking/currency crises brought about a sharp rise in the debt to GDP ratio, which more than doubled from 27% in 2002 to 56% in 2003 (see graphs 3.3, 3.2 and 3.4). This surge in indebtedness was due to the massive assumption of liabilities in the context of the government' banking crisis resolution strategy (bailout to depositors, liquidity support to troubled banks), but also to the impact of a depreciating peso on the stock of government debt, of which about two thirds was external and denominated in foreign currency.

2.3.2 THE RESTRUCTURING

As a result of the aforementioned self-fulfilling dynamics, the Dominican Republic began to experience severe liquidity pressures and fell into arrears with its bilateral official creditors

in 2003 and with some of its commercial creditors in 2004. During that same year, the authorities launched a debt restructuring process in order to settle pending arrears and to restore the sustainability of the debt repayment profile. This restructuring was preventive given that, in spite of the aforementioned relatively minor arrears, the government remained broadly current in the servicing of its external debt. The authorities opted to initiate the restructuring with the Paris Club so as to clear the arrears accumulated on bilateral debt since 2003 and to set the tone of the deal to be reached with private creditors. Eventually, a first agreement was signed in April 2004. Under this treatment, the Paris Club rescheduled the repayment of close to US$ 193 million, including arrears as of December 2003 and maturities falling due in 2004.

Table 4: Public Debt stock before the restructuring process (end-2003) (US$ million)

Public external debt	**5987**
Bilateral official	3676
Multilateral official	1983
Other official	1692
Bank loans	803
Bonds	1100
Supplier's credit	409

Source: Central Bank of the Dominican Republic.

In parallel with the ongoing negotiations with the Paris Club, the Dominican authorities launched a consultative process with private creditors in order to explore options to restructure private external debt. This was aimed at seeking further liquidity relief, in compliance with the Comparability of Treatment clause attached to Paris Club treatments. As a result, a few days after the signing of the Paris Club treatment, the government launched an offer to exchange two outstanding international bonds: a first one maturing in 2006 with a face value of US$500 million, and a second one maturing in 2013 and a face value of US$600 million. Under this offer, the authorities proposed a 5 year extension of maturities and a temporary capitalization of interest payments coming due in 2005 and 2006. The exchange involved no nominal principal or interest haircut. It was therefore aimed at providing some short-term liquidity relief, and carried an NPV loss estimated at only 1%.

In order to encourage participation in the exchange, the Dominican authorities included some disincentives to holdout creditors, such as the introduction of exit consent clauses, or the de-listing of the old instruments from the Luxemburg stock exchange in order to reduce their liquidity. In addition, the new bonds included CACs as well as cross-default clauses. However, the main incentive to tender the Dominican bonds stemmed from the risk of a default should the debt workout fail. This was explicitly stated by the authorities, which indicated in the exchange offer memorandum that the Republic "*may not be able, or could decide not to continue to make payments on existing bonds that are not tendered in the offer*". Furthermore, in order to convey a sense of urgency, the authorities threatened with missing coupon payments coming due in March 2005. Although the debt exchange

was officially to close on May 4, 2005, it was re-opened in June 2005. Ultimately, participation in the exchange reached 97%.

A third step in the Dominican restructuring was the re-negotiation of outstanding debt owed to international commercial banks. The Dominican Republic had fallen into arrears with this category of creditors in 2004 for an amount close to US$45 million. Eventually, two memoranda of understanding were signed with the London Club in June and October 2005 in order to settle arrears and to reschedule US$198 million in principal falling due in 2005 and 2006. The agreement established a two year grace period, with semi-annual amortizations resuming in mid- 2007. In line with the previous restructuring of bonded debt, the agreement with the London Club carried practically no NPV loss (the IMF has estimated it at 2%) and was primarily aimed at bridging short-term liquidity pressures. By that time, the Dominican Republic had cleared all pending external arrears[12].

Finally, in October 2005, a second agreement was signed with the Paris Club. This new treatment involved the rescheduling of bilateral debt for an amount of US$137 million, including maturities falling due in 2005. The restructuring of London Club debt was a pre-condition for this second treatment, in compliance with the Comparability of Treatment clause. Overall, this completed a restructuring of a volume of external debt of US$1628 million (7% of GDP) carried out over a period of 18 months.

2.3.3 IMF INVOLVEMENT

As opposed to some of the other cases analyzed here, the Fund's involvement in the Dominican Republic had been rather mild in the years leading to the crisis. In fact, no IMF-supported program had been in place in the Dominican Republic since 1994. However, as the situation deteriorated in 2003, the Dominican authorities approached the IMF for assistance, and a crisis-resolution program was eventually signed in August 2003. This was a 24-months SBA endowed with US$665 million (SDR 437.8 million equivalent to 100% of quota). That program's macroeconomic conditionality was focused primarily on the contention of the combined public sector deficit to 3.5% of GDP in 2003 and 2.5% of GDP in 2004. On the structural front, the program's priority was the resolution of the banking crisis, and included measures such as the congressional approval of a new banking law and of a law on financial crime, the resolution of intervened banks or a plan to strengthen the supervisory framework. The program also contemplated the submission of a tax reform proposal to the Congress aimed at broadening the tax base of income and consumption taxes, eliminate distortions and exemptions, and increase the efficiency of the tax system.

From the outset, the 2003 SBA was weakly implemented. In fact, only the first review of that program could be completed, and even that was made possible by the granting of waivers for the non-observance of several performance criteria. Soon after the completion of that review the program went off-track with large deviations especially on the fiscal front. Part of the problem was the presidential election scheduled for May 2004, which further weakened the government's resolve to put public finances in order. As a result, in 2004 the deficit of the non financial public sector exceeded the program target by as much as 3% of GDP.

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12. However, there were some minor pending arrears with private suppliers such as Unión Fenosa. Under the 2005 SBA program, the authorities committed to clear these domestic arrears.

Table 5: IMF programs in the Dominican Republic

	Approval	Expiration	Amount	% of quota
SBA	Aug. 2003	Aug. 2005	SDR 437.8 mn	100
SBA	Jan. 2005	May 2007	SDR 437.8 mn	100

Source: IMF.

The new government that took office in August 2004 was quick to express a much stronger commitment to fiscal discipline and to the bold measures needed to overcome the financial turmoil. Stressing the rupture with the previous government's policies, the Dominican authorities requested the cancellation of the 2003 SBA, an extension of repurchase expectations and the negotiation of a new program, which was eventually signed in January 2005. The new program had a duration of 28 months and a volume of US$665 million (SDR 437.8 million or 200% of quota). Again, the program's macroeconomic conditionality was centred on the fiscal front, with a non financial public sector balance targeted to evolve from a 0.7% of GDP deficit in 2005 to a surplus of 0.7% of GDP in 2006. The program carried an ambitious structural component, with a focus on institutional strengthening in the fiscal, monetary, banking and electricity sectors. Again, the program contemplated a tax reform along the lines of that already envisaged by the 2003 program. In addition, the program required progress in the completion of the consultative phase of the sovereign debt restructuring.

Overall, the 2005 program was implemented successfully, quantitative performance criteria having been met with some margin, and with a reasonable progress in the implementation of the structural agenda[13]. Given the arrears accumulated with banks in 2004, the new program was implemented in the context of the Fund's policy of Lending Into Arrears. As a result, successive program reviews included financing assurances reviews and the IMF positively assessed the Dominican authorities' commitment to negotiate in good faith with private creditors.

The IMF's involvement in the Dominican debt restructuring went beyond the assessment of the good faith criterion in successive program reviews. During the consultation process that preceded the launching of the debt exchange offer, IMF staff participated in some of the informal contacts held between the Dominican government and its largest bondholders. The presence of the IMF staff in those meetings was primarily aimed at answering questions regarding the program. Prior to these meetings, the Dominican government allowed the IMF to publish the program's letter of intent and the technical memorandum of understanding. Finally, the Fund's Managing Director released a letter to the members of the financial community, supporting the authorities' economic program and stressing that a high participation would be crucial for the Dominican authorities to achieve its financial objectives.

2.3.4 RECOVERY FROM THE CRISIS

The Dominican Republic has experienced a remarkable recovery from the 2003 crisis: GDP growth reached 9.3% in 2005 and surpassed 10% in 2006. To a large extent, this

13. Although various waivers were required as a result of delays in the approval of the budget, the non-approval of laws on procurement and public sector internal controls or the non finalization of a recapitalization plan for the central bank.

turnaround has been brought about by the ambitious economic program implemented by the administration that took office in August 2004. A prudent macroeconomic management has achieved a substantial reduction of inflation (7.4% in 2005 and 5% in 2006) and a fiscal consolidation (primary surpluses have been registered since 2005). Another contributing factor has been the set of structural measures adopted after 2005, especially in the fiscal management's legal framework and in the banking and financial sector. Domestic demand has been a key driver of the Dominican recovery, which has resulted in a widening of the current account deficit. Large capital inflows, however, have more than offset the Dominican Republic's gross financing needs, enabling the central bank to bolster its foreign exchange reserves position.

According to the debt sustainability analyses produced by the IMF in February and September 2007, the Dominican restructuring succeeded in restoring a sustainable debt path. These analyses have been conducted against the backdrop of a positive medium term outlook (average annual growth rates of at least 4%) sustained by the completion of the DR-CAFTA free trade agreement, and by a continuation of the ongoing structural reform effort. Under the baseline scenario considered by the IMF, external debt to GDP ratios should be expected to fall from 25% in 2006 to levels close to 15% in 2014. In parallel, gross external financing needs should fall from about 6-7% of GDP in 2006 to about 3% of GDP in the period 2012-2015. The sustainability of the Dominican debt rests mainly on the maintenance of the fiscal effort achieved in recent years. In addition, the IMF has stressed that these results are particularly sensitive to interest rate shocks and, in general, to a deterioration of the macroeconomic situation.

Graph 3.8 in Appendix 1 shows the evolution of sovereign spreads in the period surrounding the Dominican crisis. After the peaks registered in 2003 and 2004, by the time the debt exchange was announced the EMBI had already fallen below the 1000 bp level and have continued falling thereafter. In fact, the Dominican Republic tapped international financial markets for the first time since the completion of the debt exchange in March 2006 at a spread significantly lower than that prevailing prior to eruption of the 2003 financial crisis. All in all, this would suggest that the Dominican Republic has restored market access relatively smoothly.

2.4 Ecuador

In the summer of 1999 Ecuador became the first country ever to default on its Brady bonds, themselves the product of a previous debt restructuring. This marked the peak of a devastating financial crisis rooted in a combination of long-standing institutional weaknesses, policy failures and a string of adverse external shocks (El Niño floods, low oil prices and the effect of the Asian, Russian and Brazilian crises). In the process, most of the banking sector failed, GDP shrunk by over 8% in one year, an unprecedented wave of outward migration was triggered, the military deposed an elected government, and the US$ was adopted as the national legal tender in a desperate move to stabilize the economy. After a failed attempt to ring-fence the default and restructuring to very specific debt instruments, the authorities launched a comprehensive debt exchange offer in June 2000. Eventually, in spite of the significant losses associated with the restructuring, a high proportion of bondholders accepted the government's offer. The international community played an active role in this process, mostly through the provision of substantial volumes of financial assistance made available only after the default and dollarization had been consummated. A matter of much debate in the case of Ecuador was whether the IMF actively encouraged Ecuador to default and, if so, in what way.

2.4.1 THE DEBT CRISIS

A central factor behind the Ecuadorian crisis was the weakness of the financial system's legal, supervisory and regulatory framework, which materialized in the buildup of severe banking fragilities (widespread connected lending, off-balance currency mismatches and accumulation of non-performing loans). When the economy lost steam in the second half of the 90's (see Appendix 1, graph 4.1), these weaknesses gradually surfaced, fuelling a progressive loss of confidence in domestic financial institutions. In this context, the closure of two mid-size banks (Solbanco and Banco de Préstamos) triggered a run on deposits which engulfed some of Ecuador's largest institutions (see graph 4.7). The Central Bank responded to this unfolding crisis with the provision of emergency liquidity assistance, often extended to technically insolvent banks. Later, however, as the opening of the LOLR window failed to stop the run, the authorities introduced a blanket guarantee in a further attempt to stabilize deposits. Problems in the banking system were compounded by the ill-timed introduction of a 1% financial transaction tax. Indeed, this measure created incentives for households to increase their holdings of cash and for businesses to shift to off-shore accounts to manage their finances, which further fed the liquidity crunch (see graph 4.6). The situation got out of control in the first quarter of 1999 as none of the measures implemented in previous weeks had succeeded in restoring confidence and stemming the flight out of the banking system. Eventually, the government was forced to resort to heavy-handed administrative measures such as a one week bank holiday declared in March, later to be followed by a one-year freeze on deposits and a re-programming of bank loans[14]. As a result, the payment system virtually collapsed.

Ecuador's banking crisis was compounded by a severe run on the sucre which showed no sign of abating until the authorities officially dollarized the economy in early 2000 (see graph 4.5). Indeed, following the floating of the exchange rate in February 1999, the sucre depreciated by close to 200%. Various factors triggered this currency crisis. Most of all, capital flight and currency substitution stemming from the financial panic depleted the stock of foreign exchange reserves (see graph 4.4), exerting unbearable pressures on the sucre. To this contributed the inflationary pressures and general deterioration of the macroeconomic environment caused by the authorities' liquidity injections to the financial system. The large depreciation of the peso unleashed a wave of insolvencies throughout the household and corporate sectors as a result of extensive currency mismatches: all through the 90's large volumes of US$ debt had been contracted by non-dollar earners.

Eventually, the self-reinforcing dynamics unleashed by the crisis also pushed the sovereign into insolvency: the ratio of debt to GDP rose from 81% at end-1998 to 156% in early 2000, with a debt servicing burden jumping from 8.3% of GDP to over 18% during that same period. The deterioration of the fiscal situation was due to the cost of the banking crisis (the government assumed large liabilities to recapitalize banks and to honor guaranteed deposits), to the high proportion of foreign currency denominated sovereign debt, and to the dilution of dollar-GDP stemming from the large depreciation of the sucre (see graphs 4.2, 4.3 and 4.4).

2.4.2 THE RESTRUCTURING

Ultimately, in the summer of 1999 the government defaulted on its sovereign debt. Initially, the authorities tried to ring-fence this default to some very specific categories of debt. In this fashion, Ecuador remained current on past-due-interest (PDI) bonds while missing payments

14. The freeze on deposits was also motivated by the objective of containing the speculative attack on the sucre.

on discount bonds[15]. To do so, the authorities tried to persuade holders of PDI bonds to avail themselves of a rolling interest guarantee which had been attached to these instruments as a safeguard against the risk of a future default. This move, however, was resisted by creditors on the grounds that this guarantee could only apply to a comprehensive default, and not to missed payments on specific debt instruments. Bondholders, therefore, were quick to agree on the activation of an acceleration clause which declared the entire stock of PDIs due immediately. This contributed to poison Ecuador's relations with its private creditors, precipitating events and forcing the authorities to declare a moratorium on the payments of its entire stock of Brady bonds. As already mentioned, this was the first default ever on this type of debt instruments.

In spite of the above, the government tried to preserve a selective approach by persuading holders of Brady bonds to spare Eurobonds from the restructuring. Again, this attempt at discriminating between types of debt failed, and Ecuador was forced to default on its Eurobonds in October 1999. At that time, the external bonded debt in default amounted to US$6.5 billion, (Brady bonds with a face value of US$ 6 billion and Eurobonds with a face value of US$ 500 million), somewhat above 40% of GDP. In addition, Ecuador defaulted on external credit lines of intervened banks. For this concept, in August 2000 the authorities engaged in negotiations with foreign banks to deal with arrears for an amount of US$ 218 million. Finally, the government suspended servicing domestic obligations maturing between September 1999 and end-2000, involving debt with a face value of approximately US$ 346 million. Overall, and without including official bilateral debt, total private claims in default surpassed US$7 billion.

It took almost one year for the Ecuadorian authorities to officially launch a debt exchange offer. The protraction in the initiation of the restructuring process was due primarily to the general chaos undergone in Ecuador during the months that followed the default, with the economic debacle described above and frequent episodes of social and political unrest such as the military coup which deposed elected president Jamil Mahuad. The situation only began to stabilize with the January 2000 dollarization of the economy, and the signing of an IMF-supported program later that year.

The July 2000 offer proposed an exchange of defaulted Brady and Eurobonds for a single dollar denominated Eurobond maturing in 2030. The new instrument would have a step-up coupon starting at 4% and rising by 1% every year up to 10% in 2006 and thereafter. Bondholders were given the option of converting the 30-year bond into a 12 year bond (2012 Eurobond) with a 12% coupon in return for additional debt reduction. The exchange offer also included cash payments for past due interests, past due principal and, where relevant (for some Brady bonds), for the release of their collateral.

The new bonds contained two new features aimed at reducing the chances of a new debt restructuring in the foreseeable future. First, a "*mandatory debt management provision*" was included, committing Ecuador to retire a minimum proportion of the face value of each of the new bonds every year. This would be done either by purchasing that debt in the secondary market or by debt-equity swaps associated with privatization processes. Second, the exchange carried a "*principal reinstatement*" provision which committed Ecuador to issue additional 2030 bonds for the holders of restructured debt should a new default occur in

15. PDI and Discout bonds are two distinct categories of Brady bonds.

the 10 years following the exchange. This was aimed at providing some degree of protection against the dilution of claims by new debt holders in the event of a subsequent default.

Table 6: Debt stock at the onset of the restructuring (1999) (US$ billion)

Total public sector debt	**16.4**
External	***13.4***
Multilateral	4.0
Bilateral	2.4
Commercial	0.4
Bonds	6.6
Domestic	***3.0***

Source: De Bolle, Rother and Hakobyan.

In addition, Ecuador was the first country to include exit consents in a debt exchange. By such exit amendments, bondholders participating in the exchange would automatically give their consent to change various non-payment terms of the old instruments in order to make them less attractive and, therefore, to encourage participation in the exchange. In the absence of CACs, a change in the payment conditions of bonds required unanimity while the non-payment conditions could be changed by simple majority. The amendments deleted the requirement that all payment defaults should be cured as a condition to any decision of acceleration; the provision that restricted Ecuador from purchasing any of the Brady bonds while a payment default is occurring; the covenant that prohibits Ecuador from seeking a further restructuring of Brady bonds; the cross-default clause; the negative pledge covenant; and the covenant to maintain the listing of the defaulted instruments on the Luxembourg Stock Exchange.

The exchange officially closed in August 2000, reaching a participation rate of over 97%. However the government left it informally opened until the end of 2000, which increased final participation over that level. Eventually, holdout creditors were paid in full. The restructuring process resulted in a reduction of close to 40% in the face value of the tendered bonds, and the outcome was the issuance of the two new bonds with a face value of US$ 2,669 billion for the 2030 Eurobond, and US$1.25 billion for the 2012 Eurobond. According to IMF estimates, the restructuring of Eurobonds and Brady bonds carried an NPV loss of 25%. Others have estimated the NPV loss associated with the exchange of the five restructured bonds in the range of 18.9% to 47.2% [Sturtzenegger and Zettlemeyer (2005)].

Domestic bonds maturing between September 1999 and end-2000, in turn, were unilaterally rescheduled by the government. This consisted primarily of a roll-over aimed at alleviating short-term liquidity pressures. Indeed, according to IMF data, the restructuring of that debt carried practically no NPV loss, illustrating the differential treatment granted to domestic creditors in the case of Ecuador. A final step was the restructuring of official bilateral debt. Ecuador had accumulated arrears with the Paris Club since 1996. Eventually, after the completion of the private debt exchange, the Paris Club granted Ecuador a treatment in September 2000 for an amount of US$880 million. This treatment, which

normalized the relationship between Ecuador and the Paris Club, covered arrears as of April 30, 2000 as well as maturities falling due from May 2000 up to April 2001.

2.4.3 IMF INVOLVEMENT

No IMF-supported program was in place in the case of Ecuador at the time of the 1999 default[16]. This is not to say that the IMF had not been involved in Ecuador during the pre-default phase of the crisis. In fact, there had been ongoing negotiations on a new program at least since the fall of 1998. However, no agreement could be reached until April 2000 as a result of the political and social dislocations caused by the crisis and of dissentions over some of the fiscal and banking measures adopted by the authorities in the months leading to the default. A matter of much debate has been whether the IMF actively encouraged Ecuador to default on its sovereign debt. Indeed, it has been argued that, to some extent, Ecuador was a test case for the IMF doctrine of fostering the involvement of the private sector ('bailing-in') in the resolution of financial crises, which crystallized in the adoption of the so-called Prague Framework[17] during the 2000 annual meetings. IMF officials have denied having exerted any influence on Ecuador's decision to default and restructure. In a May 2000 account of the relationship between Ecuador and the IMF, however, Stanley Fisher has recognized that the Fund warned Ecuador that some degree of private sector involvement would be necessary and that the pros and cons of a default were openly discussed.

A turning point in the crisis was the adoption of the so-called 'Law for the Economic Transformation of Ecuador' (Ley fundamental para la transformación económica del Ecuador) on March 2000. This law consolidated the official dollarization of the economy, while outlining a crisis resolution strategy which could form the basis for an IMF-supported program. Consequently, a 12 months SBA was approved in April for an amount of SDR226.73 million (US$304 million or 75% of quota). Soon afterwards other multilateral agencies followed suit: the World Bank approved a US$425 million loan, IADB a US$620 million loan and CAF another US$700 million loan. The IMF program was approved under the Policy of Lending Into Arrears and, therefore, was made subject to the completion of financing assurances reviews and the authorities' good faith in negotiating with private creditors. This policy ceased to apply in May 2001, when the Ecuadorian government completely cleared its arrears with private creditors.

This program's macroeconomic conditionality was rather demanding, targeting a primary surplus of 6.5% of GDP for 2000 which was later revised downwards to 5.5% of GDP. On the structural front, the program focused primarily on the enactment of legal and regulatory measures to support the bank restructuring, and on a tax reform to broaden the VAT base, lower energy subsidies and reduce revenues earmarking. Overall, the program was successfully implemented and the fiscal targets for 2000 were actually outperformed: the primary surplus reached 9% of GDP as a result of a rise in oil prices and of higher than expected rates of economic growth. In 2001, instead there was a worsening in public finances. Progress with the structural measures contemplated in the program was slower mainly because of Congressional opposition to some of the key elements of the fiscal reform. As a result, the approval of the second review of the program was delayed and, eventually, the program was extended until December 2001.

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16. The last program was a 1994 SBA expired in December 1995.

17. The Prague Framework for crisis resolution basically established that the financing gap facing a crisis country should be covered through a combination of official assistance, the catalysis of private capital flows, and private sector involvement.

Table 7: IMF programs in Ecuador

	Approval	Expiration	Amount	% of quota
SBA	May 1994	Mar. 1996	SDR 130 mn	59.3
SBA	Apr. 2000	Apr. 2001	SDR 226.73 mn	75
SBA	Mar. 2003	Apr. 2004	SDR 151mn	49.9

Source: IMF.

