Debt Resolution Mechanisms: Should there be a Statutory Mechanism for Resolving Debt Crises?

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD
DEBT RESOLUTION IN TURKEY

Both the Debtor’s and the Creditor’s Perspective

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Turkish Treasury
Outline

- The Debtor’s Perspective
  - Public Debt Management during the 2001 Crisis
  - Debt re-structuring operations of 2001
  - Structural Reforms after 2001

- The Creditor’s Perspective
  - Undertaken Guaranteed Payments
  - On-lent of foreign debt
  - Restructuring of On-lent or Undertaken Guaranteed Repayments
  - Conciliation
THE DEBTOR’S PERSPECTIVE
Public Debt Management during the 2001 Crisis
The Financial Crisis of 2001: Some Reasons

- Structural problems of the public sector
  - High deficits
  - Quasi-fiscal operations
  - Short-term debt

- Unhealthy structure of the banking sector
  - Balance sheet mismatches
  - Lack of structural rules and regulatory institutions

- Chronically high inflation
The Financial Crisis of 2001: Effects on Public Debt

- Surge in interest rates
- Rapid growth of the borrowing requirement
- Dramatic decrease in maturities
- Plunge of confidence with regard to public debt sustainability
- Bonds issued to recapitalize the balance sheets of public and intervened banks in 2001 led to a sharp increase in public debt stock
The Financial Crisis of 2001: Effects on Public Debt

Central Government Debt Stock (billion TRY)
The Financial Crisis of 2001: Effects on Public Debt

Domestic Debt Stock (billion TRY)
The Financial Crisis of 2001: Government Response

- Bail-out of public banks and bankrupt private banks
  - Issuance of debt securities to assume losses
- A major debt re-structuring operation
  - A voluntary and market based debt exchange to extend maturities and mitigate roll-over risk
- Financing from International Institutions
The Financial Crisis of 2001: Government Response

- And a structural reform agenda

Public Sector Reform
- Granting Central Bank Full Independence
- Ensuring Universality of the Budget
- Public Finance and Debt Management Law
- Indirect Tax Reform (Special Consumption Tax Law)
- Public Procurement Law
- Private Pension Law

Financial Sector Reform
- Closing down of Unviable Banks and a thorough Overhaul of the System
- Bank Recapitalization and Corporate Debt Restructuring
- State Banks’ Reform

Creation of Regulatory Authorities and Adoption of International Practice
- Electricity Market
- Natural Gas Market
  - Sugar Market
  - Tobacco Market
- Telecommunication
- International Arbitration
Debt re-structuring operations of 2001
Debt re-structuring operations of 2001 Preceding process

Average Term and Cost of the Domestic Debt (2000-2001)
Debt re-structuring operations of 2001
Preceding process

Domestic Debt (2000-2001)
## Debt re-structuring operations of 2001

### Table: Effects of the Swap Operation

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of Bonds Exchanged</td>
<td>TRL 9.3 billions (net)</td>
</tr>
<tr>
<td>Bonds Repurchased</td>
<td>Lira-denominated short-term bills with an average day to maturity of 6 months</td>
</tr>
<tr>
<td>Bonds Issued</td>
<td>1 and 2-year TRL-denominated bonds with quarterly coupons</td>
</tr>
<tr>
<td></td>
<td>3 and 5-year floating-rate US dollar-indexed bonds with six monthly coupons</td>
</tr>
<tr>
<td></td>
<td>Average maturity: 37.5 months</td>
</tr>
<tr>
<td>Increase in the Maturity of the Debt Stock</td>
<td>from 8 months to 20 months</td>
</tr>
<tr>
<td>Direct Reduction in Redemptions for 2001</td>
<td>TRL 6.4 billions</td>
</tr>
</tbody>
</table>
Debt re-structuring operations of 2001 Result

- In terms of debt sustainability:

**Time to Maturity of Cash Domestic Debt Stock (Months)**

![Graph showing time to maturity of cash domestic debt stock](image)
Structural Reforms after 2001
Areas of Reform

- Complete Legal Structure
- Reputable Institutional Structure
- Transparency
- Accountability
- Sound Debt Management
- Fiscal Discipline and Efficient Policy Coordination
Legal Framework

- Define objectives of debt management
- Set basis for authority
- Describe the main principals
- Restructures debt management organization
- Assures transparency and accountability in debt management
Legal Framework

Law No 4749 : Regulation on Public Finance and Debt Management

Defines Treasury as the sole borrowing entity

- Specifies the limits for new borrowing and Treasury guarantees
- Defines the procedural rules
  - domestic borrowing
  - external borrowing
  - guarantee issuance and undertakings
  - on-lent loans
  - collection of financial receivables
Organizational Structure

- Review & improve organization of debt management process
  - Debt and Risk Management Committee
  - Risk management unit
- Define the decision making process
- Ensure internal and external co-ordination
  - within the debt management unit
  - with fiscal & monetary policies
- Develop human resources
Sound Debt Management Strategies

- Medium-long term perspective
- Risk-based analysis and strategies
  - Market Risk
  - Counter-Party Risk
  - Operational Risk
- Cost-Risk targets
- Diversified instrument set
- Enhanced investor base
- Improved risk profile
- Transparency and Accountability
  - Monthly and Annual Debt Management Reports
  - Reporting to the Parliament
Sound Debt Management Strategies: Integrated Debt and Cash Management

- Efficient Cash Management
  - New regulations
  - New instruments developed for active cash management
  - Public Electronic Payment System to be launched

- Strong Treasury Cash Reserve Policy
  - To mitigate liquidity risk
Sound Debt Management Strategies: Credit Risk Management

- Guarantee and On-lent Loan