During the implementation of the 2001 SBA, the IMF actively encouraged creditors' participation in the debt restructuring process: in the week prior to the completion of the exchange the IMF released a letter from Stanley Fischer to the President of the Ecuador External Debt Negotiations Commission, a commission created by holders of Ecuador's debt. This letter welcomed the progress made by Ecuador and expressed the belief that the exchange would help bring Ecuador's payment obligations in line with its medium-term payment capacity. The Fund, instead, played a somewhat lesser role as a provider of information. Indeed, neither the reviews of the SBA nor the 2000 Article IV consultation were published during the exchange.[18]

2.4.4 RECOVERY FROM THE CRISIS

Eventually, the Ecuadorian economy began to stabilize following the adoption of the US$ as the national tender and the successful completion of the debt restructuring. The government's fiscal consolidation effort translated into a succession of primary surpluses above 4% of GDP in the years following the crisis. This was partly due to the adoption of a new Fiscal Responsibility and Transparency Law in September 2002. Although inflation spiked to 22% in year 2001, it fell quite drastically thereafter, bottoming at 2% in 2004. As a result of the dollarization of the economy and of the relatively high inflation rates registered in its immediate aftermath, the real effective exchange rate appreciated by 39.4% in 2001 and by 11.3% in 2002. This contributed to a reversal of the current account, which turned into deficit in year 2001 (see graph 4.5). Mostly as a result of an increase in oil exports' proceeds, however, Ecuador's external position has gradually strengthened thereafter. The domestic financial system also recovered after year 2000, with private credit to the private sector growing by 17% in 2001 and by 14% in 2002. With the liquidation of five financial institutions failed during the crisis, deposits began to rise quite markedly in 2003 (see graph 4.7). In this more favourable context, the economic decline of the late 1990s could be reversed as positive, albeit moderate, rates of GDP growth were registered at the turn of the century: 2.8% in year 2000 and 5.1% in year 2001 (see graph 4.1).

The IMF has placed Ecuador in an intermediate range in terms of the medium-term vulnerabilities arising from its stock of sovereign debt[19]. In the IMF's baseline scenario, the debt to GDP ratio would decline from 53% in 2003 to 42% by year 2010. This would require the maintenance of primary surpluses in the range of 2-5%. The Fund's sensitivity analyses, however, suggest that vulnerabilities are still pronounced and that a debt to GDP ratio of 70% may be more likely. The sustainability of Ecuador's debt profile is challenged

18. The selected issues publication came out in October, when the exchange was already concluded.
19. *Sovereign debt restructuring and debt sustainability. An analysis of recent cross-country experience,* 2007.

by numerous factors such as the volatility of oil prices, and domestic political instability. In addition, several structural reforms are much needed, such as a fiscal reform to increase the flexibility of the budget, or a further effort to strengthen the banking system.

Graph 4.8 in Appendix 1 suggests that Ecuador has experienced quite a protracted loss of access to international financial markets. In spite of the drastic decline of the EMBI that took place after the completion of the 2000 debt exchange, spreads have remained well above 1000 bp since late 1999 until the beginning of 2004. In October 2005, however, Ecuador did successfully place an international bond for the first time since the crisis at a spread of 700 bp.

2.5 Pakistan

In 1999 Pakistan became the first country ever to restructure its Eurobonds, somehow paving the way for some of the other restructurings studied in this paper. Indeed, this case is often referred to as having changed perceptions about the feasibility of bonded debt workouts: contrary to prior expectations, the first ever such restructuring was a success and over 99% of bondholders agreed voluntarily to participate in the exchange. However, securitized external debt was only a minor component of total debt in the case of Pakistan. In fact, over 90% of the international obligations restructured between 1999 and 2001 were owed to bilateral official creditors while international bonds represented less than 5% of total external debt in 1998. The restructuring of bonded and commercial debt responded primarily to pressures from the official sector to comply with the Paris Club Comparability of Treatment Clause. Also, as a result of a requirement from the Paris Club, the IMF was closely involved in the Pakistani restructuring from the outset, especially as a provider of information and as an 'adjustment agent'.

2.5.1 THE DEBT CRISIS

After a series of nuclear tests carried out in May 1998, the G-7 countries imposed bilateral sanctions on Pakistan and multilateral agencies suspended all new non-humanitarian assistance to that country. These events triggered a loss of investors' confidence which, together with the interruption of official flows, caused a severe balance of payment crisis and pushed Pakistan to the brink of default. However, the crisis can only be understood against the background of the severe structural weaknesses of the Pakistani economy and a mediocre macroeconomic performance all through the 1990s (see Appendix 1, graph 5.1).

Indeed, although positive rates of GDP growth were consistently registered (on average, 4.4% between 1993 and 1999), various indicators suggest that poverty was on the rise throughout the 1990s, partly reflecting intense demographic pressures. In addition, the Pakistani economy has traditionally exhibited a dependence on agricultural output, and thereby a marked vulnerability to exogenous factors related with weather conditions and crops' disease. As a result, the growth path has tended to be volatile. Other structural obstacles to a stable pattern of sustained growth have been a low savings and investment ratio compounded by an inefficient banking system which has hampered financial intermediation, a generally weak institutional framework, the ensuing lack of macroeconomic discipline, and an underdeveloped social and economic infrastructure (see graph 5.7).

Among the major weaknesses of the Pakistani economy was the persistence of sizable budget deficits: on average 7% of GDP between 1993 and 1998. These resulted primarily from a narrow revenue base, an inefficient tax administration, large defence

expenditure and rising interest payments (see graph 5.2). Consequently, the stock of public debt reached 89% and 92% of GDP in 1998 and 1999 respectively, slightly above half of which was held by residents (see graph 5.3). The Pakistani fiscal problem was compounded by the large current account deficits registered during the years leading to the crisis: on average over 5% of GDP during the period 1993-1998. As a result, total external debt stood at 57% of GDP in 1998 and at 63% of GDP in 1999 (see graph 5.5). Over 80% of that external indebtedness was attributable to the public sector and was mostly owed to bilateral creditors and multilateral agencies (see graphs 5.3 and 5.4). The volume of debt owed to commercial banks and of tradable securities was relatively minor: 4.2% and 3.3% of total external debt respectively in 1999.

After the May 1998 events various measures were adopted in an attempt to respond to the looming crisis. On the fiscal side, various subsidies were cut, an effort was launched to reduce planned expenditure, and a revenue sharing agreement was reached between the provinces and the Federal government. The rupee was devalued in June 1998. Soon after, however, a dual exchange rate system was established with a free interbank rate and an official rate applied to a narrow set of transactions. In addition, a number of capital controls were introduced to reduce capital outflows including a freeze on foreign currency deposits (see graph 5.6). On the structural side, the autonomy of the central bank was reinforced, various trade liberalization measures were adopted, a plan to restructure public financial institutions was launched and an effort was made to improve governance and public accountability.

However, by that time it was increasingly clear that Pakistan's debt stock had become unmanageable. Indeed, according to the IMF, at the turn of the century interest payments on public debt were absorbing almost 50% of total government revenues and the servicing of external debt amounted to 64% of current foreign exchange receipts and to almost 13% of GDP. In addition, the share of effective short-term debt stood at about 20% of total debt by the end of the 1990s, exceeding the volume of foreign exchange reserves (US$450 million in November 1998) by a considerable margin. In this context, although Pakistan remained current on its obligations to private creditors, a substantial volume of external arrears began to be accumulated on the servicing of bilateral debt: US$1.6 billion at the end of 1998.

2.5.2 THE RESTRUCTURING

In order to address its debt crisis, Pakistan carried out a debt restructuring which was launched at the end of 1998 and completed by December 2001. Overall, Pakistan restructured debt with a face value of US$19 billion amounting to approximately one third of its GDP at the beginning of the restructuring. The bulk of the debt restructured in this process (about 93% of total) was owed to bilateral official creditors. However, as we shall see in more detail, private creditors were also involved in the Pakistani debt restructuring, primarily as a result of the comparability of treatment clause attached to Paris Club treatments. As a result, Pakistan became the first country ever to restructure Eurobonds. It is worth noting that domestic debt was mostly left out of the restructuring. Indeed, no domestically issued debt instrument was restructured in this process, although residents held about one third of the bonds exchanged in late 1999.

The first step in Pakistan's debt restructuring was the agreement reached with the Paris Club on January 1999. This agreement was made possible by the partial lifting of economic sanctions imposed by the G7 countries. It was endorsed by an IMF paper issued in

December 1998 which outlined a medium-term policy framework and evaluated Pakistan's external financing requirements for the following years, stating it clearly that a rescheduling of sovereign obligations would be required in order to restore debt sustainability. In total, US$3.25 billion of bilateral debt representing about 11% of total external public debt and close to 5% of GDP were rescheduled at that time. This agreement covered pending arrears as well as maturities falling due in 1999 and 2000.

Table 8: Debt stock at the time of default (1998) (US$ million)

Total Public debt	**27088**
Paris Club	10264
Multilateral	12186
Eurobonds+ Foreign currency bonds	915
Commercial Loans	1225
Military debt	1006
Short-term	552
IMF	1415

Source: State Bank of Pakistan, Annual Report 2000-2001

The agreement reached with the Paris Club in January 1999 required the Pakistani authorities to have reached some progress in its negotiations with other private and non-Paris Club bilateral creditors by year-end. Consequently, the authorities approached bondholders in order to obtain a debt relief similar to that granted by the Paris Club. This was to involve the holders of three Eurobond series amounting to US$610 million: a bond maturing in December 1999 with a face value of US$150 million; a bond maturing in May 2000 with a face value of US$300 million; an exchangeable bond with an amount of US$160 million. A first exchange offer was advanced in May 1999, and the tender was eventually launched in November 15th of that same year under the following terms: in exchange for the old bonds, the authorities offered a single bond with a 6-year maturity, a 10% coupon payable semi-annually, a small nominal increase in principal, and a three-year grace period on principal repayments (first principal payment due in December 2002).

By year end the exchange was completed having reached a quasi-universal participation rate: 99% of bondholders tendered their claims. Various factors contributed to the success of the Pakistani restructuring of bonded debt. First of all, the volume of bonded debt and the number of bond holders involved were relatively limited (mostly Middle Eastern financial institutions and retail investors), which facilitated the negotiating process. In addition, the NPV losses associated with this exchange were relatively moderate, ranging between 29.8% and 33.3% for the three bond series [Sturzenegger and Zettlemeyer (2005)]. Another factor was the rating by Standard & Poor's on the new bond, which was better than that for the tendered ones. This basically reflected the fact that analysts viewed the

success of the debt exchange as crucial in order to avoid Pakistan defaulting on its sovereign obligations. It is worth noting that Pakistan's bonds were governed by United Kingdom law and, therefore, carried collective action clauses. These clauses, however, were not invoked during the restructuring. This was a conscious choice on the part of the authorities aimed at avoiding calling a bondholders' meeting which could have channelled opposition to the restructuring.

In parallel with the negotiations to restructure its tradable securities, Pakistan contacted its commercial lenders in order to restructure a number of loans. In July 1999 the Pakistani authorities reached an agreement with the London Club in order to reschedule commercial loans with a face value of US$929 million.

The Pakistani debt restructuring was completed with two further Paris Club treatments. The first one was signed in January 2001, involving bilateral debt with a face value of US$1,752 million. Under this agreement, arrears as of November 2000 together with maturities falling due between December 2000 and September 2001 were rescheduled. The second treatment, signed in December 2001, was much more generous, involving bilateral obligations amounting to as much as US$12.5 billion, the entire stock of Paris Club debt as of November 2001. The State Bank of Pakistan has estimated the NPV reduction associated with this exchange to be in the range of 28-44% (see annual report FY 00/01). The generosity of this last treatment has been attributed to geopolitical considerations after the September 11th attacks and to the role of Pakistan as an ally of the US in the 'war on terror'.

2.5.3 IMF INVOLVEMENT

The IMF was closely involved in Pakistan's sovereign debt restructuring. This partly reflects the relevance of bilateral official debt in that restructuring and the fact that the Paris Club requires the presence of an on-track IMF-supported program in order to grant a treatment. The Fund's involvement in Pakistan, however, was unrelated with the Policy of Lending Into Arrears. This is so because, as mentioned above, although Pakistan accumulated substantial arrears on its bilateral obligations, it remained current on its private external debt. In addition, the volume of financial resources mobilized by the IMF to back Pakistan's debt restructuring were relatively modest in comparison with some of the other cases analyzed here. The main role played by the IMF in this process, therefore, was that of providing a medium-term macroeconomic framework against which to anchor negotiations and restore debt sustainability.

During the 1990s and prior to the launching of the debt restructuring, Pakistan signed successive programs with the IMF. However, these programs' implementation record was rather weak and most never went beyond the first or second tranche releases. The program in place at the time of the launching of the restructuring was an Extended Fund Facility approved in October 1997 combined with an Enhanced Structural Adjustment Facility (ESAF), the concessional facility that preceded the PRGF. Both programs gave access to resources for an amount of SDR 1,137.3 million, equivalent to approximately US$1558 million or 100% of Pakistan's quota. In addition, just prior to the first Paris Club treatment in January 1999, Pakistan made one purchase under the Compensatory and Contingency Financing Facility (CCFF) for an amount of SDR352.7 million in order to compensate for a shortfall in export earnings. This brought the Fund's exposure to Pakistan to 110% of that country's quota.

The conditionality embedded in the IMF program in place at the time of the launching of the restructuring was centred primarily in the fiscal area. The overall budget deficit was projected to fall to 4% of GDP by year 2000. In addition, targets were established on domestic credit and changes in the stock of foreign exchange reserves, and some restrictions were set on the accumulation of debt with a maturity under five years. The program carried quite a demanding structural component focused primarily on the reform of the financial sector, the tax system and the management of public companies. During the first year of the program, the Pakistani economy performed better than expected, especially as regards the behaviour of the current account. The authorities pushed ahead with the financial sector and the deepening of the interbank foreign exchange market. Progress with the restructuring of public enterprises, tax reform or the privatization of financial institutions, instead, was much slower.

In any case, the May 1998 events drastically changed the context in which the IMF-supported program was being implemented. As a result, together with the World Band and the Pakistani authorities, a new medium-term policy framework was outlined in the later months of 1998. This set the stage for a continued access to the un-disbursed resources committed under the EFF/ESAF signed in 1998 and to the CCFF. At this juncture, the IMF clearly stated that in order for Pakistan to meet its sizable residual financing gap for the years ahead, a comprehensive debt restructuring would be necessary. One of the most salient features of the medium-term policy framework issued in December 1998 is that it clearly set a domestic adjustment path, targeting a decline in the overall budget deficit from 5.5% of GDP in 1997/98 to 4.3% of GDP in 1998/99 and 3.3% of GDP in 1999/00. Together with the other structural measures outlined in this document, this constituted the basic framework for the debt treatment granted by the Paris Club in January 1999.

On May 1999, once the Paris Club treatment was already signed and in the midst of negotiations with private creditors, the IMF approved the third review under the EFF (the first one after the divulgation of the new medium-term policy framework) considering that Pakistan had remained broadly in line with its program commitments. In July, however, the program went off-track largely as a result of lags in the implementation of the structural agenda. Nevertheless, this development did not prevent the IMF from issuing a comfort letter supporting the exchange of bonded debt later that year, which was seen by investors as a declaration of intent regarding the IMF's commitment to remain engaged with Pakistan in the future. Later, however, the change of government resulting from the October 1999 coup, together with a controversy regarding Pakistan's misreporting of fiscal data (alleged breach of Art VIII) to the IMF stood in the way of a resumption of the program.

A new IMF-supported program, a 12-months SBA, was approved in November 2000 for an amount of SDR 465 million (about US$596 million) equivalent to 45% of quota. This program set the macroeconomic framework that backed a new round of negotiations with the Paris Club which culminated with the January 2001 treatment. Again, the program's conditionality focused primarily on the fiscal area with the objectives of containing the public deficit, expanding the revenue base and improving both tax compliance and the framework for the monitoring of the budgetary position. As opposed to previous programs, the November 2000 SBA was implemented quite successfully and never went off-track, although it lagged behind in some aspects such as tax collection or the promulgation of a new income tax law. It is worth noting, however, that in the wake of the September 11th events, the IMF was accused of relaxing its standards for approving the release of the third and last tranche of

the program, a claim that has always been denied by the Institution on the grounds that this move had already been decided prior to the attacks.

Table 9: IMF programs in Pakistan

	Approval	Expiration	Amount	% of quota
EFF/ESAF	Oct. 1997	Jul. 1999	SDR 1.137 mn	110
SBA	Nov. 2000	Nov. 2001	SDR 465 mn	45
PRGF	Dec. 2001	Dec. 2004	SDR 1031 mn	100

Source: IMF.

Irrespective of whether the new international geopolitical order contributed to the approval of the last program review, it is quite clear that the American stance towards Pakistan changed substantially after the September 11th attacks. This was especially clear with the December Paris Club treatment which, as mentioned above, was exceptionally generous. This last stage in Pakistan's debt restructuring was backed by a 3-year Poverty Reduction and Growth Facility approved in December 2001 for an amount of SDR 1034 million (about US$ 1322 million or 100% of quota).

2.5.4 RECOVERY FROM THE CRISIS

Pakistan experienced quite a marked economic turnaround in the years following the completion of the debt exchange, with rates of GDP growth reaching levels as high as 7.5% in 2004, 8.6% in 2005 and 7% in 2006. This recovery was brought about by a combination of domestic and external factors. On the domestic side, the authorities implemented a prudent macroeconomic policy in the immediate aftermath of the restructuring, with fiscal deficits falling under 3% of GDP in between 2002 and 2004, and inflation rates falling under 4% in year 2004. In addition, these were years of wide-ranging structural reforms aimed at controlling public finances and accelerating growth, focused primarily on the fiscal, financial and energetic sectors. On the external side, the recovery was supported by an increase in remittances, a strong performance in export-oriented industries, and an improvement in Pakistan's external financing conditions in a context of buoyant liquidity in international financial markets. This enabled the central bank to rebuild its stock of foreign exchange reserves, which rose by US$2.9 billion in between 2001 and 2004 (see graph 5.4).

Pakistan's restructuring, together with the economic recovery that followed, enabled the authorities to regain control over debt dynamics. In the 2004 Article IV report, the IMF described various scenarios for the medium-term, all of them yielding a declining tendency in the public debt to GDP ratio[20]. Moreover, this downward trend was judged solid and not overtly sensitive to lower primary balances, exchange rate depreciations, or lower growth. There are, however, a number of structural vulnerabilities that remain to be addressed given the still high external debt burden and the underlying weaknesses of the Pakistani

20. In particular, under the baseline and high-growth scenarios, public debt declines from around 89% in 2000/01 to around 50% of GDP by 2008/09, and the low-growth scenario would imply a somewhat slower but still substantial decrease of public debt, representing around 60% of GDP by 2008/09.

economy. In addition, the political environment has markedly deteriorated, casting doubts on Pakistan's future performance. Although the economy has continued to exhibit robust growth in recent years, macroeconomic policies have become more expansionary, resulting in higher fiscal deficits and in rates of inflation around 8%.

As mentioned above, access to international markets played an important role in Pakistan's economic recovery. As shown in Graph 5.8 in Appendix 1, spreads fell quite dramatically in the aftermath of the December 2001 Paris Club treatment, falling below 1000 bp relatively fast. By the time Pakistan issued its first international bond after the completion of the debt rescheduling (February 2004), spreads had fallen under 500 bp.

2.6 Russia

In the summer of 1998 Russia shocked the international financial community by defaulting on its sovereign debt as part of a broader package of heavy-handed measures to stabilize the economy. Apart from plunging Russia into a deep recession, this event unleashed a wave of financial distress affecting both mature (LTCM crisis) and emerging market economies. The Russian crisis was largely unforeseen because during the months leading to the default investors appeared to believe that country to be 'too big' or 'too nuclear' to fall, meaning that an international bailout was expected should the need arise. The IMF, instead, suspended its financial support to Russia when the Parliament blocked the fiscal measures contained in its program's conditionality. In this sense, the IMF's stance towards Russia constituted one of the triggers of the default, although its underlying causes were much deeper, rooted in an unfinished transition process and the government's fiscal profligacy. Among the cases analyzed here, the Russian restructuring stands out in particular because it was centred on domestically-issued local currency debt rather than on external hard currency obligations. The IMF played only a minor role in this restructuring given that no on-track program was in place during the design and completion of the debt exchange. However, once this first debt workout was finalized, a new IMF-supported program approved in 1999 was instrumental for the restructuring of Soviet-era debt in the hands of the Paris and London Clubs. This program, however, was quickly dropped reflecting deep disagreements between Russia and the international community.

2.6.1 THE DEBT CRISIS

The 1990's was a period of intense transformations for the Russian economy. Indeed, as part of its transition to a market economy, the centralized planning system was dropped, prices were liberalized, the bulk of state enterprises were privatized and the current and capital accounts were partially opened. This was a costly process and between 1989 and 1996 GDP contracted by a yearly 8% on average, unemployment increased dramatically, most major industries (especially those concentrated in the military-industrial complex) saw production plunge, and the country experienced various bouts of hyperinflation. In 1997 the situation looked rosier, with private capital flowing into the country at an unprecedented pace, inflation under control, a current account surplus and a positive rate of GDP growth expected for the first time since the collapse of the Soviet Union [see Appendix 1, graphs 6.1, 6.5 and 6.6)]. By year-end, however, this apparent economic recovery was brought to an end as a consequence of contagion from the Asian financial crisis and the deterioration of Russia's terms of trade (declining oil prices). Throughout 1998 the situation gradually deteriorated and in August events took a dramatic turn when the Russian government announced the aforementioned package of emergency measures.

The Russian crisis was primarily the consequence of an unfinished transition process which, in spite of the aforementioned reforms, had failed to consolidate a modern market economy and to rationalize the role of the State in the system. However, to some extent Russia's debt crisis was also an unintended consequence of a successful monetary stabilization. Indeed, just prior to the crisis, the authorities had managed to bring inflation down to single digits from over 300% in 1994. This was achieved primarily by pegging the exchange rate and consolidating the independence of the Central Bank of Russia, thereby ruling out the monetization of budget deficits. The search for non-inflationary ways to finance the perennial budget deficits (see graph 6.2) led to the development of a domestic debt market in 1994, which was opened to foreign investors in 1996. By December 1997 the volume of Russian sovereign debt issued domestically (primarily short-term GKOs) reached a peak of US$82 billion, representing 38% of total debt. In addition, Russia began issuing Eurobonds in 1996 although by December 1997 foreign currency denominated bonds still amounted to less than 3% of total debt.

As mentioned above, the situation deteriorated sharply at the end of 1997 and continued to worsen throughout 1998. The authorities responded to this unfolding crisis by intervening in defence of the ruble, tightening monetary policy, attempting to complete certain fiscal reforms[21] and securing the support of the international community. These measures, however, failed to restore investors' confidence and the ruble underwent a series of speculative attacks from October 1997 until the August 1998 events, halving Russia's stock of foreign exchange reserves and setting the stage for a self-fulfilling crisis (see graph 6.5). As a result of the rising risk of devaluation, the government faced growing problems to roll-over ruble-denominated short-term debt (mainly GKOs) (see graph 6.4). In contrast, supported by international rating agencies' surprisingly stable outlook, Russia was able to tap international financial markets up until just a few weeks prior to the August default and various Eurobond issues were successfully launched in the summer of 1998[22]. In fact, the government's strategy at that time was to substitute upon maturity high cost ruble-denominated domestic debt for lower yielding bonds issued abroad[23]: during the first half of 1998 the proportion of foreign currency bonds to total debt rose to 9% (US$16 billion).The failed July 1998 voluntary swap of GKOs for Eurobonds described below was part of this strategy to alleviate liquidity pressures.

The final trigger of the crisis was the rejection by the Parliament of a fiscal package aimed at complying with the conditionality attached to the July 1998 augmentation of the IMF-supported program. This was the final blow of the ongoing political tensions between market-oriented reformists and post-communist immobilists, a constant throughout the 90's which had created an endemic uncertainty about the course of economic policies. As a result, the IMF suspended disbursements to Russia, and the government announced the emergency measures of August 1998, among which the devaluation of the ruble, a 90 days

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21. In February 1998 a new tax code aimed at rationalizing the tax system and at increasing fiscal revenues was submitted to the Duma for discussion. The code that was finally approved, however, ignored critical provisions to increase revenues, thereby aggravating the debt problem.

22. This has been often pointed out as a clear evidence of IMF-induced creditors' moral hazard. Indeed, it has been argued that international investors' relative inobservance of Russia's sovereign risk was largely fuelled by the broad-based expectation that the international community would bail out Russia should the need arise.

23. The rationale for doing so was the emergence of a large and growing spread between the cost of ruble and foreign currency denominated debt. This spread reflects the fact that concerns were centred on the devaluation risk rather than the default risk. Pinto et al. (2004) decompose the default risk premium and the devaluation risk premium of ruble denominated debt in the weeks leading to the default. According to their estimates in mid August 1998 109.5% of a 144.9% yield of GKOs was attributable to a devaluation risk premium, while only 23.8% was attributable to a default risk premium.

moratorium on private sector payments on external liabilities (enforced through extensive capital and exchange controls) and the suspension of the servicing of ruble-denominated domestically issued debt (GKOs and OFZs). This amounted to a default on a debt of approximately US$30.4 billion at the pre-default exchange rate[24]. A few weeks later, the authorities were forced to float the ruble and Russia defaulted on some components of its Soviet era external debt.

Table 10: Debt stock at the outset of the restructuring (1998) (US$ billion)

External	**158.7**
Russia-era	**56**
Multilateral	26
Bilateral	9.7
Private	20.3
Soviet-era	**102.7**
Official Bilateral (inc. Paris Club)	59.7
Commercial (London Club)	29.7
Other	13.3
Domestic	**25.7**
GKOs	0.8
OFZs	22.3
Other	2.6

Source: "Russia Rebounds".

2.6.2 THE RESTRUCTURING

This paper focuses on the 1998-2000 default and restructuring of mostly domestically issued debt. It is worth noting, however, that by that time the Russian Federation had already restructured a substantial volume of external obligations inherited from the Soviet Union. In 1993, following an agreement with the former Soviet republics, Russia assumed the responsibility for servicing the entire Soviet Union's external debt in exchange for the sole claim on its assets. According to IMF estimates using the average real exchange rate during 1993, as a result of this agreement the Russian Federation assumed a debt burden equivalent to approximately 50% of its GDP. Successive Paris Club treatments were signed in 1993, 1994, 1995 and 1996 to reschedule bilateral obligations for an aggregate amount of almost US$70 billion. In addition, a rescheduling agreement was signed with the London Club in December 1997 to restructure US$28 billion of commercial debt. As we shall see later, further rescheduling of both bilateral and commercial Soviet-era obligations was needed following the 1998 default. In fact, throughout the crisis resolution period, the Russian

24. As a consequence of the devaluation of the ruble, the dollar value of restructured debt had fallen to US$8.3 billion when the terms of the exchange were finally approved in March 1999.

authorities drew a clear distinction between external debt issued before and after the collapse of the Soviet Union, committing to remain current only on the latter.

At the time of the default, Russia's debt to GDP ratio stood at close to 60%, of which external debt represented around 45% of GDP. About two thirds of that external debt at the time of the default had been inherited from the Soviet Union. Although, as mentioned above, liquidity pressures arose primarily from domestically issued debt (mostly short-term GKOs) that category of debt constituted only about 15% of GDP and, therefore, was a relatively minor component of total debt. It is unclear which proportion of that debt was held by non-residents, and estimates range between US$6 and US$20 billion. Primarily as a result of rapid currency depreciation and declining economic activity, the debt to GDP ratio rose substantially after the August 1998: by end-1999 it stood at 93.3% of GDP, and in 2000 it surpassed 100% of GDP.

As mentioned above, during 1998 the Russian authorities were trying to substitute ruble-denominated debt for Eurobonds primarily in order to take advantage of the yield-differential between both categories of debt. It is in this context that the government launched in July 1998 an offer to exchange domestically issued GKOs maturing prior to July 1999 for foreign currency Eurobonds with longer maturities. This debt swap was aimed at alleviating liquidity pressures and at providing non-residents with an option to exit the GKO market (and hence get rid of the devaluation risk) without adding pressure on the balance of payments and the stock of international reserves. Ultimately, however, this measure was largely ineffective as only US$4.4 billion of a total eligible debt of US$41 billion were exchanged. About half of the converted debt was exchanged by non-residents. A significant portion of the remainder was exchanged by domestic public banks acting in line with the needs of the government in order to lower the yields at which the exchange was carried out. This contributed to crowd out private creditors and, thereby, to reduce participation in the exchange. There are reasons to believe that the swap was not only ineffective but also counterproductive in its objective of alleviating balance of payment pressures. Indeed, the low participation rate in the exchange is likely to have signalled the extent of the liquidity pressures undergone by the sovereign, portraying the image of a government 'gambling for resurrection', fuelling investors' concerns and further feeding upward pressures on yields.

Moving on to the post-default phase of the crisis, the months that followed the August 1998 events were characterized by political sclerosis and the ensuing inability of the authorities to articulate a credible stabilization plan to back the restructuring. In this context, a first restructuring offer advanced by the authorities as early as August 25 1998 was largely rejected by market participants. After this failed attempt, the restructuring process stalled until the launching of the so-called Novation scheme in March 1999. The terms of this restructuring offer can be summarized as follows:

(i) The restructuring would cover GKOs and OFZs maturing between the date of the default and end- December 1999.

(ii) The flow of defaulted payments would be discounted to August 19 1998 at a rate of 50% per annum.

(iii) Creditors would receive a combination of cash (3.33%), zero-coupon 3-months and 6-months GKOs (6.66%), cash-value OFZs usable for paying tax arrears (20%) and longer-term OFZs with maturities ranging from four to five years (70%).

(iv) The exchange offer was combined with extensive capital controls. Indeed, foreign creditors were to face important restrictions to repatriate their investments since all cash proceeds had be placed in a non-interest bearing 'transit account' for one year prior to exiting the country. Cash proceeds from the sale of cash-value OFZs would have to be deposited in restricted ruble accounts (the so-called S-accounts) usable only to invest in certain Russian bonds and equities.

(v) The Novation scheme did not cover certain categories of creditors such as the central bank of Russia, households, and pension funds forced by law to hold government securities. These creditors received a preferential treatment.

Eventually, the exchange was quite successful and by end-May 1999 about 95% of residents and 88.5% of non-residents had agreed to take part in it. Non-resident holdout creditors were paid in full. However, because they were forced to place their proceeds in the restricted S-accounts and faced repatriation restrictions for a period of 5 years significant losses were also imposed on holdouts. As a result of this package, it is not easy to compute the losses imposed on investors. If capital controls are not taken into account, Sturzenegger and Zettlemeyer (2005) have estimated an NPV haircut in between 41 and 55%. If these restrictions are computed, the losses associated with the exchange rise to 49-70%. If the losses derived from the devaluation of the ruble are included in this calculation, losses jump up to 95%. Finally, as a result of the aforementioned restrictions, non-resident holdout creditors faced losses ranging in between 55-84%, not far from those undergone by the creditors that opted to participate in the exchange.

As regards non-ruble denominated debt, the Russian authorities discriminated between creditors depending on who the original debtor was. Indeed, from the outset the authorities committed to remain current on the servicing of the Eurobonds issued by the Russian Federation since 1996. In contrast, in 1998 and 1999 the authorities defaulted on various debt instruments inherited from the Soviet Union. For each defaulted instrument a specific debt workout was needed as summarized in what follows:

(i) In December 1998 the government missed payments on one of the bonds issued in the context of the 1997 rescheduling with the London Club: the so-called principal notes or PRINs. In June 1999 Russia also defaulted on interest arrears notes or IANs, another London Club instrument[25]. Altogether, this amounted to a default on US$29 billion. An agreement was reached with the London Club in August 2000 in order to restructure that debt[26]. The main elements of this agreement were a nominal haircut of about 36%, an exchange of PRINs and IANs for a new 2030 Eurobond with a step-up coupon (2.25% to 7.5%), an exchange of past-due interests for a 2010 Eurobond with an 8.25% coupon, and a small cash "sweetener". Eventually, in spite of carrying an NPV loss of about 50%, participation in the exchange was nearly universal (99%). This was primarily due to the fact that, at the time of the exchange the market value of PRINs and IANs was extremely low (just about US$6 billion) and that, in any event, commercial banks had already cleared the losses associated with Soviet era debt from their balance sheets.

(ii) In May 1999 the Russian government defaulted on a full tranche of another category of Soviet era debt: the domestically issued dollar-denominated "MinFin III" bond

25. Both PRINs and IANs were dollar-denominated, floating interest long-term bonds.
26. The agreement also covered past-due interests for an amount of US$2.8 billion.

(US$1.3 billion). An open ended exchange offer for this bond was launched in November 1999 and later modified in January 2000. Bondholders were offered either a new eight-year bond similar to the original instrument (dollar denominated), or a four years OFZ (rouble denominated) paying an interest of 15% in the first year and 10% thereafter. Zettlemeyer and Sturtzenegger (2005) have estimated an NPV haircut of about 40% under both options.

(iii) As the situation gradually deteriorated after the August 1998 default, the Russian Federation accumulated substantial arrears on its Paris Club obligations. Following the approval of an IMF-supported program, a Paris Club treatment was signed in August 1999. This treatment covered arrears as of June 1999 and obligations falling due from July 1999 to December 2000. In total, this amounted to a debt of US$8.113 million or 16% of total obligations to the Paris Club. In 2000 Russia was expected to reach a new agreement with the Paris Club to treat the remainder of Soviet era debt. However, on that occasion no agreement was reached and some arrears were accumulated in the first months of 2001. Later that year Russia cleared these arrears and renewed its commitment to remain current on Paris Club debt.

(iv) On similar terms, in 2001 and thereafter Russia gradually reached agreements to restructure bilateral obligations to non-Paris club members, mostly former COMECON countries. In addition, in 2001 the authorities reached an agreement to restructure obligations in arrears to uninsured suppliers on similar terms to the restructuring of London Club debt.

2.6.3 IMF INVOLVEMENT

The Russian crisis has often been presented as a test case of the moral hazard potentially induced by investors' expectations of an IMF rescue package. Indeed, the prevalent view is that investors were caught by surprise in the Russian default because, for strategic reasons, the international community was expected to step in with a bailout should the situation deteriorate too much. This would contribute to explain why the Russian Federation was able to tap international financial markets up until just a few weeks prior to the default. The interruption of the Fund's financial support, instead, precipitated events, and is crucial to understand the emergency measures adopted in August 1998. This is not to say that the IMF was responsible for Russia's decision to default on part of its sovereign debt. Rather, it points at lesser political pressures than expected in the Institution's decision making process. It may also reflect a changing doctrine regarding the role of the IMF in the resolution of financial crises, with a growing importance attached to the need of 'bailing in' investors. In any case, several empirical investigations have found that the non bailout to Russia induced a reassessment of the financial safety net articulated around the IMF, thereby reducing creditors' moral hazard.

The Russian Federation joined the IMF in 1992, soon after which it began making use of the Fund's financial support[27]. Although the IMF was almost continuously involved in Russia during its transition to a market economy, it has been argued that the Institution's leverage on the policies ultimately implemented by the authorities was rather weak. According to this line of thinking, this was the result of the political pressures exerted by the G-7 on the Fund to be lenient with Russia in spite of the authorities' inability to mount a credible

27. The first program was an SBA approved in August 1992 for an amount of SDR719 million. In June 1993 a Structural Transformation Facility with two tranches of SDR1078 million was approved. In April 1995 a 12-months SBA for an amount of SDR4131.4 (100% of quota) was approved.

stabilization plan during the first half of the 1990's. An SBA approved in 1995, instead, was more successful in supporting the government's anti-inflationary policies. It is during its successful implementation that the Fund negotiated with Russia the terms of a coherent medium-term action plan to form the basis of a longer-term program.

The IMF-supported program in place at the time of the August 1998 default was a three years Extended Fund Facility (EFF) approved in March 1996 for an amount of SDR6.901 million (US$10.087 million or 160% of quota). The program's macroeconomic conditionality focused primarily on the government's deficit, which was projected to trend downwards from 4% of GDP in 1996 to 2% of GDP in 1998. In addition, it carried an ambitious structural agenda centred on the liberalization and development of the domestic financial system, the reform of the budget system, a redesign of intergovernmental fiscal relations, the strengthening of property rights and a program of privatizations and corporate governance reform. The program underperformed, especially in the fiscal sphere: the federal deficit reached 6.8% of GDP in 1997. In addition, progress was slow in the implementation of the various structural reforms. However, partly as a result of the aforementioned political pressures to be soft on Russia, with few exceptions there were only minor delays in the Fund's disbursements and the program's successive reviews.

In spite of the underperformance of the 1996 EFF, in July 1998 it was augmented in a last attempt to bolster Russia's foreign exchange reserves and to restore investors' confidence on the authorities' ability to avoid a full-blown crisis. This move provided Russia with an additional financial support totalling SDR8.5 billion (about US$11.2 billion)[28]. Other international financial institutions followed suit, providing an additional US$11.4 billion. Of the Fund's augmentation, about SDR3.6 billion (US$4.8 billion) were to be made available immediately. The program's frontloading, however, was limited by the need to ratify parliamentary some of the measures contained in its conditionality. The conditions attached to the July 1998 augmentation focused primarily on fiscal adjustment: the federal deficit was targeted to fall to 5.6% of GDP by year end and to 2.8% of GDP in 1999. In addition, the program's structural agenda was reinforced, with a focus on the development of the private sector, the resolution of the non-payment problem, several banking measures and the reform of the labour market. Finally, the program contemplated the exchange of GKOs for Eurobonds described above.

Again, the program failed to restore confidence and Russia's stock of foreign exchange reserves continued to dwindle in the weeks following the augmentation. However, the final *coup de grace* of the Russian crisis was the government's failure to gather sufficient parliamentary support to the program's conditionality. Indeed, as the DUMA failed to ratify the measures contemplated in the Fund's program, the IMF withheld its support to Russia, which precipitated events. It is in that context that the ruble was devalued and that the government defaulted on domestically issued debt as part of the August 1998 package of emergency measures.

As a result of the crisis and the political tensions that followed the August 1998 events, the relationship between Russia and the IMF stalled for several months. The authorities were unable to put forward a credible stabilization plan under which the Fund could resume disbursements or approve a new program. Only in May 1999,

28. The EFF was augmented by SDR 6.3 billion (US$8.3 billion), of which SDR 4 billion (US$5.3 billion) were to be made available under the SRF. In addition, SDR2,16 billion (US$2,9 billion) were made available under the CCFF, presumably to compensate for a shortfall in export proceeds as a result of a fall in oil prices.

did the IMF and Russia agreed on the elements of a new economic program which was approved as a 17 months SBA in July 1999. The program, for an amount of SDR 3.3 billion (about US$4.5 billion) or 56% of quota was conceded under the LIA policy. As with previous programs, structural conditionality was focused on reform of the financial sector (including bank restructuring), private sector development, liberalization of foreign direct investment and international trade and enhancement of fiscal management. The macroeconomic conditionality included a tightening of fiscal policy both through an increase in tax collection and through the compression of non-interest spending (improvement in tax administration, elimination of unproductive expenditures and enhancement of spending controls). This resulted in a decline in the overall deficit of the federal government from 5.9% of GDP in 1998 to 5.1% of GDP in 1999. Another important element of the program's conditionality was the establishment of a monetary policy conducted in the context of flexible E/R and geared to reducing inflation.

Importantly, in its Letter of Intent, Russia recognized that it was looking for debt relief, arguing that its external debt ratio of 90% of GDP (US$150 billion) was unsustainable. Indeed, the 1999 program served as stepping-stone for the agreement reached with the Paris Club in August of that same year.

Macroeconomic policy performance was generally in line with the program, helped by higher oil prices, the recovery of growth in the economy and, in general, good macroeconomic performance. However, stories in the press about corruption and misuse of public funds led the IMF, encouraged by G7 countries, to ask for various structural improvements in accounting and control practices. These were not fully implemented, which gave the Fund a reason for not making the disbursement under the SBA that was due in November. At that time, political attitudes towards Russia had hardened, not only due to the aforementioned scandals, but also as a result of the second Chechen war [Odling-Smee (2004)]. As a consequence, Russia made only one purchase under the SBA upon approval of the arrangement (a de facto roll-over of Russian obligations vis-à-vis the Fund). Performance criteria were observed, many with a large margin. However, there were considerable shortfalls with regard to structural benchmarks in 1999. In 2000 the authorities indicated that they intended to request a cancellation of the arrangement to seek further support under a new SBA. No reviews were concluded and, presumably, the Fund never had to assess whether Russia was negotiating with good faith with its creditors. Once the program went off-track, there were initial discussions to modify conditions under the July 99 SBA. Since mid-2000, however, conversations were more geared towards negotiating a new arrangement, probably a precautionary SBA. In fact, most aspects of the policy package to attach to the new arrangement were agreed by early 2001. However, ultimately Russia decided not to request a precautionary SBA and, in February 2005, the Russian Federation completed early repayment of outstanding obligations with the IMF.

Table 11: IMF programs in Russia

	Approval	Expiration	Amount	% of quota
EFF	Mar. 1996	Mar. 1999	SDR 6.9 bn	160
Augmentation	Jul. 1998	-	SDR 8.5 bn	143
SBA	Jul. 1999	Dec. 1999	SDR 3.3 bn	56

Source: IMF.

Summarizing, it would seem that the LIA policy was only briefly implemented in Russia. Indeed, only during the 1999 program were there outstanding arrears to private creditors. However, this program went off-track quite early, and the Fund did not have the time to assess whether Russia was negotiating in good faith. Additionally, the Novation scheme, which was the main component of the restructuring, was practically completed before an IMF's arrangement could be reached. As a result, the Fund played no role in determining the resource envelope of that workout. It might have played a role for the Paris Club arrangement (since an IMF program was required), and therefore for the London Club arrangement, which was signed soon after (Comparability of Treatment Clause). However, the evidence is that the Fund's LIA policy played, at most, a minor role in the outcome of the Russian debt restructurings that took place following the 1998 crisis.

2.6.4 RECOVERY FROM THE CRISIS

The Russian crisis is often referred to as a crucial turning point in Russia's recent economic history. Indeed, the high rates of GDP growth registered after year 1998 (see Appendix 1, graph 7.1) stand in stark contrast with the seemingly unstoppable economic decline that characterized the post-soviet years. To a large extent, the economic expansion that followed the 1998 crisis was driven by a favourable external environment and by the combination of high energy prices and a depreciated rouble. As a result, the current account moved from a deficit of close to 3% of GDP in 1998 to a surplus of 18% of GDP in year 2000 (see graph 6.5). This set the stage for a substantial accumulation of foreign exchange reserves and for the aforementioned early repayment of obligations to the IMF (see graph 6.4). Other factors behind that recovery were the sound macroeconomic policies implemented after 1998 as well as the structural measures undertaken to strengthen the treasury expenditure control, to downsize civil service and to reform the tax administration. Public finances behaved better than expected in the aftermath of the crisis, with primary surpluses of 7.5% in 2000 and 5.4% of GDP in 2001 (see graph 6.2). Inflation fell markedly from 84.5% in 1998 to 20.1% in 2000. Thereafter, however, the authorities experienced problems to further reduce inflation due to the growth in money supply resulting from the partially un-sterilized accumulation of foreign exchange reserves that took place following the crisis.

The debt workout and the solid macroeconomic performance that followed did restore the sustainability of Russia's public finances. This is best illustrated in Moody's upgrade of Russia's debt to investment-grade in 2003. IMF estimates in the aftermath of the crisis concurred with this favourable assessment of Russia's debt dynamics[29]. Indeed, the Fund's debt sustainability analyses conducted at the time projected the stock of public debt to fall from an already low 22% of GDP in 2004 to 7% of GDP in 2010. These projections were made under the assumption of the maintenance of sizable primary surpluses in the range of 5 to 9 percent, which was not considered unrealistic given the importance of energy proceeds in the budget, and the evolution of oil prices. In fact, the stress tests conducted in these analyses concluded that the riskier shock for Russia's public finances would be a pronounced decline in the price of oil, which has been far from materializing in recent years. In any case, even such a shock would have resulted in a relatively manageable stock of debt around 30% of GDP.

Russia regained access to international financial markets relatively fast. As shown in graph 6.8, after the explosive dynamics that characterized the behaviour of sovereign spreads

29. Source: Finger, H and M.Mecagni (2007). *Sovereign debt restructurings and debt sustainability. An analysis of recent cross-country experience.*

following the events of August 1998, the EMBI stabilized at around 1000 bp in June 2000. Russia issued successfully its first international bond in October 2001.

2.7 Serbia

The Federal Republic of Yugoslavia emerged from the armed conflicts of the 1990s as a 'pariah' state in the international arena, excluded from multilateral organizations and strangled by financial and trade sanctions. The fall of the Milosevic regime in the fall of 2000 marked a turning point, setting the stage for the normalization of Serbia and Montenegro's relations with the rest of the world and for the reconstruction of its economy. In a matter of months Yugoslavia's membership in international organizations, including the IMF and the World Bank, was resumed. This forced Serbia and Montenegro and its public and private creditors to seek for a solution to the unsustainable burden of sovereign debt inherited from the former Yugoslavia. Serbia and Montenegro's debt restructuring and settling of pending arrears was carried out in four stages: first were settled arrears with international organizations; Paris Club and other bilateral creditors followed in 2001; an agreement was reached with the London Club in 2004; the government is still settling domestic arrears stemming from a 'confiscation' of households' foreign currency deposits during the conflict years. The IMF has played an important role in supporting Serbia and Montenegro's efforts to regain presence in the international context. Its emergency post-conflict assistance, followed by a more stable financial support through an SBA approved in 2001, together with its influence for a successful restructuring of Paris Club debt, has paved the way for Serbia and Montenegro's recovery in the subsequent years.

2.7.1 THE DEBT CRISIS

Serbia and Montenegro's economic collapse was primarily rooted in the break-up of the Socialist Federal Republic of Yugoslavia and the subsequent two waves of military conflicts that ravaged the country during the 1990s. In part, these were the result of the spiralling social and political tensions brought about by a failed transition to a market economy. This process began in the early 1990s with a series of structural reforms which profoundly altered production relations by privatizing an industrial system traditionally based on socially-owned enterprises. Together with the armed conflict and the imposition of international sanctions on the Federal Republic of Yugoslavia, the failure of these reforms led to an economic debacle: by 1994 GDP had more than halved with respect to its level in 1990 and industrial output had fallen by approximately 70%. In parallel, Yugoslavia's macroeconomic outlook deteriorated sharply. In 1993 the nominal fiscal deficit stood at close to one third of GDP and was largely financed by money printing. As a result, in 1993 and 1994 the Federal Republic of Yugoslavia underwent one of the worst bouts of hyperinflation ever recorded in history[30].

During the mid 1990s Yugoslavia witnessed some degree of stabilization: in between 1994 and 1998 output growth averaged 6.5% and inflation was gradually brought down to an average of 43% (see Appendix 1, graph 7.1). This was primarily a result of the Dayton peace agreement for Bosnia, the ensuing suspension of international sanctions by the United Nation's Security Council in 1995[31], and the adoption of a stabilization program in January 1994. However, the Kosovo crisis in 1998 and 1999 plunged Yugoslavia back into an armed conflict, which undid the economic achievements of previous years: according

30. According to the IMF, by January 2004 monthly inflation rates surpassed 300 billion percent.

31. However, the US and other countries still maintained some of these sanctions, which affected Yugoslavia's membership to international organizations.

to IMF and UN estimates GDP dropped by almost 20% in 1999 and the level of poverty doubled to encompass about two thirds of the population.

Largely as a result of the debt inherited from the former Yugoslavia and of the 1990's GDP contraction, by year 2000 Serbia and Montenegro's debt to GDP ratio had risen to an unsustainable 136% (see graph 7.3). Overall, this amounted to an external debt of about US$12 billion. Given that Yugoslavia suspended the servicing of most of its external obligations during the armed conflict, at the turn of the century about 85% of that debt was in arrears (see graph 7.4). The bulk of these obligations were owed to official creditors (58% of total), including both bilateral creditors (mostly Paris Club) and multilateral creditors (21% of total). In addition, the Federal Republic of Yugoslavia had inherited a substantial volume of commercial debts from the former Yugoslavia. As a result, by end-2000 it owed almost US$3 billion to London Club creditors. On top of these external arrears, during the conflict years the government accumulated substantial domestic arrears both on domestic debt and on social security payments. In December 2001, non-debt arrears were estimated at about 10% of GDP.

Table 12: Debt stock at the outset of the restructuring (end-2000) (US$ million).[32]

Creditor class	**Outstanding debt**	%	**In arrears**
Multilateral	2574	21	2170
IBRD	1812	14.8	1740
IMF	151	1.2	0
Other	611	5	430
Paris Club	4567	37.3	4497
London Club	2809	22.9	2035
Others	2317	18.9	1831
Total Public Sector Debt	**12267**	**100**	**10533**

Source: World Bank.

2.7.2 THE RESTRUCTURING

The overthrow of the Milosevic regime in September 2000 paved the way for a normalization of Yugoslavia's standing in the international community. A first and crucial move in this direction was the gradual lifting of international trade and financial sanctions, which began in October 2000. In November, Serbia and Montenegro regained its membership in the United Nations after an absence of almost a decade, and soon afterwards it joined OSCE and other international and regional organizations.

The normalization of Serbia and Montenegro's relations with international financial institutions required the restructuring of multilateral obligations in arrears, which were especially relevant in the case of the World Bank. In December 2000, the Federal Republic of

32. Source: World Bank.

Yugoslavia succeeded the membership of the former Yugoslavia at the IMF. This was made possible after the settlement of outstanding arrears. As we shall see below, soon after the resumption of membership the IMF began extending its financial support through the emergency post-conflict assistance window. A few months later, in May 2001, Yugoslavia regained full membership in the World Bank conditional on the settlement and restructuring of about US$1.7 billion in arrears. This was achieved through the exchange of inherited obligations for six 30-years consolidation loans, which re-opened the Bank's lending window for Serbia and Montenegro.

A second step in Serbia and Montenegro's sovereign debt workout was the restructuring of bilateral official obligations. This was made possible after the resumption of Yugoslavia's membership in the IMF and the approval of a Stand-By arrangement in June 2001, a precondition for Paris Club treatments. An agreement with bilateral creditors was eventually reached in November of that same year, treating US$4324 in obligations. This agreement had two components. The first one was the cancellation of debt for an amount of US$2743 million. The remainder was rescheduled over 22 years with a 6 year grace period, entailing a debt relief of about 66% in NPV terms. In compliance with the comparability of treatment clause, the terms of this agreement were extended to other bilateral creditors such as Libya and China, to which Yugoslavia owed US$196 million.

Negotiations with commercial creditors, instead, proved to be much more lengthy and contentious. Indeed, although a bank advisory committee was established soon after the Paris Club treatment, no agreement could be reached until July 2004. The final settlement with the London Club wrote off approximately 62% of eligible debt. Inherited commercial loans were to be exchanged for an international dollar-denominated bond listed on the Luxembourg stock exchange for an amount of US$1.08 billion, with a 3.75% coupon, a maturity of 20 years and a 5-years grace period. The NPV loss associated with this exchange has been estimated at about 62%, which the Paris Club considered as broadly comparable with its own treatment. As a result, Serbia and Montenegro's debt to GDP ratio was brought down by 7% to about 60%, and international debt arrears were completely cleared.

The final component of Serbia and Montenegro's restructuring was the settlement of domestic arrears. These had arisen primarily as the consequence of a suspension of residents' withdrawals from households' foreign exchange balances decreed in 1991 in order to compensate for a drop in foreign exchange reserves. In 1998, the government committed to repay the entire stock of frozen deposits assuming a liability of DM7.4 billion equivalent to 35% of GDP. An overtly ambitious repayment schedule was announced at that time to complete the repayment. In 2001, however, the original schedule had to be dropped for a more gradual one in order to alleviate pressures on public finances. The repayment of frozen deposits was done through the issuance of special state bonds limited to 0.8% of projected GDP. Frozen deposits should be fully repaid by 2001.

2.7.3 IMF INVOLVEMENT

As mentioned above, the IMF played a crucial role in paving the way for the normalization of Serbia and Montenegro's financial relationship with the rest of the world. The Federal Republic of Yugoslavia requested the resumption of its membership in the IMF soon after the overthrow of the Milosevic regime. This was made conditional on three developments: the clearance of arrears with the Fund amounting to US$128 million (SDR101 million or about 22% of the proposed quota); a positive assessment of Serbia and Montenegro's capacity to fulfil its obligations under the Fund's Articles of Agreement; the payment of the Federal

Republic of Yugoslavia's increased subscription after the 11th review of quotas. Eventually, all these pre-requisites were met and Serbia and Montenegro resumed its membership in the IMF in December 20, 2000.

Soon after, the IMF's financial assistance was made available to Serbia and Montenegro through a post-conflict emergency purchase of SDR117 million (about US$148 million or 25% of quota). This short-term program covered the period through March 2001 and pursued three basic objectives. The first one was to facilitate the clearance of arrears to the IMF: the bulk of the emergency purchase was used to repay the bridge loans that had been provided by Norway and other members to help Serbia and Montenegro clear arrears in December 2000. Second, the program set the basis for the articulation of a short-term stabilization strategy. Accordingly, it focused mainly on the containment of inflation through a tightening of macroeconomic policies. In addition, the program contemplated the introduction of a managed float with current account convertibility. Third, the post-conflict emergency assistance 'bought time' for the newly elected government to develop the institutional capacity required for the design a more comprehensive stabilization and reform strategy that could be backed by a longer-term upper credit tranche program.

In June 2001, a new 12 months SBA was approved for an amount of SDR200 million (US$253 million or 43% of quota). This program had an ambitious structural agenda, including a major tax reform, tax liberalization, a banking resolution strategy and enterprise privatization. Macroeconomic policies continued to be focused on the lowering of inflation and the achievement of fiscal sustainability. In addition, the program contemplated the rescheduling of the repayment of frozen deposits in order to moderate its impact on the budget. From the outset, the IMF specified that this program would be implemented under the umbrella of the policy of Lending Into Arrears. Consequently, successive program reviews carried financing assurances reviews and were made conditional on the authorities' good faith in their negotiations with private creditors. The 2001 SBA was successfully implemented and, as mentioned above, it formed the basis for the Paris Club treatment signed in November.

On May 2002 a new SDR650 million (US$829 million or 139% of quota) was approved to succeed the 2001 SBA. Again, the program's macroeconomic conditionality focused primarily in the reduction of inflation and the containment of budget deficits, with a substantial fiscal tightening programmed for 2003 and 2004. On the structural front, the program contemplated a continuation of fiscal and banking reforms as well as the design of an appropriate legal and institutional framework to continue with the privatization of public and socially-owned enterprises. The implementation record of this EFF was mixed. Indeed, partly as a result of domestic political dissentions, progress was limited in the implementation of the programmed structural reforms. In addition, growing concerns about a relaxation in the government's fiscal stance and mounting external imbalances contributed to delay the program's final reviews.

Table 13: IMF programs in Serbia

	Approval	Expiration	Amount	% of quota
SBA	Jun. 2001	Apr. 2002	SDR 200 mn	43
EFF	May 2002	May 2005	SDR 650 mn	139

Source: IMF.

2.7.4 RECOVERY FROM THE CRISIS

With an average growth rate of 5% registered in between years 2000 and 2004, the economic decline of the 1990s was eventually brought to an end (see graph 7.1). This was the result of the normalization of Serbia and Montenegro's standing in the international arena, and of the adjustment and reform effort that followed. Inflation was brought down to single digits by the end of 2003 from levels above 110% in 2000, and Serbia's fiscal deficit was brought down to 1.3% of GDP in 2001 against the 6.1% of GDP contemplated by the IMF-supported program (see graph 7.2). In spite of the aforementioned achievements, significant macroeconomic imbalances have resurfaced after year 2004 with rising inflationary pressures and a widening of the current account deficit, which reached levels above 10% of GDP in 2005 (see graph 7.5). This has been brought about by internal demand pressures and by a failure to tackle rigidities in labour markets and in the financial system. In this context, the IMF has been advocating for an acceleration of crucial structural reforms and for a tightening of monetary and fiscal policies.

Over the past years the IMF has disclosed various debt sustainability analyses for Serbia and Montenegro. In the 2003 DSA (produced in the context of that year's Article IV consultation), the IMF described a baseline scenario in which the public sector debt to GDP ratio falls from 84.5% of GDP in 2002 to a more manageable 50% of GDP in 2007. This scenario assumed a gradual fiscal adjustment during 2002-2007, with primary deficits shifting from 2.2% of GDP in 2002 to levels below 1% in 2007. This optimistic view was reinforced by various stress testing exercises[33]. The latest DSA, presented in the 2006 Article IV consultation, considered public debt in Serbia to be sustainable in a context of robust GDP growth and continued prudent fiscal policies. It highlighted, however, a marked vulnerability to exchange rate shocks. In the Fund's baseline scenario which assumes the maintenance of primary surpluses and robust rates of GDP growth, Serbia's debt-to-GDP ratio declines from 61% in 2005 to 19% in 2011. However, the stress testing exercises showed that a large depreciation of the currency caused, for instance, by a confidence crisis, could lead to a substantial increase in the debt to GDP ratio. This is due to the fact that close to 87% of public debt is denominated in foreign currency. Other scenarios, such as those in which a current account or interest rate shock are considered, could also lead to a significant rise in the debt-to-GDP ratio.

Serbia issued its first (and last) international bond after the restructuring in April 2005. The spread on the Serbian EMBI has remained stable ever since, fluctuating at around 200 bp (see graph 7.8). All in all, this would suggest that Serbia has secured some degree of access to international financial markets.

2.8 Ukraine

In 1998 and 1999 Ukraine carried out a series of selective debt restructurings focused on specific types of instruments including both domestic and international loans and bonds. These were attempts at bridging short-term liquidity needs stemming from investors' flight to quality following the Russian crisis. However, as soon as year 2000, Ukraine was forced to carry out a further and more comprehensive restructuring of its entire stock of outstanding international bonds. Although Ukraine was quite successful in these successive restructurings, gathering a participation rate of 99% in the 2000 exchange, this case illustrates the drawbacks of a piecemeal approach when dealing with an unfolding debt crisis. Indeed, the selective restructurings of 1998 and 1999 simply postponed the problem

33. Only a situation in which by 2003 there was a 30% depreciation would increase the debt-to-GDP ratio, although the subsequent trend until 2007 would still be a declining one.

and protracted the resolution of the crisis. The IMF was closely involved in the resolution of the Ukrainian crisis through an Extended Fund Facility approved in September 1998. This program's implementation was difficult due to significant policy slippages, difficulties to cover residual financing needs and allegations of misuse of the Fund's financial assistance. Although the program went off-track on various occasions, the IMF supported the restructuring all through the process, arguing in favour of the need to involve private creditors to overcome the crisis. In hindsight, however, supporting the authorities' piecemeal approach may have been a mistake. Indeed, the IMF could have used its leverage on the Ukrainian authorities to press for a comprehensive approach from the outset, which may have favoured a more expeditious exit from the debt crisis.

2.8.1 THE CRISIS

At the beginning of 1998, Ukraine showed some signs of recovery from the dramatic economic decline that characterized the post-soviet era, and a positive rate of GDP growth was expected for the first time since independence (see Appendix 1, graph 8.1). However, the situation rapidly worsened in the second half of the year and the economy plunged back into recession. This was primarily the result of contagion from the Russian crisis, to which Ukraine was particularly exposed.

One of the most pervasive problems of Ukraine's transition to a market-oriented economy was the fragility of its public finances. Indeed, in spite of the government's effort to modernize fiscal management and reduce the size of the shadow economy, successive deficits of a substantial scale (5.6% of GDP in 1997) were recorded all through the 90's (see graph 8.2). During the earlier years of the decade, the authorities extensively resorted to the monetization of these deficits, which resulted in intense inflationary pressures including several bouts of hyperinflation. After the monetary stabilization achieved in 1996 the government began to issue debt rather than money in order to cover its financing shortfalls. At that time, foreign investors grew an interest in Ukraine's domestic bonds and the authorities were able to tap international financial markets on various occasions[34], especially in 1997 during which the treasury-bill market became the major source of financing for the budget. However, as a result of investors' flight to quality following the Asian and especially the Russian crisis, Ukraine began to face serious problems to rollover peaks of incoming debt obligations and accumulated new debt at rapidly increasing yields. Eventually, in spite of having a relatively low debt to GDP ratio (41.8% in early 1998[35]), the government was forced to restructure sovereign debt in order to bridge substantial financing gaps (see graphs 8.3 and 8.4).

This deteriorating environment translated into intense pressures on the currency. As a result, the authorities were forced to carry out a series of adjustments in the exchange rate bands and, ultimately, to float the hryvnia in March 1999. In the meanwhile, the central bank depleted its stock of gross foreign exchange reserves, which fell from 148% of short-term debt in 1996 to 14% at the end of 1998 (see graph 8.4). This trend was particularly acute from January to September 1998, during which reserves fell from US$2.34 billion to just US$900 million. Apart from increasing the burden of foreign currency denominated obligations, thereby further feeding the debt problem, the depreciation of the exchange rate had adverse implications for the banking system (see graph 8.5). This was partly due to a September 1998 decree which forced Ukrainian banks to keep up to 75% of their currency holdings in hryvnia. However, the impact of the crisis on the banking system

34. The first launch of an Ukrainian Eurobond took place in August 1997 raising US$396 million at a 12% interest rate.
35. By 1999 this ratio had jumped to 66.7%, partly as a result of the depreciation of the Hryvnia.

was less severe than in some of the other cases analyzed here. In any case, due to its relative underdevelopment, the banking system did not become a major source of macroeconomic instability during the Ukrainian crisis (see graph 8.7).

2.8.2 THE RESTRUCTURING

During the period 1998-2000 Ukraine restructured debt for a value of close to US$2.9 billion (not including the Paris Club treatment), equivalent to 8.8% of GDP. About 85% of this debt (US$2.4 billion) was external and some US$ 300 million were in the hands of domestic banks. The restructuring involved various loans and bonds, some of which were restructured twice in this process. Apart from two very brief periods, one starting in June 1999 and another in January 2000, Ukraine remained broadly current on its obligations to private creditors throughout the restructuring process. It was, however, in arrears with official bilateral creditors since January 2000. This situation persisted until a settlement was agreed with the Paris Club in 2001.

Table 14: Debt stock at the onset of the restructuring (1998) (US$ billion)

Total public sector debt	**16.4**
External	**11.8**
Multilateral	4.8
Bilateral	2.7
Commercial	0.7
Bonds	3.5
Domestic	**4.7**

Source: De Bolle, Rother and Hakobyan.

Ukraine's debt restructuring was carried out in two distinct phases. A first one involved a series of selective restructurings and was aimed at alleviating short-term liquidity pressures exerted by peaks in incoming payment obligations. Eventually, however, this selective approach simply postponed the problem, and Ukraine was forced to comprehensively restructure its international bonds in year 2000. Table 11 summarizes the debt instruments involved at the various stages of the Ukrainian restructuring. With few exceptions, these restructurings did not carry a nominal loss. In some cases, upfront cash payments were used to sweeten the government's offer.

During the first stage of the debt workout in 1998 and 1999 Ukraine carried out four selective restructurings involving a total debt of US$900 million[36]. The first selective restructuring was announced in August 1998 affecting a variety of domestic treasury bills held by Ukrainian banks for an amount of HrV800 million (about US$130 million broadly equivalent to one third of total banks' holdings of domestic T-bills). Maturing instruments were exchanged at par value while newly issued instruments were exchanged at a face value loss of around 35%. The new instruments issued in exchange for the old ones were denominated in domestic currency, had maturities ranging from 3 to 6 years,

36. During this process, one of the targeted debt instruments was restructured twice.

and yielded 40% during the first year, and the 6 month T-bill rate plus 1% for the remainder. This implied relatively mild haircuts ranging between 5 and 9%.

In September 1998, immediately after closing the deal with domestic creditors, the Ukrainian government launched an offer to exchange the local currency denominated treasury bills in the hands of non-residents. This involved a debt amounting to approximately US$300 million. The government gave two options to foreign creditors. Under the first one, which was ultimately largely ignored by investors, old instruments could be exchanged for a new bond denominated in Hryvnia with a 22% yield. Under the second one, investors would receive a 2 year-zero-coupon US$ Eurobond with a 20% yield. In addition, some of the original bonds (9 to 12 months, issued in December 1997) featured guaranteed minimum dollar returns (currency hedges) marketed through Merrill Lynch. The holders of such bonds received a payment in cash for the 20% of the principal present value. The NPV loss associated with this exchange ranged between 39% and 57%, significantly larger than that overcome by domestic creditors. This difference in haircuts is mostly explained by the fact that the yield offered to residents was the market rate, which at that time was close to 70%, much larger than the 20% offered to foreign creditors.

This wave of selective debt restructurings continued with a deal reached with Chase-Manhattan Bank to review the terms of a US$109 million fiduciary loan coming due in October 1998. Under that agreement, the Ukrainian authorities were to repay 25% of the loan in cash, while reconverting the remaining 75% into a new loan, with a US$-rate of 16.7%, payable quarterly since 1999. Principal payments would be of 2 million per quarter during the first year, the rest being due in four instalments in 2000. This deal implied a haircut of around 31%.

Together with the IMF-supported program signed in September 1998, these three selective restructurings relieved liquidity pressures for the remainder of 1998 and for most of 1999. However, as a US$163 million (including interests) 10-months bond placed through ING in August 1998 was coming due in June 1999, the government was forced to seek for a new debt workout. This time, the authorities offered to pay in cash 20% of incoming debt obligations while swapping the remainder for a new international bond with a three-year maturity. The main holder of that bond, however, refused the government's offer and demanded the full servicing of incoming obligations. Ultimately, that payment was missed and for a brief period of time Ukraine was in arrears to its private creditors. Eventually, an agreement was reached in July implying a 20% cash payment and an exchange of the remainder for a DM Eurobond on a 94.3 cents per dollar basis. This operation implied an NPV loss of about 38%. At that time, the authorities took advantage of the occasion and offered the holders of the US$500 million zero-coupon bond issued in September 1998 through Merrill Lynch to join the exchange, this time at a 55 cents to a dollar which could be raised up to 75 cents should investors agree to increase their holdings of the restructured bonds by 15%. This exchange was accepted by about half of eligible bondholders, and implied an NPV loss of 34%.

Table 15: The various stages of the Ukrainian restructuring

	Date	Type of debt	Debt holders	Amount	Remarks
Selective restructuring	August 1998	Domestic T-bills	Domestic Banks	HrV 800 mn	
	September 1998	Domestic -bills	Foreigners (Merrill-Lynch)	$ 300 mn	
	October 1998	Loan	Chase-Manhattan	$ 109 mn	
	August 1999	Loan	ING	$ 163 mn	
		Bonds	Merrill-Lynch (1998 bonds)	$ 250 mn	This amounts to the 50% of the outstanding $500 mn debt with Merrill-Lynch
Comprehensive restructuring	February 2000	Eurobond	Foreigners	$ 500 mn	This bond was issued in March 1998, just before the first restructuring wave
		Eurobond	Foreigners	DM 750 mn	
		Eurobond	Chase-Manhattan	$ 74 mn	This bond had been originated during the October 1998 loan restructuring
		Eurobond	Merrill-Lynch	$ 258 mn	This corresponds to the remaining debt with Merril-Lynch already restructured in 1998 which was not re-restructured in 1999
		Bonds	Gazprom	$ 1 bn	

Source: Authors´ calculations based on various sources.

As mentioned above, the selective restructurings of 1998-1999 simply postponed a broader resolution of Ukraine's unfolding debt problems. This is so because short-term liquidity pressures were only alleviated at the cost of concentrating servicing obligations in years 2000 and 2001. Indeed, total obligations for year 2000 amounted to about US$3 billion[37] with a stock of foreign exchange reserves in late 1999 of just US$1 billion. In this context, Ukraine was forced to carry out a new sovereign debt restructuring adopting, this time, a more comprehensive approach.

The authorities launched a restructuring offer in February 2000. Table 11 summarizes the main features of the debt instruments involved in the second stage of Ukraine's restructuring, as well as the NPV loss ultimately associated with the government's offer[38]. Ukraine made no principal payments in January 2000, and missed coupon payments in February. The grace period expired while the exchange was open, implying that Ukraine was technically in default for a brief period of time. Under the government's proposal, these bonds would be exchanged for a 7 years coupon amortization bond, issued under English law with a one-year grace period. Investors were given two options: a euro denominated bond, with a 10% coupon and a dollar bond with an 11% coupon. Ultimately, the losses associated with these two options were very similar ranging between 29 and 35%. Only the Merrill Lynch deal carried a nominal 5% loss in principal. As part of the exchange, past due and accrued interests were fully repaid in cash.

Ukraine's restructuring involved three bonds under Luxembourg law which carried collective action clauses (85% threshold) and a bond governed under German law without such CACs. In order to cope simultaneously with both types of bonds and to discourage holdouts, a 'hybrid' scheme was devised. Under that scheme, holders of instruments without CACs were directly offered to tender their old bonds for the new ones in a single step. Instead, holders of instruments with CACs willing to accept the government's offer were asked first to grant a proxy vote in favour of the proposed amendments on the old bonds[39]. Upon receipt of a sufficient number of proxy votes, the authorities would call bondholder meetings with the certainty that the terms of such amendments would be accepted, after which the debt exchange would be carried out.

Ultimately, this scheme proved to be quite successful and participation in the exchange reached 99%. This was favoured by various factors. Most of all, the market assessment of the government's offer was quite positive, as suggested by the fact that, as opposed to the other cases analyzed here, the secondary price for the tendered instruments jumped up soon after the completion of the exchange. In addition, the bonds eligible for the restructuring, and especially those including CACs, were in the hands of a few institutional investors, which facilitated the coordination process. Although one of those creditors expressed his intention to litigate, he was unable to gather sufficient support. Retail investors, in turn, were contacted through various investment banks.

On top of the aforementioned four bonds, in year 2000 Ukraine restructured its Gazprom bonds owed to Russia. This debt amounted to close to US$1 billion, carried an 8.5% yield and was due between March 2000 and March 2007. The exchange carried a

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37. Including US$1.1 billion in bonds, US$900 million to the IMF, and US$250 million owed to the Russian Federation.

38. This table reports the losses associated with the dollar denominated bond option. Source: Sturzenegger and Zettelmeyer (2005).

39. Basically, these proxy votes ensured that bondholders would not change their mind as regards their participation in the exchange during bondholders' meetings.

reduction in principal ranging between 0 and 33% depending on the original maturity of the bonds, and implied an average NPV loss estimated at 22%.

A last component of Ukraine's restructuring was bilateral official debt. As mentioned above, Ukraine was in arrears with its Paris Club creditors since January 2000. After lengthy negotiations, in July 2001 an agreement was signed treating under classical terms US$580 million comprising arrears and maturities falling due between December 19, 2000 and September 3, 2002. It included a grace period of three years, and repayment was expected over 12 years. As in all Paris Club agreements, a pre-condition for this treatment was the presence of an IMF-supported program, in the case of Ukraine the 1998 EFF described below. The comparability of treatment clause associated with the Paris Club agreement entailed no further action for Ukraine, given that the restructuring of official debt came after the restructuring of obligations to private creditors.

2.8.3 IMF INVOLVEMENT

Ukraine joined the IMF as an independent state in September 1992. It began making use of the IMF's resources in October 1994, when a drawing was made from the Systemic Transformation Facility[40]. The first formal post soviet-era Ukrainian IMF-supported program was an SBA approved in April 1995 for an amount of SDR 997.3 million (US$1492 million or 54% of quota). This was combined with a second drawing under the Systemic Transformation Facility for an amount of SDR293.3 million (US$373 million) which brought the Fund's financial exposure to Ukraine up to SDR1246.6 million (US$1865 million or 125% of quota). Subsequently, as can be seen in table 12, new SBAs were signed in May 1996 and August 1997. These first programs were aimed at supporting Ukraine's stabilization process, targeting primarily the budget deficit and the growth of the monetary base. Structural conditionality was concerned mostly with the completion of various market-oriented reforms such as the liberalization of prices or the privatization of public enterprises. The implementation record of these three IMF programs was mixed. Indeed, as a result of significant policy slippages, only 54% of the resources committed under the 1995 SBA and 46% of the resources committed under the 1997 SBA were ultimately disbursed. This last program went off-track as a result of larger budget deficit and monetary base expansion than targeted under the program.

Table 16. IMF programs with Ukraine

	Approval	Expiration	Amount	% of quota
SBA	April 1995	April 1996	US$ 1.32 bn	
SBA	April1996	December 1996	US$ 0.79 bn	
SBA	August 1997	August 1998	US$ 0.53 bn	
EFF	September 1998	September 2001	US$ 2.2bn	165
EFF extension	May 1999	–	US$ 336 mn	20

Source: IMF.

40. The Systemic Transformation Facility was created in 1993 to support transition countries. It entailed small amounts of financial support and a soft conditionality. This facility was let to elapse in April 1995.

The program whose implementation coincided with the Ukrainian sovereign debt restructuring was the Extended Fund Facility approved in September, 4 1998. The total amount of resources committed under that program was SDR 1,646 million, equivalent to US$ 2,226 million or 120% of quota. This program was aimed primarily at boosting Ukraine's effort to contain the impact of a worsening regional outlook following the Asian crisis and the Russian August 1998 default. It backed the government's medium-term strategy, which included the following key elements. First of all, the program envisaged a reduction in the overall fiscal deficit to 3.3% of GDP in 1998 and 2% of GDP in 1999. This was to be achieved through the containment of expenditure and the scaling back of several subsidies, but also through the downsizing of the public sector, a structural tax reform and an improvement in the budgetary process. Monetary policy was to be directed at containing inflation and maintaining a stable exchange rate. In addition, the program envisaged a clarification in the relationship between the government and the National Bank of Ukraine and a reduction of the bank's direct financing to the budget. The program carried an ambitious structural agenda which included measures to deregulate, privatize and de-monopolize the economy, to restructure the banking sector and to strengthen banking supervision. The reform of the public administration, the energy and the agriculture sectors was also contemplated under the program.

It is worth noting that the original medium-term strategy advanced by the government in August 1998 in the context of the request for the Fund's financial assistance did not make any reference to the rescheduling of external obligations. In the context of a worsening regional environment, it was recognized at that time that Ukraine would struggle to cover substantial financing gaps, which the authorities hoped to bridge with the assistance of international financial institutions and through a better management of public debt. However, just prior to the approval of the EFF a Letter of Intent was released recognizing that Ukraine was facing growing difficulties to roll-over its short-term debt and that some kind of debt workout would be needed in order to avoid a default. Concretely, the government announced that it was in negotiations with Merryl Lynch and Chase Manhattan Bank to roll-over short-term obligations and that a scheme for the rescheduling of treasury bills held both by residents and non-residents was about to be launched.

It is unclear whether the IMF exerted pressure on the Ukrainian authorities to carry out the selective restructurings of 1998 and 1999. However, the fact that the September 4, 1998 Letter of Intent announcing such restructurings was released just prior to the Executive Board's deliberations on the Ukrainian program suggests that the Fund had concerns about residual financing gaps for the remainder of 1998 and 1999. It might well be that the need to bridge these financing gaps in order to aspire to the Fund's support influenced the authorities' decision to launch the restructurings. In any case, what is clear is that the IMF made no objections to the initial piecemeal restructuring approach of the Ukrainian government. In hindsight, this turned out to be a mistake, given that the first wave of selective restructurings did not avoid the 2000 more comprehensive debt workout.

The implementation of the 1998 EFF was a difficult one. Indeed, soon after the disbursement of the first tranche (about US$300 million), the program went off-track mostly as a result of fiscal fragilities and the postponement of some structural policies. In March 1999, however, the authorities made a further attempt to bring the program back on track and complete the first review of the EFF. Eventually, the IMF agreed to resume the EFF and release the second tranche, for which the authorities committed to intensify their fiscal effort, to reactivate some of the structural policies originally contemplated under the program

and to withdraw some exchange restrictions adopted in the context of the crisis. A few weeks later, the IMF's Executive Board discussed Ukraine's Article IV. In this discussion, some concern was raised about the government's ability to honour its external obligations. As stated in the Public Information Note that was issued following the Board's discussion: "*Even with full implementation of the authorities' reform program and with full support from international financial institutions and other creditors, Ukraine will still face a challenge given the magnitude of the debt service obligations in relation to the level of foreign reserves. Accordingly, Directors encouraged the authorities to initiate timely discussions with foreign creditors to ensure that debt service can continue to be paid in a timely and orderly manner*" (PIN No 99/38, April 27, 1999).

On May 1999, the IMF approved the second review of the EFF, together with an augmentation of the original program by SDR274.4 million (about US$ 366 million equivalent to 20% of quota). Again, it was made clear at the time that the management of the Ukrainian crisis would require a further involvement of private creditors. In fact, the government's Letter of Intent requesting the augmentation announced the ongoing discussions with external creditors to reschedule upcoming obligations. In addition, it was stated that the next program purchase would include a financing assurances review. The third program review was also approved without delay, reflecting an improvement in Ukraine's macroeconomic performance as well as the successful rescheduling agreements reached in August through Merryl Lynch and ING. However, it is worth noting that during the Board's Discussion on the third review of the program, Executive Directors argued that the level of private sector involvement achieved on the ING bonds was insufficient and that this restructuring did not represent a durable solution to Ukraine's debt problems.

Soon after the completion of the third review the program went off-track and remained so for the following months. This was partly due to severe policy slippages during the heated electoral process that led to the November presidential election, but also to allegations of misuse of the Fund's financial support. In any case, during the final months of 1999 it became increasingly apparent that the sizeable repayment peaks due in 2000 and 2001, to some extent a consequence of the previous selective restructurings, constituted an evident threat in the medium-term. At this juncture, the Ukrainian authorities began to explore the possibility of carrying out a final and more comprehensive restructuring which, as we know, was launched in February 2000.

The 2000 debt restructuring, therefore, was conducted when the IMF program was off-track. In fact, as mentioned above, at the time of the restructurings the relationship between Ukraine and the IMF had entered a difficult stage due to the misreporting of international reserves on the part of the central bank during the implementation of the 1996 and 1997 SBAs. After the completion of various audits on the central bank it was concluded that Ukraine had breached its obligations to the IMF, which stood on the way of a resumption of a normal program relation. In spite of this turn of events, the IMF continued to support Ukraine's debt restructuring. Indeed, in February 2000, the Fund's management sent a letter of support describing Ukraine's macroeconomic situation and arguing that the conditions of the debt exchange could be consistent with a program supported by the IMF [IMF (2006), *Cross-Country Experience with Restructuring of Sovereign Debt and Restoring Debt Sustainability]*.

In December 2000, partly as a result of a marked improvement in Ukraine's economic performance (a positive rate of GDP growth was registered for the first time since

independence) and of the success of the 2000 debt restructuring, the EFF could be brought back on track. The resumption of the program was particularly relevant given that Ukraine was in the midst of negotiations with its bilateral official creditors and that the Paris Club requires the presence of an on-track IMF program in order to grant a treatment. However, the next program reviews could not be completed due to significant slippages in base money growth and in some of the government's structural reforms. In spite of the fact that the IMF program was once more off-track, the Paris Club treatment was signed in July 2001. Nevertheless, it was established at the time that the debt relief conceded by the Paris Club of creditors could only come into effect with the approval of the fifth program review. Eventually, in August 2001, the IMF's Executive Board approved this review, thereby enabling the Ukrainian debt restructuring to be completed.

The fifth and sixth reviews of the Ukrainian EFF could be completed without much delay. It is worth mentioning that at that time Ukraine had accumulated substantial arrears on gas imports from Russia. The IMF treated these arrears as external arrears to private creditors, implying that the Fund's Policy of Lending Into Arrears came into effect during the final stage of the program's implementation. The Ukrainian EFF eventually expired in September 2002. Overall, from the US$2.56 billion committed by the IMF Ukraine only purchased US$1.54 billion, slightly above 60% of total. The size of un-disbursed commitments illustrates the problematic implementation of the 1998 EFF.

2.8.4 RECOVERY FROM THE CRISIS

At the turn of the century, and following the completion of the comprehensive debt exchange, Ukraine experienced quite a significant economic recovery, with GDP growth averaging over 8% in between years 2000 and 2004 (see Appendix 1, graph 8.1). To a large extent, this was driven by a favourable external environment, booming exports to Russia and China, and a succession of current account surpluses registered after 1999. In addition, a surge in credit to the private sector together with rising wages and remittances from abroad brought about a robust expansion of domestic demand. Inflation was brought down from 26% in 2000 to a historical low of -0.6% in 2004 and the government implemented prudent fiscal policies, with moderate primary surpluses maintained during the years that followed the crisis. On the negative side, relatively few structural reforms were undertaken during that time, undermining long-term growth prospects and failing to improve a generally weak investment climate. After 2004, the situation began to deteriorate again with declining rates of GDP growth and renewed inflationary pressures[41].

Ukraine's relatively low debt to GDP ratio suggests that the crisis was rooted in a problem of illiquidity rather than a problem of insolvency. Consequently, most observers including the IMF judged Ukraine's debt dynamics to have entered a sustainable path following the liquidity relief achieved with the comprehensive debt workout, The baseline scenario of the DSA produced by the IMF in 2004 predicted a decline in Ukraine's debt to GDP ratio to 17% by year 2009. The stress tests conducted by the IMF assessed this public debt profile to be quite robust to various shocks, the main risks being the advent of a sharp recession combined with a substantial relaxation of the fiscal stance.

As shown in Appendix 1, Graph 8.8, Ukraine's sovereign spreads declined quite markedly following the Paris Club treatment signed in July 2001. The EMBI fell under

41. Inflation reached double digits again in year 2004. This was the result of unsterilized interventions to maintain the peg to the US$, and of the inflationary dynamics brought about by rising wages.

the 1000 bp level by the end of that year, and Ukraine issued its first international bond after the restructuring in mid-2002 at a spread of approximately 600 bp.

2.9 Uruguay

Largely as a result of contagion from Argentina, Uruguay underwent a severe recession and financial crisis at the turn of the century. As part of a broader crisis resolution effort, in 2003 the authorities launched a sovereign debt restructuring by means of a bond exchange. To some extent, and with the support of international financial institutions, this debt workout was designed and conducted as the antithesis of the Argentine restructuring. Indeed, the authorities went at great length to remain current on international obligations, stressing the market-friendly, voluntary and cooperative nature of the restructuring. Together with the moderate losses imposed on investors, this approach secured a quick outcome and a relatively high participation in the exchange. However, whether the Uruguayan restructuring carried a sufficient relief to restore debt sustainability has been a matter of much debate. This case illustrates some of the trade-offs facing the authorities when designing a debt restructuring strategy. On the one hand, a cooperative stance is likely to accelerate the process, anticipating the relief of liquidity pressures and probably facilitating a future re-access to international financial markets. On the other hand, this market-friendly approach is contingent on the imposition of moderate losses on investors, which on occasions may be insufficient to restore debt sustainability.

2.9.1 THE DEBT CRISIS

In 1999, following years of economic expansion, the Uruguayan economy abruptly slid into recession: GDP shrunk by 7.5% in years 1999-2001 (see Appendix 1, graph 9.1). This was caused primarily by a string of external factors such as the depreciation of the Brazilian real and, more importantly, a worsening regional environment as a result of the Argentine crisis. This recession degenerated into a banking crisis in 2002 when cash-strapped Argentines started to withdraw deposits from Uruguay on a large scale[42] (see graph 9.7). As the panic extended to nationals, by July 2002 more than 40% of deposits had been withdrawn from domestic banks, forcing the central bank to pump liquidity into the system. However, the provision of LOLR assistance failed to stop the run on banks and, eventually, the authorities had to resort to more heavy-handed measures: foreign currency deposits were re-programmed and the operations of some of the largest financial institutions suspended. Largely as a result of the liquidity squeeze caused by this banking crisis, Uruguay's GDP declined by 11% in 2002.

Given that most of the deposits withdrawn from the banking system fled the country and that the general loss of confidence in the Uruguayan economy triggered a process of currency substitution, the peso underwent intense pressures in 2002 (see graph 9.5). Eventually, as the stock of foreign exchange reserves dwindled, the central bank was unable to sustain the peg to the US$ and the currency was floated in June 2002. In a matter of weeks the peso underwent a depreciation of about 50% (see graph 9.4). In turn, the twin banking/currency crises triggered adverse dynamics in the debt to GDP ratio, which more than tripled between 1999 and 2003 (see graph 9.3). This was due to the fiscal impact of the recession (see graph 9.2), to the cost associated with the banking crisis and the extension of liquidity assistance to troubled banks and, most of all, to the fact that a large portion of Uruguay's sovereign debt was denominated in foreign

42. About 50% of deposits in Uruguay's banking system were held by Argentines. These withdrawals were primarily caused by the deposit freeze enacted in Argentina at the peak of the crisis (the 'Corralito' and the 'Corralón).

currency. By early 2003, the debt to GDP ratio reached 95% and most observers concurred that the only way out of the crisis would be a sovereign restructuring.

2.9.2 THE RESTRUCTURING

On March 11, 2003, Uruguay announced the restructuring of its entire stock of tradable securities denominated in foreign currency with an initial maturity over 12 months[43]. Overall, about 42% of total debt was eligible for the restructuring, amounting to US$5.3 billion in the hands of both residents (44.1% of total) and non-residents (55.9% of total). This included 65 bond issues: 46 domestic bonds amounting to US$1.6 billion in principal; 18 Eurobonds with a face value of US$3.5 billion; 1 Samurai bond amounting to US$250 million. These instruments' remaining maturities ranged from a few days to year 2027.

Table 17: Debt stock at the onset of the restructuring (2002) (US$ billion)

Total public sector debt	**12.2**
External	**8.3**
Multilateral	4.5
Bilateral	0.3
Commercial	0.4
Bonds	3.1
Domestic	**4.0**

Source: De Bolle, Rother and Hakobyan.

From the outset, the authorities insisted on the market-friendly nature of the debt workout and international creditors were actively involved in the design of the restructuring offer through a series of road shows and consultations in the major financial centres. The tender was eventually launched in April 2003. At the time, the authorities' committed to carry out the exchange should a minimum acceptance rate of 90% be reached[44]. Bondholders were given a choice between two options:

(i) A maturity extension option under which payments on principal would be extended by 5 years on average. The exchange would be carried out at par value and coupons would remain unchanged. The new instruments would be combined in some cases with a new 30 year bond capitalizing interest payments for the first five years.

(ii) A benchmark bond option under which old bonds would be exchanged at par value for a smaller number of new bonds (four domestic bonds and three external bonds) in order to increase the liquidity of the new instruments. Again, coupons would remain broadly unchanged, with new maturities after the extension ranging from 7 to 30 years.

43. The restructuring excluded debt owed to international financial institutions, tradable securities with an initial maturity of less than a year and non-tradable debt held with other private and public creditors.

44. The government specified that no debt exchange would take place with an acceptance rate under 80% while retaining its discretion to carry out the exchange should that acceptance rate be comprised in between 80 and 90%.

In addition, some bondholders were offered some small up-front cash payments to compensate for accrued interest on the old bonds and the holders of two Brady bonds received the net present value of these instruments' principal in cash.

Less than 3 months after the launching of the restructuring process, on May 29 2003, the exchange was officially closed, although the central bank announced in June that it would continue accepting domestic bonds not yet submitted. The participation rate in the exchange surpassed 92% with domestic creditors almost universally tendering their bonds (98.8%) and a somewhat lower participation among non-residents (89.2%). About two thirds of participants chose the benchmark bond option.

Various factors contribute to explain the high participation in the Uruguayan debt exchange. First of all, the losses associated with this debt workout were low. In fact, bondholders incurred no nominal loss and coupons remained broadly unchanged. However, the exchange carried an NPV loss. This is so because the discount rate used to compute the NPV impact of the restructuring is inevitably higher than the yields attached to the exchanged instruments, which were determined when Uruguay was still enjoying investment grade ratings. The IMF has estimated the NPV loss associated with the exchange to be in the range of 8 to 20%, depending on the discount rate used in the calculation. Second, as already mentioned, the exchange was carried out in market friendly terms, and the authorities went at great length to consult investors and to try to accommodate their demands. Third, the exchange included a variety of disincentives to holdouts such as the de-listing of old bonds[45], the use of exit consents to vitiate the claims of holdouts and worsen the conditions of non-tendered instruments, or the introduction of "cross default clauses" in the new bonds making it easer for the government to selectively default on the old ones. Last but not least, at the time of the launching of the restructuring investors were conscious of the fact that, should the exchange fail, there would be a high risk of Uruguay following the path of Argentina and defaulting on its sovereign debt. As we shall see later, the IMF contributed to this perception by making it clear that a failure of the restructuring (i.e. an insufficient participation in the exchange) would force the Institution to suspend its financial support to Uruguay.

The exchange resulted in the tendering of bonds with a face value of close to US$5 billion, bringing about a substantial alleviation of liquidity pressures: principal payments on medium and long-term debt due during the period 2003-2007 were reduced from US$2.1 billion to US$300 million. For year 2003 alone, debt servicing payments were reduced from US$469 million to US$23 million. In spite of this liquidity relief, which is likely to have avoided a sovereign default, many observers argued that Uruguay's restructuring was carried out in too lenient terms and that, consequently, it failed to restore debt sustainability. This was grounded in the idea that, given that the exchange carried no nominal losses, the debt to GDP remained unchanged at 94%, an excessive burden for a small emerging market like Uruguay. As a result, it was argued that Uruguay was left exposed to an excessive level of vulnerability following the debt workout. We shall come back to this issue later.

2.9.3 IMF INVOLVEMENT

The IMF played a decisive role in the Uruguayan sovereign debt restructuring along the following dimensions. In the first place, it was an important actor in the decision making

45. This implied that the risk-weighting of old bonds would be 100% for banks' capital adequacy purposes, and that pension funds could no longer hold old bonds. In addition, the central bank announced that it would not accept old bonds as collateral in the provision of liquidity assistance.

process that led the authorities to launch the restructuring. This is so because, as we shall see below, the Fund's decision to expand its financial assistance to Uruguay was made conditional on the elimination of sizable residual financing gaps, which was feasible only through the restructuring of the sovereign's obligations. Second, in relative terms, the IMF provided financial assistance to back Uruguay's crisis resolution efforts on an unprecedented scale: after the two augmentations, the program became the largest in the history of the IMF if measured against the size of the recipient economy. Third, the IMF created an incentive scheme which encouraged bondholders to participate in the exchange. Indeed, in a comfort letter issued prior to the launching of the bond exchange, the IMF made it clear that subsequent program reviews would be possible only if a large portion of bondholders took part in the exchange. Given the scale of Uruguay's liquidity problems and the size of the program, it was clear at the time that a suspension of the Fund's financial support would entail a sovereign default.

There are various reasons that explain the Fund's support to Uruguay's debt restructuring. Among the cases analyzed in this paper, Uruguay's comes closer to the 'innocent bystander' scenario in which the crisis was caused by contagion rather than policy slippages. In addition, there was an interest on the part of both the Uruguayan authorities and the IMF to present this debt workout as an antithesis to the Argentine restructuring. As mentioned above, this contributes to explain the market friendly approach of the restructuring as well as the moderate haircuts imposed on investors. It is worth noting that, as a result of the lack of external arrears with private creditors throughout the restructuring, the Policy of Lending Into Arrears never came into effect in Uruguay's case.

As we can see in table 14, the IMF was almost continuously involved in Uruguay since the early 90's. The program in place at the outset of the crisis was a 22-months SBA approved on May 2000 for an amount of SDR 150 million (US$197 million) equivalent to 50% of Uruguay's quota. This program was initially intended to be treated as precautionary and was primarily aimed at trying to shield Uruguay against contagion from the crises of Argentina and Brazil. It basically provided the Fund's seal of approval on the government structural reforms and fiscal consolidation efforts. Eventually, however, as the situation continued to deteriorate throughout 2001 and 2002, Uruguay drew the full amount of the resources committed under the program prior to its expiration. This constituted the prelude of a much tighter IMF involvement in the management of the Uruguayan crisis.

Table 18: Recent IMF programs in Uruguay

Arrangement	Approval	Expiration	Amount	% of quota
SBA	May 2000	Mar 2002	SDR 150mn	49
SBA of which SRF	Apr 2002 Jun 2002	Mar 2005 Aug 2002	SDR 1988.5mn SDR 128.7mn	695
SBA	Jun 2005	Jun 2008	SDR 766.25mn	250

Source: IMF.

Right after the expiration of the 2000 program, a new two-years SBA was approved for an amount of SDR 594.1 million (US$743 million) equivalent to 194% of quota. Again, the program's main concern was to offset the contagion effects triggered by the Argentine

crisis. Its macroeconomic conditionality focused primarily on fiscal consolidation, targeting a rise in the primary surplus of the combined public sector to 3.2% of GDP. The program also envisaged a number of structural measures focused on the rationalization of the tax system and the reinforcement of the banking sector. Among other measures, the program required Uruguay not to reopen intervened banks until the restoration of their viability and the fulfilment of all prudential norms.

The new SBA, however, failed to stabilize the Uruguayan economy and during the weeks following its approval the situation continued to worsen, especially in the banking system which was in the midst of a seemingly unstoppable run on deposits. As a response, in a matter of months the IMF approved two successive augmentations of the original program. The first one was approved in June 2002 for an amount of SDR 1.16 billion (about US$1.5 billion), bringing the total amount of resources committed by the IMF to SDR 1.75 billion (US$2.28 billion) equivalent to 571% of quota. The second one was approved in August 2002, this time for an amount of SDR 376 million (US$ 494 million). Together with the previous one, total IMF's financial exposure to Uruguay was brought up to SDR 2.13 billion or US$ 2.8 billion equivalent to 695% of quota. Both augmentations were aimed primarily at boosting the authorities' efforts to restore confidence in the banking system: the resources committed by the IMF were used to feed a government-supported fund for the provision of liquidity and, if needed, capital support, to the banking sector[46]. In fact, one of the most novel features of the IMF package for Uruguay is precisely its focus on the support of the Authorities' capacity to provide Lender of Last Resort assistance in the context of a highly dollarized financial system[47].

However, what matters most for our analysis is that it is during the negotiations of the two augmentations that views began to converge about the need to restructure Uruguay's sovereign debt. This is so because, in spite of the size of commitments by the IMF and other IFIs, substantial financing gaps persisted in the short to medium term. Indeed, as argued in the 2005 IMF's Ex-post Assessment of Longer-Term Program Involvement in Uruguay, "(…) *the IMF is precluded from providing further financing, absent a credible program entailing the restructuring of the debt in a manner that ensures medium-term sustainability. The August 2002 augmentation was thus provided with the understanding that a solution would be found to the debt problem that would ensure sustainable debt dynamics over the medium term*." According to this statement, although the official launching of the debt workout took place a few months later, by the second augmentation the decision to restructure had already been taken.

The second review under the 2002 SBA, which was scheduled to take place in October 2002, suffered some delay. This was due to a combination of factors including an insufficient progress with the resolution of suspended banks. However, what appears to have constituted the main obstacle to the approval of the second review of the SBA is the failure to agree on a strategy to eliminate the aforementioned residual financing needs. Eventually, on March 2003 the Uruguayan authorities communicated their intention to carry out a comprehensive debt restructuring, which broke the deadlock in the negotiations[48]. Soon

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46. The Funds' financial assistance for that purpose was complemented by both the World Bank and the IADB, which committed to disburse US$500 million per year in 2002 and 2003.

47. In fact, it has been argued that IMF-supported program may not be well-suited to pursue this objective as a result of their tranche structure: immediate disbursements tend to be too small while the overall size of the program tends to be too large (Uruguay: Ex Post Assessment of Longer-Term Program Involvement, 2005).

48. This was done through a March 12, 2003 supplement to the letter of intent dated February 24. In this letter, the Uruguayan authorities stated that the objectives of the restructuring were: "(i) to provide sufficient cash flow relief

after, the second review was completed, releasing a disbursement of SDR 218.5 million (US$303 million). In addition, the SBA was extended by one year, and repayment expectations under the SRF arising in 2003 were deferred.

The IMF appears not to have played a substantive role in the design of Uruguay's restructuring offer, for which the authorities relied on their own financial and legal advisors. However, as mentioned above, the IMF was an important provider of incentives to participate in the exchange. Indeed, right after the approval of the second program review it was made clear that the third one would be made conditional on the attainment of sufficient cash flow relief through the debt exchange. This was communicated to the market in a letter dated April 22, 2003 addressed by the IMF's Managing Director to members of the international financial community: "*Achieving these objectives is a condition for completion of the next (third) review under Uruguay's Stand-By Arrangement. A successful debt exchange requires high participation to allow the program to go forward and the forthcoming review to be completed*". This is likely to have constituted an important factor in explaining the high participation rate in Uruguay's debt workout given that investors were aware of the high risk of default that a suspension of the Fund's financial support would have entailed.

The IMF also played a role in Uruguay's restructuring as a provider of information. This was done through the divulgation of the staff report on the second review of the SBA on April 25, 2003. Apart from outlining the government's economic program and putting the Fund's seal of approval on this policy framework, the report contained an evaluation of Uruguay's financing needs in the medium-term. This evaluation fell short of a Debt Sustainability Analysis. However, it clearly outlined the cash relief needed from the debt workout in order for the debt servicing profile to be sustainable until year 2007. More precisely, the staff report established that the debt workout should reduce Uruguay's financing needs by US$470 million in 2003 and by US$800 million on average for 2004 and 2005. It was estimated that, given that the government's debt strategy was to extend maturities without changing coupons, this cash flow relief could be attained only if participation in the exchange reached about 90%.

On June 2003, the SBA's third review was completed, reflecting the success of the debt exchange. Subsequently, in spite of some delays with some structural measures, the program's implementation was successful partly helped by a faster than expected economic recovery and by the authorities resolve on the fiscal front. The various reviews were approved until the expiration of the program on March 2005. A new three-years SBA for an amount of SDR 766.3 million (US$ 1.13 billion equivalent to 250% of quota) was approved on June 2005, partly in order to smoothen Uruguay's exit from the IMF's financial assistance. By mid-2006, however, Uruguay began anticipating the repayment of its obligations to the IMF, further reflecting the recovery from the crisis.

2.9.4 RECOVERY FROM THE CRISIS

Following the completion of the debt restructuring, Uruguay experienced a remarkable recovery from the crisis. Indeed, by year 2003 positive rates of GDP growth were already being registered (2.5%), later to rise to a record 12% in 2004 (see Appendix 1, graph 9.1). After the price pressures of the crisis years (14% in 2002 and 19% in 2003), inflation was brought down to single digits in year 2004. The external sector substantially contributed to

in order to fully eliminate any residual financing needs during 2003-2005; and (ii) achieve a sustainable debt and debt service profile over the medium-term, under the economic assumptions contemplated in the Letter of Intent. We understand that achieving the above-defined objectives is a condition for the completion of the review under the Stand-By arrangement".

this economic turnaround. The current account balance changed sign in 2004, registering a surplus of 0.3% of GDP. In addition, substantial FDI and portfolio flows, together with the financial assistance by IFIs, contributed to strengthen Uruguay's balance of payment and to re-constitute the central bank's stock of foreign exchange reserves[49] (see graph 9.6). The financial system also stabilized in those years, and deposits reached 80% of their pre-crisis level in 2004. This reflects the steps taken to restructure the domestic banking system, which contributed to improve credit conditions and to support Uruguay's economic recovery.

Crucial to the recovery of the Uruguayan economy has been the authorities' resolve on the fiscal front: the primary balance evolved from a deficit of 1.2% of GDP in 2001 to a surplus of 3.8% of GDP in 2004. Together with the appreciation of the peso and a robust economic growth, this has brought about positive debt dynamics which are best illustrated in the early cancellation of the IMF supported program in 2006. By end-2005 the debt to GDP ratio had already been brought down to 69% from its peak of 104% in 2003 (see graph 9.3).

However, in spite of this positive trend, several observers raised doubts about the sustainability of Uruguay's sovereign debt. In fact, it was often argued at the time that the relief obtained with the debt restructuring was insufficient. The debt sustainability analyses published by the IMF in 2003 and 2004 highlighted the considerable vulnerabilities that still lied ahead after the debt workout. The IMF's baseline scenario foresaw a decline in the debt to GDP ratio from 92% of GDP in 2004 to a more manageable 50% in 2012. However, this was contingent on the difficult maintenance of primary surpluses on the range of 3.5-4% over this time span, and on the successful completion of several structural reforms (fiscal reforms, public enterprise and labour markets reforms, expanding trade opportunities and development of capital markets just to name a few). Furthermore, this scenario did not take into account the potential emergence of certain contingent liabilities associated with public banks' restructurings. Finally, stress tests revealed the existence of significant vulnerabilities, especially related with the evolution of economic growth, the exchange rate and the interest rate.

As shown by the evolution of the EMBI, Uruguay's sovereign spreads began to decline with the launching of the debt restructuring offer, falling below 1,000 bp right after the completion of the exchange (see graph 9.8). However, spreads remained above pre-crisis levels until 2005, possibly reflecting the fact that, at the time, investors were still dubious about the sustainability of Uruguay's sovereign debt. In any case, Uruguay was able to issue an international bond in November 2003, just a few months after the completion of the restructuring. This would suggest that, all in all, Uruguay regained access to international financial markets relatively fast.

49. The stock of foreign exchange reserves reached US$2.5 billion at the end of 2004, 80% of the 2001 level.

3 Conclusions

This paper has reviewed 9 recent sovereign debt restructurings with a special focus on the role, if any, played by the International Monetary Fund during these episodes. Our analysis reveals the existence of important differences between the cases analyzed here regarding the roots of the debt crises, the ways in which the restructurings were conducted, the size of haircuts and distribution of the losses undergone by the various categories of creditors involved, the extent to which the IMF exerted an influence in the restructurings, and the speed at which countries recovered access to international financial markets after the completion of the debt workouts.

A first crucial differentiation is between *pre-emptive* restructurings, in which sovereigns remained broadly current on the servicing of their obligations while renegotiating the terms of their debt, and *post-default* restructurings, where the sovereigns interrupted the servicing of their obligations until a settlement was reached with private creditors. The cases of Belize, the Dominican Republic, Pakistan, Ukraine and Uruguay correspond to the first scenario, and the cases of Argentina, Ecuador, Russia and Serbia to the second. A relevant question is what were the factors that shaped the sovereigns' decision to continue honouring their obligations or to defaulting. Various hypotheses can be advanced in that respect. A first one is that pre-emptive restructurings are associated with situations of illiquidity and post-defaults ones with situations of insolvency. However, reflecting the complicated dynamics of debt restructurings, this dichotomy is not always straightforward. In fact, some of the pre-emptive debt restructurings analyzed here had worse liquidity and solvency indicators than some of our post-default cases. For instance, Pakistan and Uruguay had higher debt service to reserves and debt to GDP ratios than Russia or Serbia.

All in all, domestic political, institutional and social factors seem to have played a substantial role in shaping the government's decision to default. This is particularly clear in Argentina, where the default followed the fall of an elected government and was partly aimed at calming social unrest and signalling a change in the course of economic policies; in Russia, where the default followed the rejection by the parliament of a stabilization package which could have resulted in a resumption of IMF disbursements; or in Serbia, where the default was largely a by-product of the armed conflicts of the 1990s. However, this leaves unanswered the question of why the other countries of our sample did opt to remain current on their obligations while negotiating with their creditors and, thereby, to postpone the liquidity relief until the completion of the debt workout.

Our analysis points at the existence of various types of incentives for sovereigns to restructure pre-emptively. The countries that avoided defaulting tend to coincide with those that applied a market-friendly and cooperative approach, largely aimed at limiting the reputational cost associated with the crisis. We find evidence that remaining current on the servicing of debt tended to facilitate the restructuring in terms of duration (on average, a settlement was reached much faster than in the post-default cases), creditors' participation (there was a lower proportion of holdout creditors in the pre-emptive cases) and international litigation. Perhaps more importantly, among the countries of our sample, those that remained current on their international obligations, and especially the Dominican Republic and Uruguay, restored access to international financial markets much more quickly than defaulters. It would seem, therefore, that bringing about a rapid normalization of their standing in the international

financial community was the strongest incentive for sovereigns to avoid defaulting. On the other hand, defaulters secured a substantially larger debt relief than non-defaulters: on average, the average 'haircuts' measured in NPV terms associated with our post-default cases reached 41.8% against 19% in the pre-emptive cases. This may reflect the fact that the act of defaulting tends to alter the bargaining power of creditors and the sovereign debtor in favour of the latter.

A second differentiating factor is the degree of *comprehensiveness* with which the sovereigns conducted the restructurings. While a few of the sovereigns studied here did involve most creditors in the restructurings, thereby bringing about some degree of inter-creditor equity, others tried to ring-fence certain categories of creditors from the effects of the crisis. In fact, most of the cases of our sample did feature some degree of selectiveness at some point of the debt restructuring process. Often, this reflected a 'gambling for resurrection' strategy aimed at bridging liquidity pressures while avoiding a full-fledged default. For instance, Argentina and Russia carried out two voluntary debt exchanges at an early stage of the crisis (the July 1998 exchange of ruble-denominated debt for Eurobonds and the June 2001 mega-swap of Argentine bonds), Ukraine carried out a series partial restructurings with various specific creditors in 1998 and 1999, and Ecuador tried originally to persuade its creditors to limit the default to PDI and Discount bonds. In most of these cases, these partial attempts failed, anticipating future solvency problems and even aggravating the crisis. For instance, financial engineering operations such as the Argentine mega-swap were carried out at a NPV gain which substantially increased debt repayments in the medium term, Russia's failed debt exchange further raised awareness about the extent of the liquidity pressures undergone by the government, and Ukraine's partial restructurings simply postponed a longer-lasting solution to the debt crisis.

An interesting pattern revealed by our case studies is that, through the comparability of treatment clause attached to its agreements, the early involvement of the Paris Club of official creditors may have a bearing on the extent to which sovereigns try to discriminate between types of creditors. This is so because the comparability of treatment clause requires the sovereign to secure debt relief from private creditors on a similar scale as that granted in the first place by official creditors. As a result, those countries like the Dominican Republic, Pakistan or Serbia which involved official creditors at an early stage of the crisis were forced into adopting a comprehensive approach from the outset, even when external private debt did only constitute a minor component of total debt (as was the case of Pakistan). In this context, some countries (for instance, Argentina) may have had an incentive to postpone negotiations with the Paris Club in order to retain their ability to discriminate between investors and types of debt.

The treatment of resident vs. non-resident creditors deserves special attention given the propensity for sovereigns to discriminate between these two categories of investors, and given the implications of the losses undergone by nationals for the domestic economy. On the one hand, sovereigns may try to exploit their jurisdictional competences over domestic creditors, encouraging or even coercing them into absorbing new debt or participating in a restructuring. The cases of Argentina and Russia suggest that the authorities may be particularly prone to adopting such a strategy at an early stage of the crisis, in an attempt to exhaust all potential domestic sources of finance and not to face a more contentious restructuring of external obligations under foreign jurisdictions. On the other hand, when the restructuring of external debt becomes inevitable or when a default is consummated, sovereigns may try to give a preferential treatment to national creditors, either to limit

the impact of the restructuring on the domestic economy (and especially on the domestic banking system) or for political economy reasons. The sovereigns' incentives to discriminate between residents and non-residents, therefore, may evolve over time as debt problems unfolds, with important implications for burden-sharing, inter-creditor equity and, ultimately, recovery from the crisis.

Our analysis reveals that the IMF can play a significant role during sovereign debt restructurings along a number of possible dimensions. First of all, the IMF provides financial assistance at a time in which countries are most likely to have lost all meaningful access to international financial markets. In this context, the foreign exchange provided by the IMF can be of crucial importance for containing the impact of the crisis on the real economy and the export sector. Second, through the conditionality associated with its programs, the IMF contributes to determine a domestic adjustment path for the short to middle term. In such a way, the Fund's conditionality can contribute to anchor the negotiations between the sovereigns and their private creditors. Third, the IMF can function as a provider of information, releasing program-related or other types of documents. Again, this can be particularly important in the context of a sovereign debt restructuring given the heightened uncertainty and informational asymmetries that tend to characterize such episodes. Fourth, the IMF can provide incentives to the parties involved in a restructuring, for instance, through the 'good faith criterion' associated with the policy of lending into arrears, or through the issuance of 'comfort letters' in which the Managing Director encourages private creditors to take part in a debt exchange.

As in other aspects of the sovereign debt restructurings analyzed in this paper, the extent to which the IMF has acted along the aforementioned dimensions has substantially varied from case to case. For instance, the size of IMF-supported programs has varied from 75% of quota in the case of Ecuador or 100% of quota in Pakistan, to 695% of quota in Uruguay or 800% of quota in Argentina. Furthermore, the IMF's role as a provider of financial assistance is very much shaped by the existence or not of *inherited* programs at the time of the launching of the debt restructuring. Especially when large, If such inherited programs were in place, the new programs approved in the context of the debt restructuring may have partially or fully served to roll-over the government's obligations vis-à-vis the IMF. This was particularly the case of Argentina, where the various programs approved after December 2001 did only maintain the IMF's exposure to that country, without providing additional resources.

We have also observed differences in the amount and type of information provided by the IMF during a restructuring. To a large extent, this is a result of the transparency policy of the IMF, under which the publication and disclosure of any relevant document is the prerogative of the member. Finally, the extent to which the IMF provided incentives to the parties involved depended upon the activation or not of the Policy of Lending Into Arrears. Indeed, if this policy was not activated, as was the case in the pre-emptive restructurings analyzed here, member states were not formally required to negotiate in good faith. In any case, and especially after the Argentine experience, many observers have raised doubts about the effectiveness of the 'good faith' criterion, given its fundamentally judgemental and arbitrary nature.

Probably, where the highest degree of consistency between our various case studies is found is in the role of the IMF as the setter of a short to medium term macroeconomic framework to anchor negotiations. Indeed, in most of the cases covered here, the IMF did

incorporate a conditionality specifying a path for domestic adjustment over the program period. However, even in that dimension we do find an important exception: the Argentine debt restructuring. In that case, the program's conditionality was set in soft and short-term oriented terms (the September 2003 program established a 'floor' on the primary surplus of 3% of GDP without specifying a target for 2005 and 2006), probably in order not to alter the bargaining power of the government and its creditors.

To conclude, our paper has revealed the lack of a single model of sovereign debt restructurings. Indeed, the governments analyzed here have adopted very different strategies depending on social, political and institutional factors, on the structure of the debt to be restructured and on the roots of the crisis. The IMF has adopted a case by case approach in order to adapt to the various possible debt restructuring scenarios. This flexibility, however, may have come at the cost of heightening the uncertainty regarding the intervention of the IMF in particularly disruptive scenarios such as sovereign debt restructurings. A relevant question, therefore, is whether a pre-specified IMF policy to deal with sovereign debt restructurings is needed. Such a policy would need to establish and rationalise ex ante the role that the IMF is to play along each of the different dimensions of its potential involvement in sovereign debt restructurings. These issues are further explored in the companion paper by Díaz-Cassou et al. (2008).

ACRONYMS

CACs	Collective Action Clauses
DSA	Debt Sustainability Analysis
CAFTA	Central America Free Trade Area
CAF	Corporación Andina de Fomento
CPI	Consumer Price Index
CCFF	Compensation and Contingency Financing Facility
COMECON	Council for Mutual Economic Assistance
EMBI	Emerging Markets Bond Index
ESAF	Enhanced Structural Adjustment Facility
EFF	Extended Fund Facility
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GKOs	Russian Government Treasury Bills (Russian acronym)
IADB	Inter American Development Bank
IAN	Interest Arrears Notes
IFIs	International Financial Institutions
IMF	International Monetary Fund
LOLR	Lender of Last Resort
LC	London Club
NPV	Net Present Value
OFZs	Russian Federal Loan Bonds (Russian acronym).
OSCE	Organization for Security and Cooperation in Europe
PC	Paris Club
PDI	Past Due Interest
PRIN	Principal Note
SBA	Stand-By Agreement
SDR	Special Drawing Rights
SDRM	Sovereign Debt Restructuring Mechanism
SRF	Supplemental Reserve Facility
UN	United Nations
VAT	Value-added Tax

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Argentina

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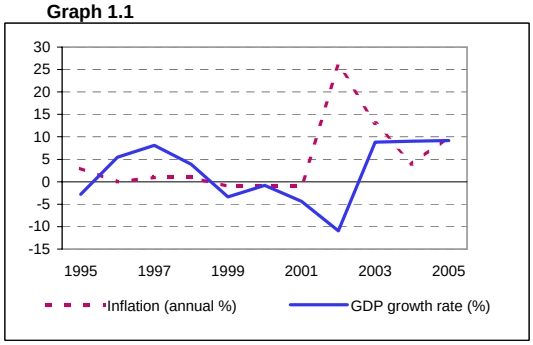

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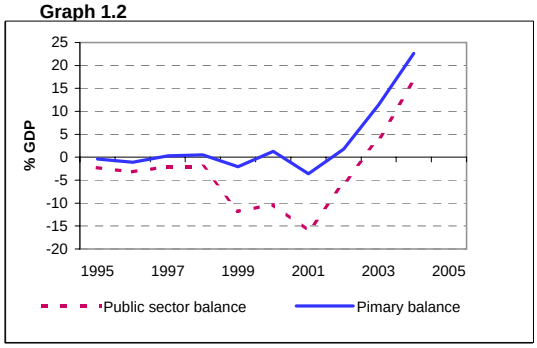

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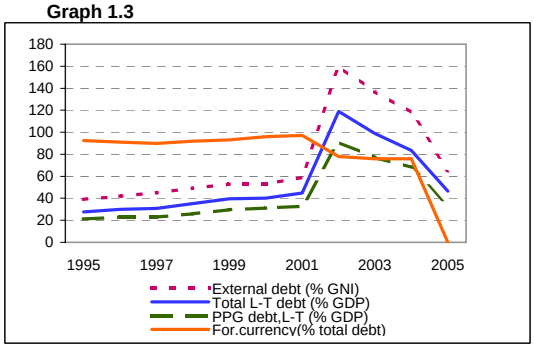

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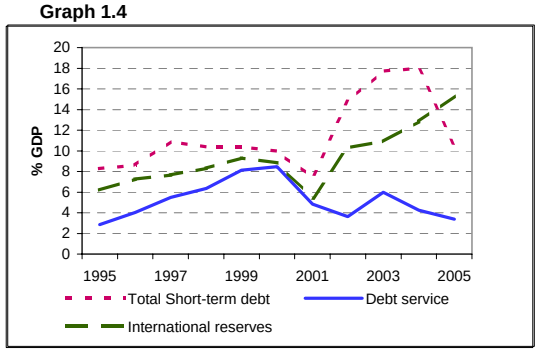

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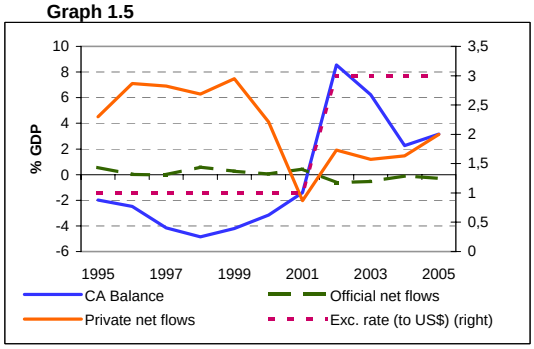

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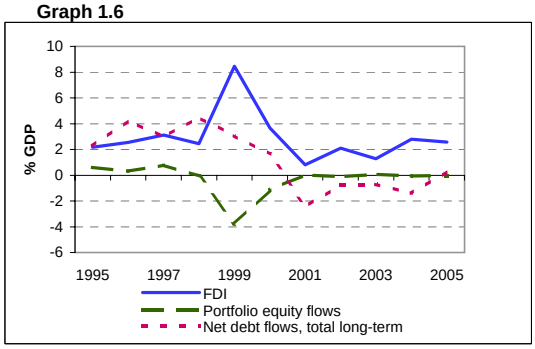

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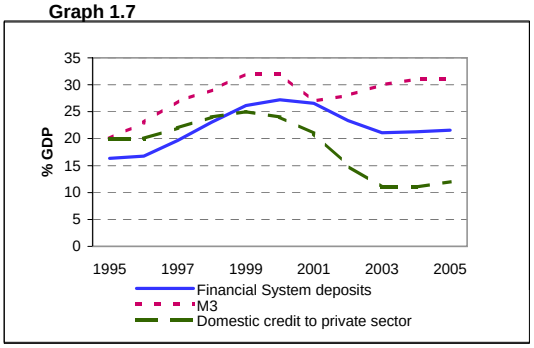

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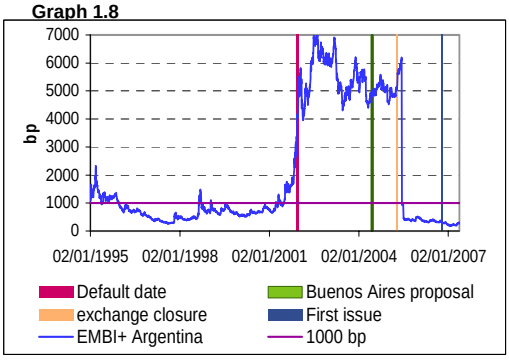

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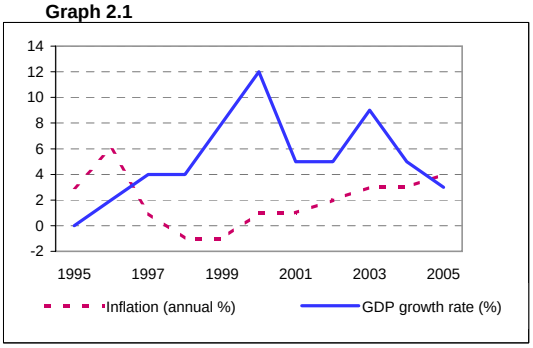

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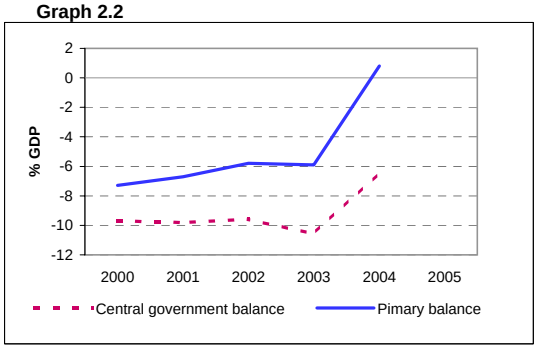

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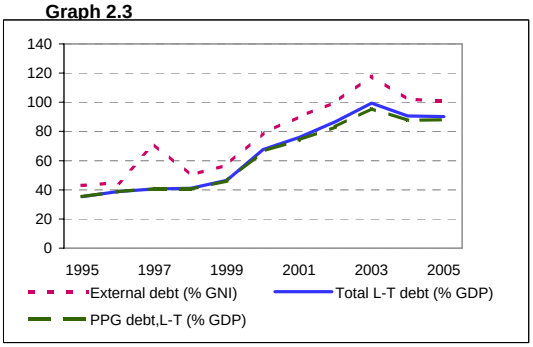

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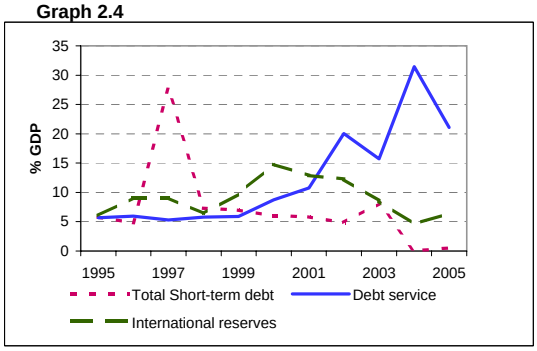

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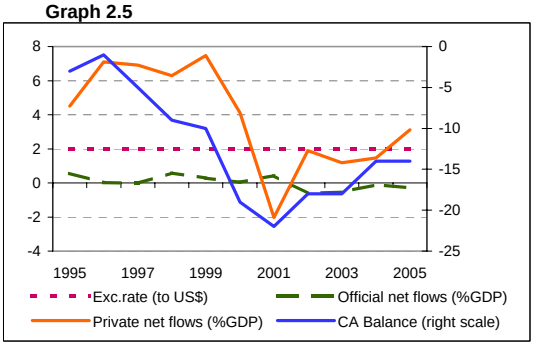

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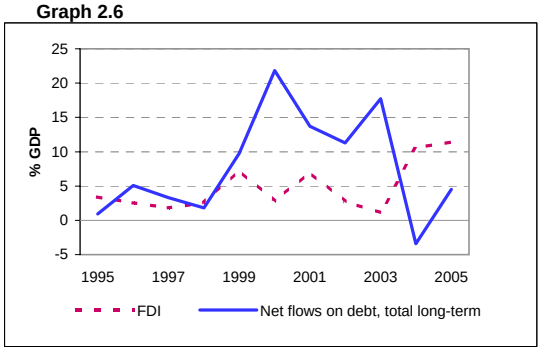

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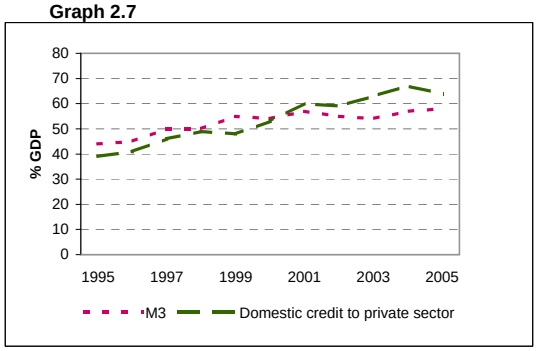

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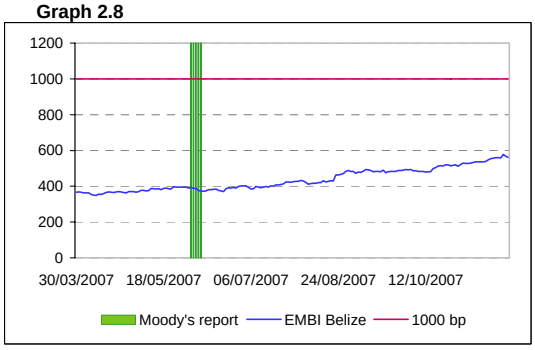

Dominican Republic

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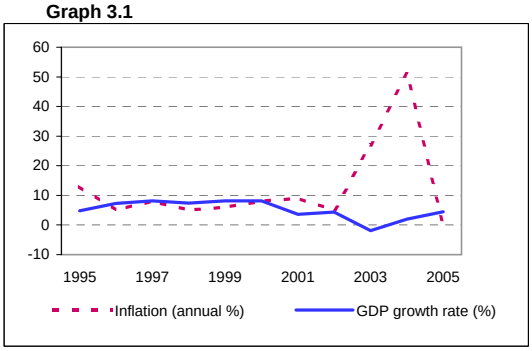

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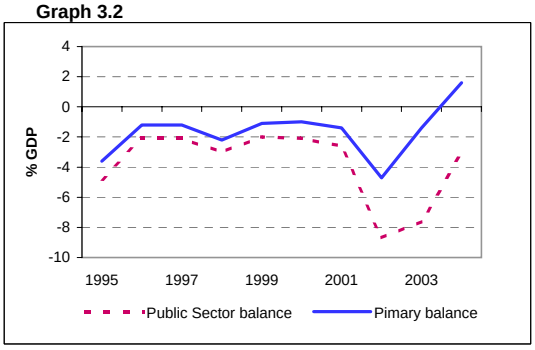

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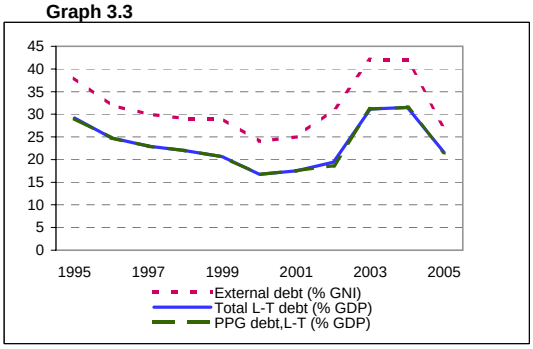

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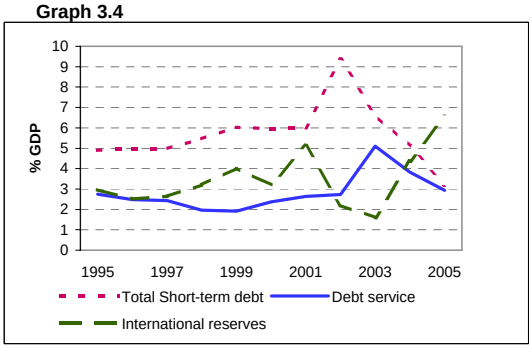

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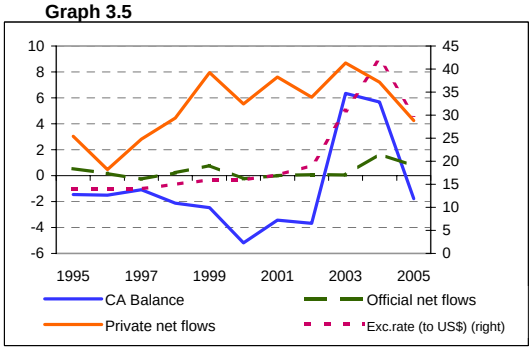

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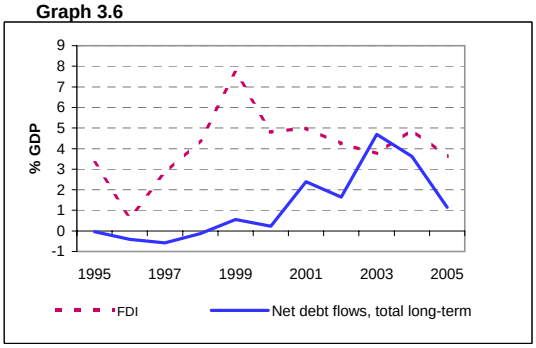

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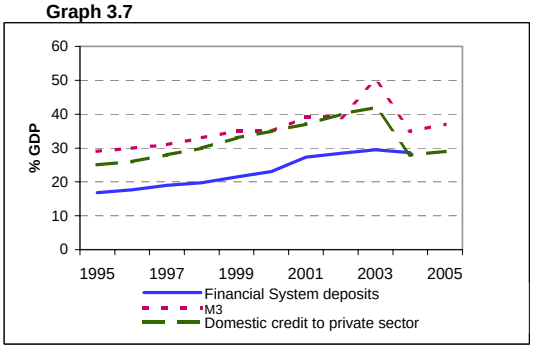

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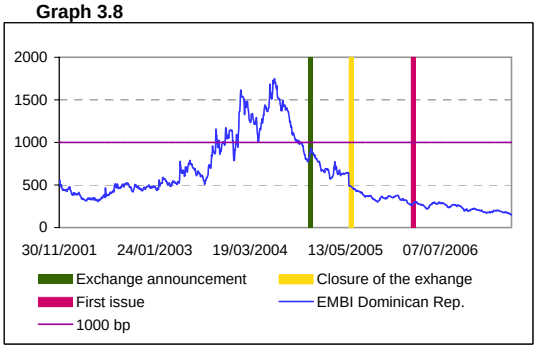

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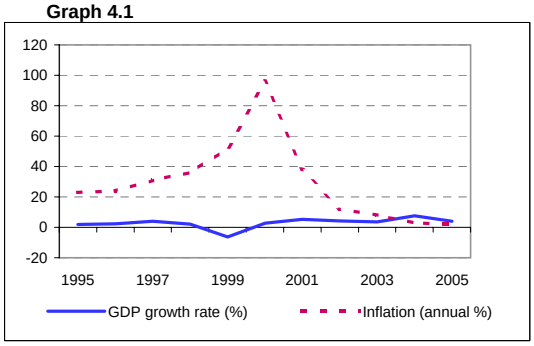

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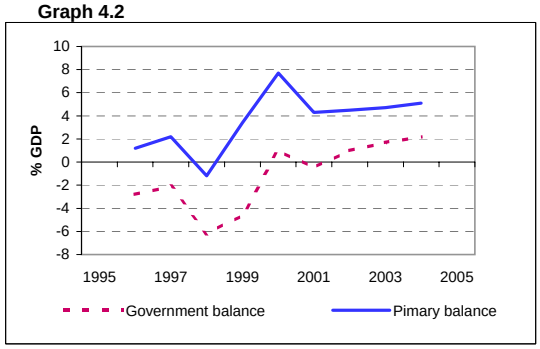

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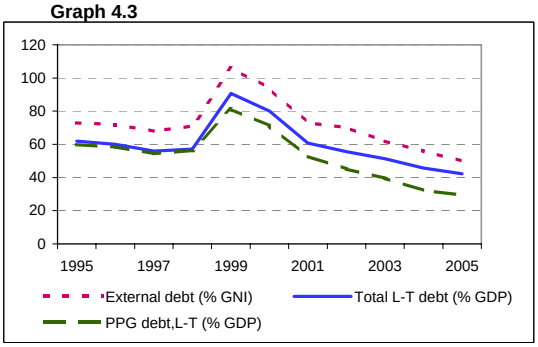

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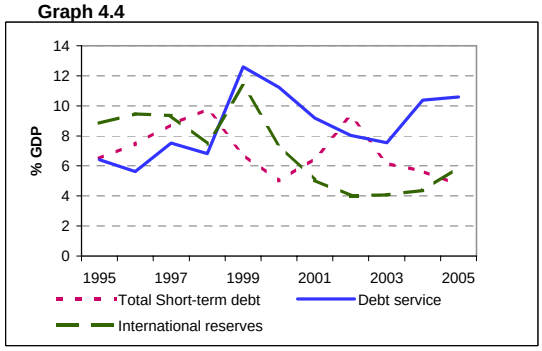

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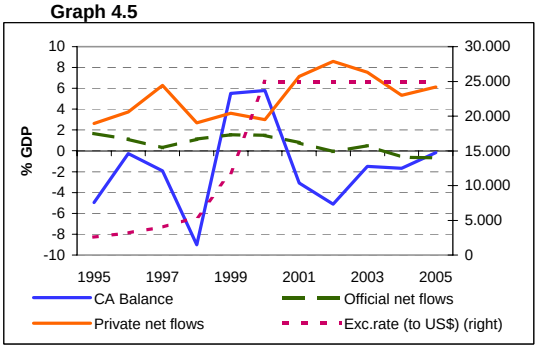

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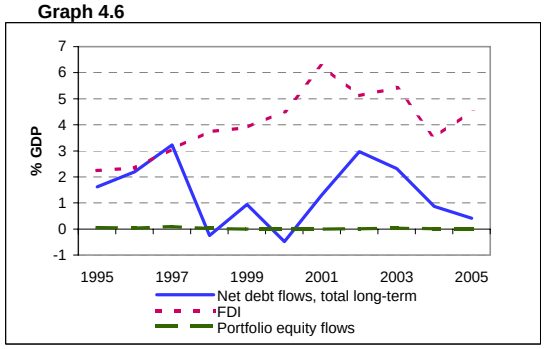

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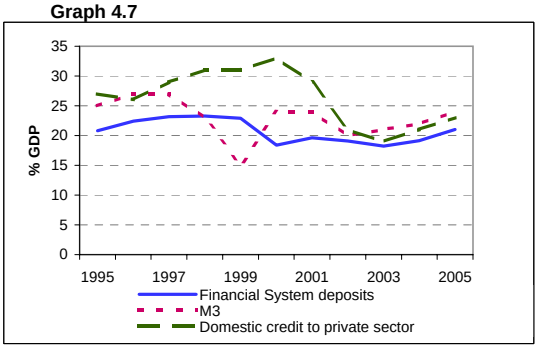

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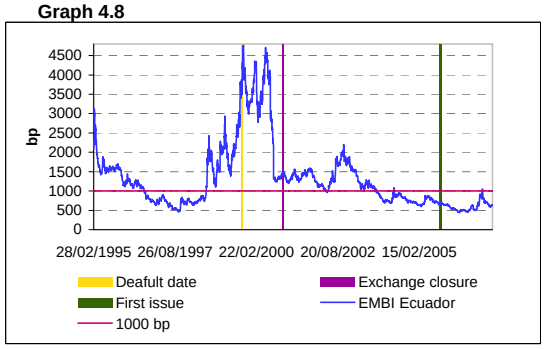

Pakistan

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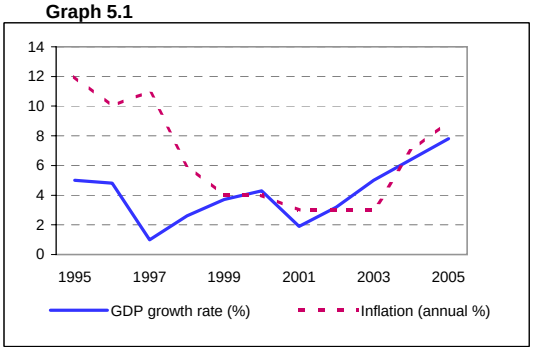

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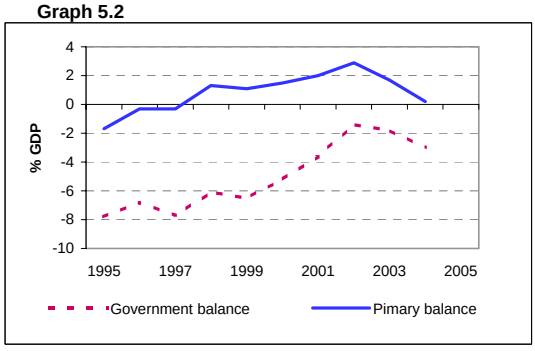

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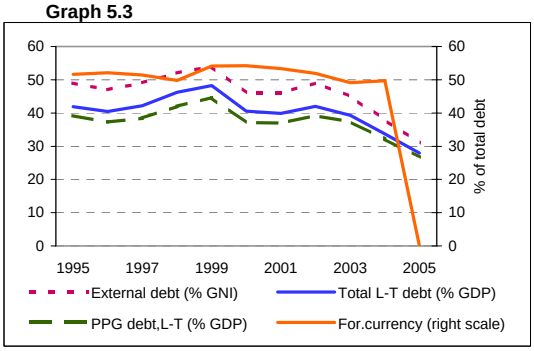

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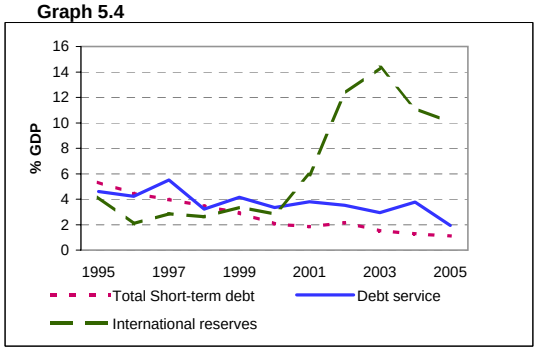

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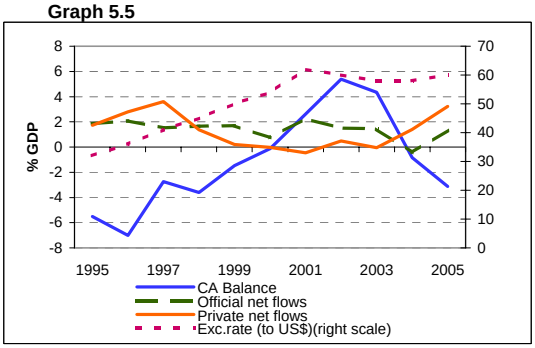

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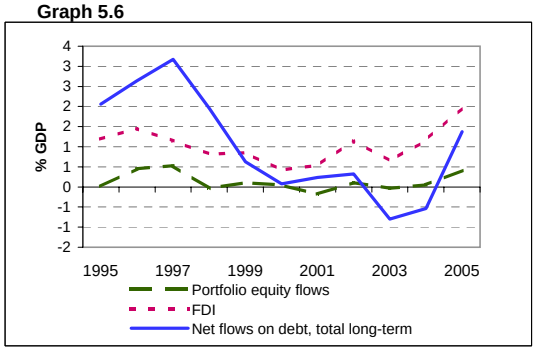

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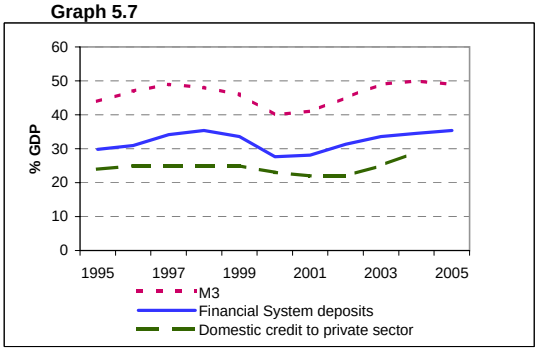

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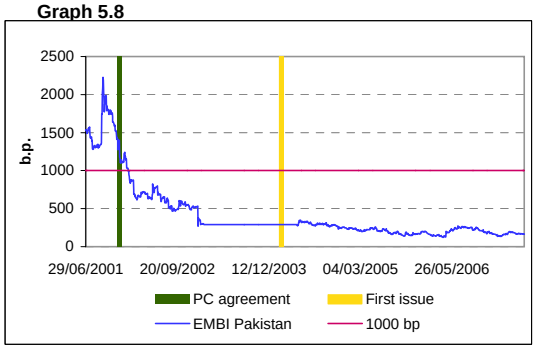

Russia

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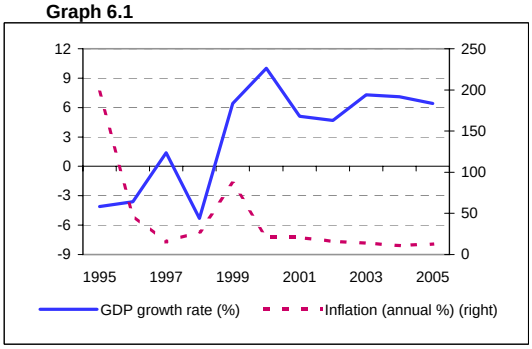

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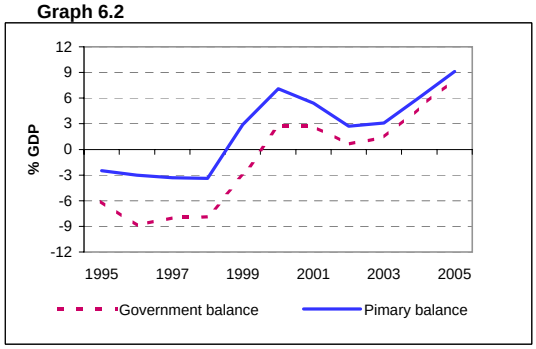

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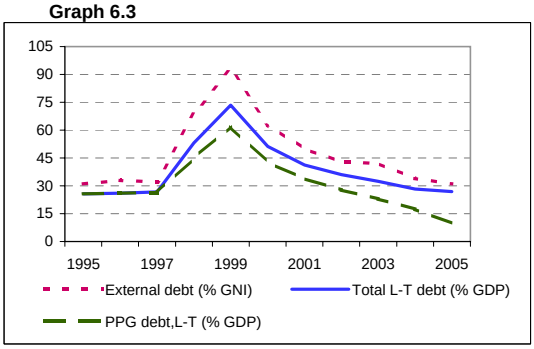

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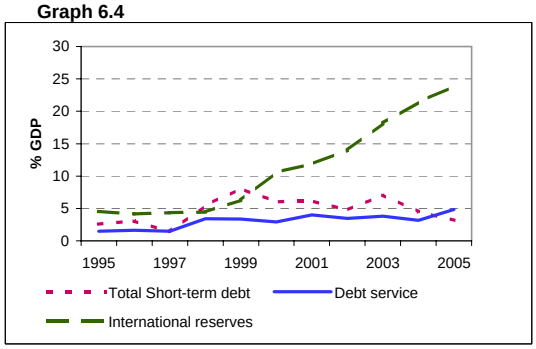

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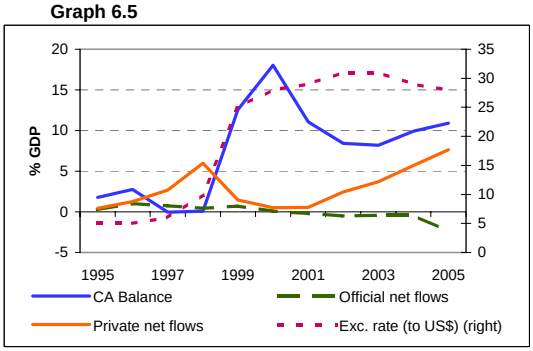

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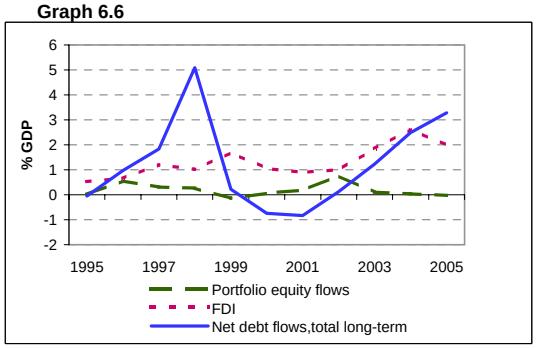

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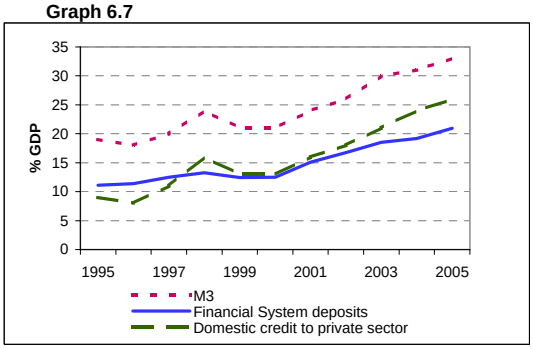

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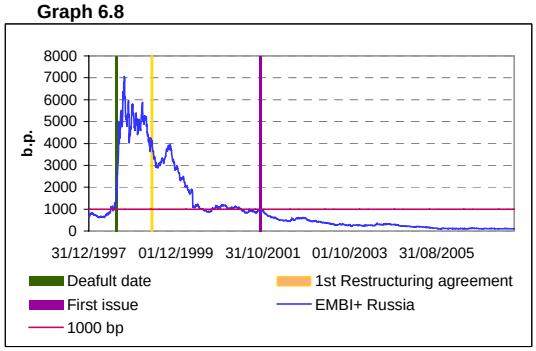
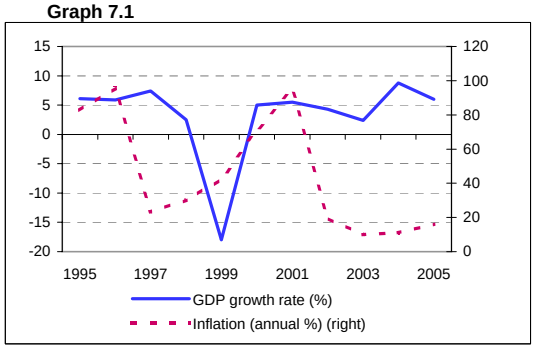
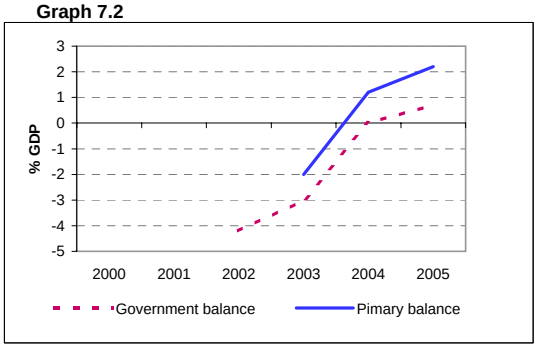


Serbia

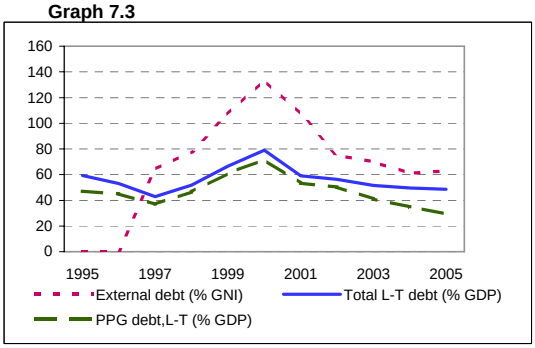
Graph 7.1



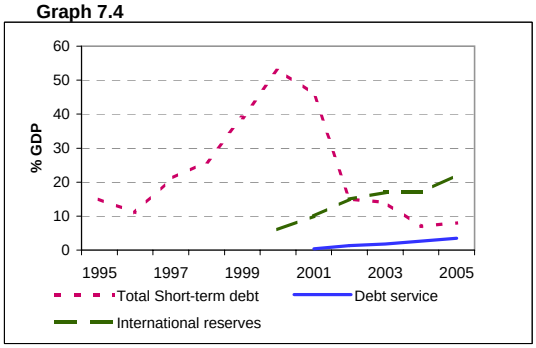
Graph 7.2



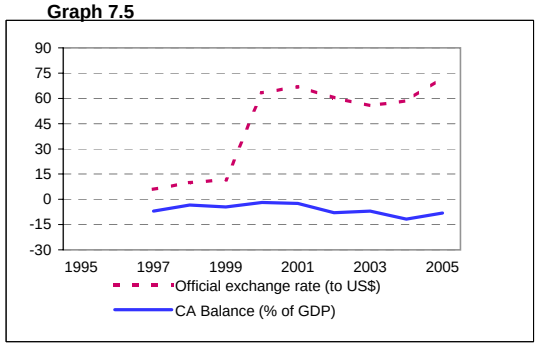
Graph 7.3



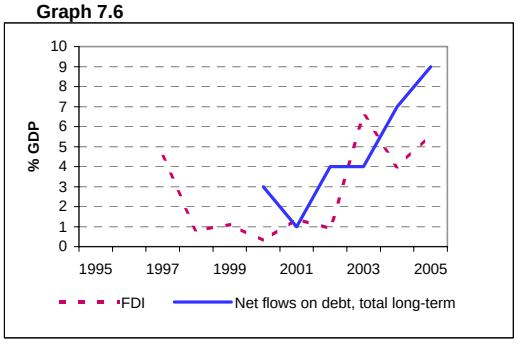
Graph 7.4



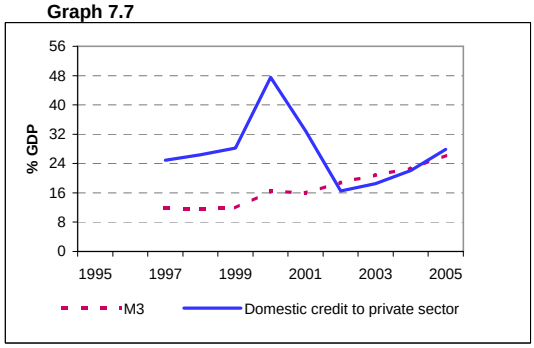
Graph 7.5



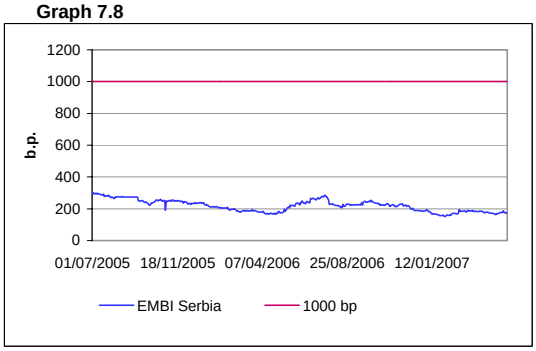
Graph 7.6



Graph 7.7

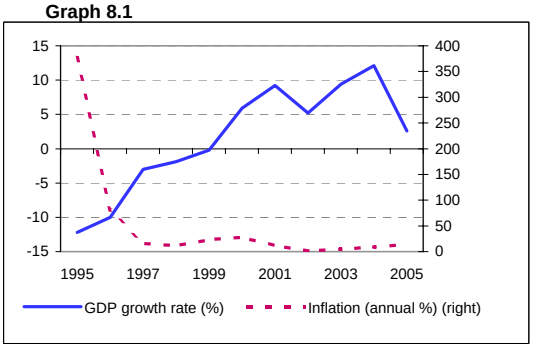


Graph 7.8

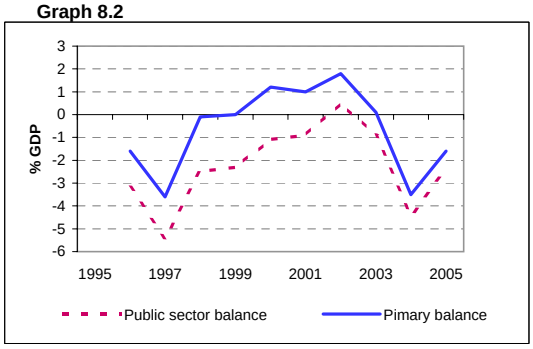


Ukraine

Graph 8.1



Graph 8.2



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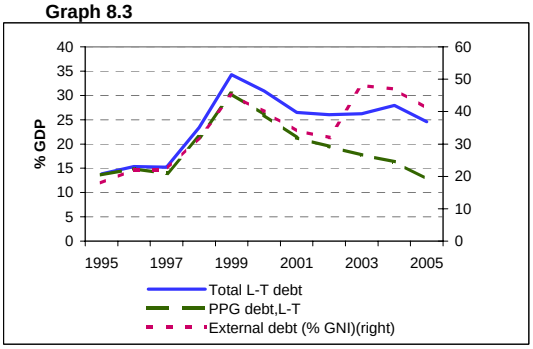
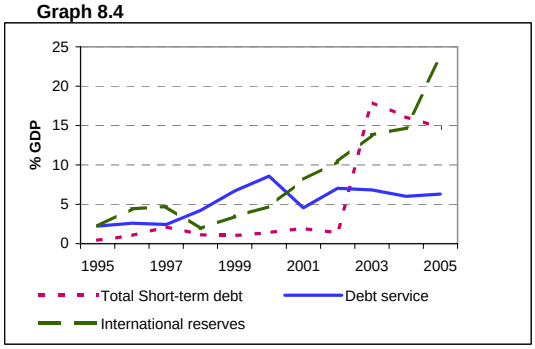


Graph 8.4



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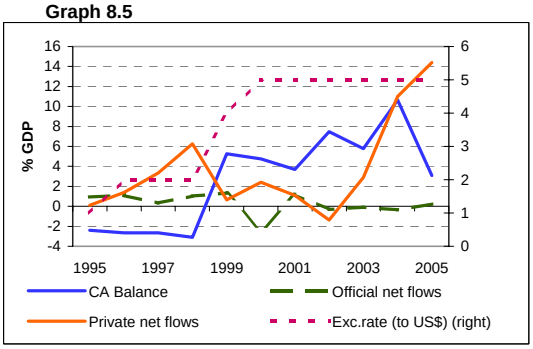

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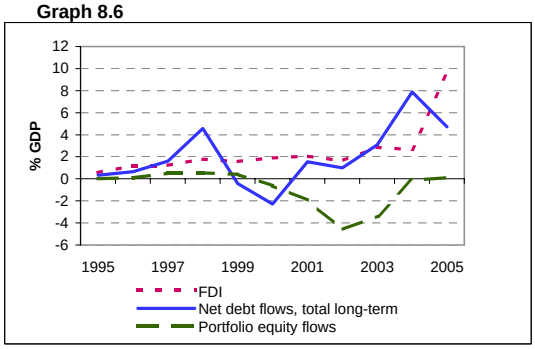
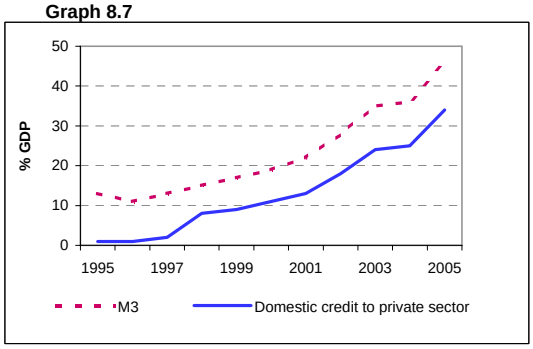
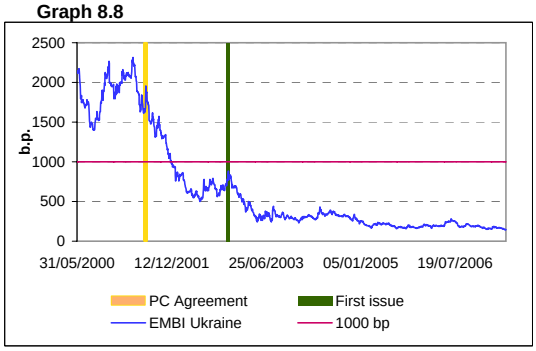


Graph 8.7

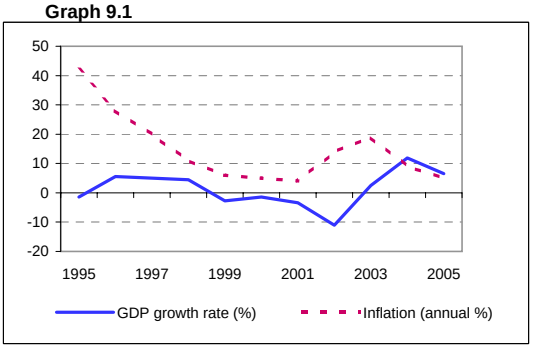


Graph 8.8

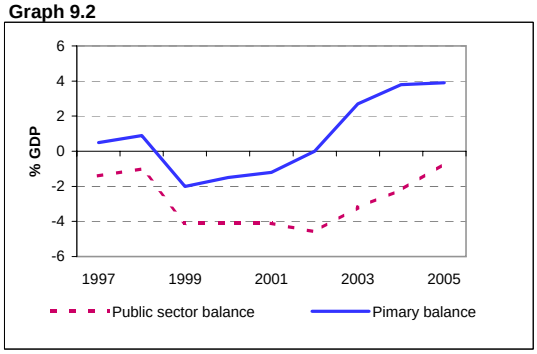


Uruguay

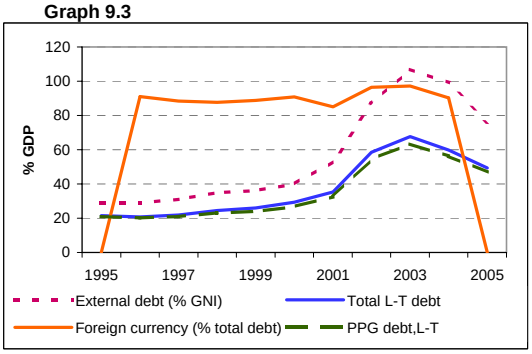
Graph 9.1



Graph 9.2



Graph 9.3



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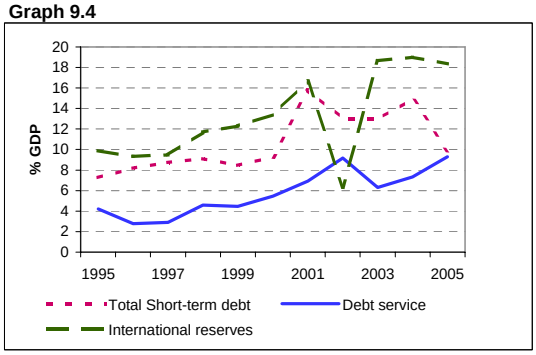

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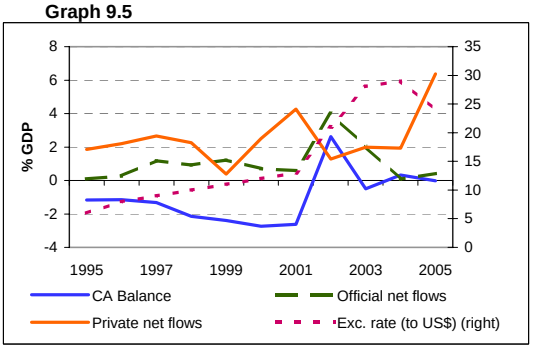

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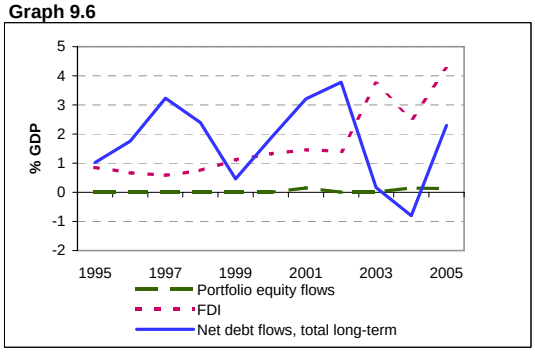
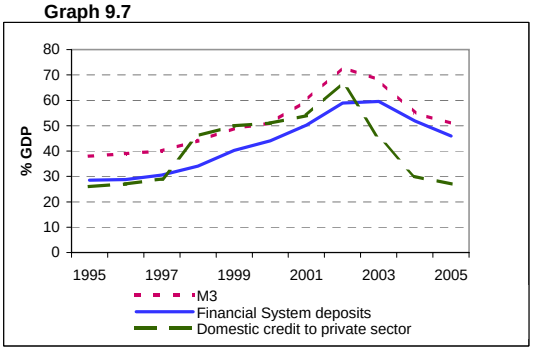
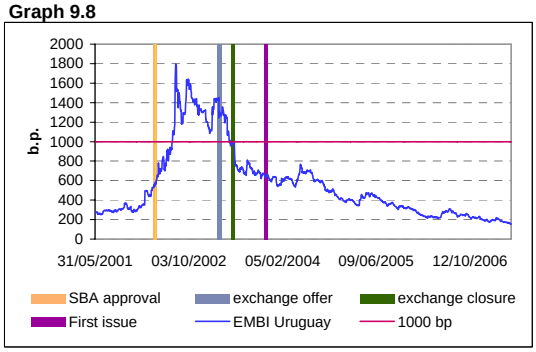


Graph 9.7



Graph 9.8



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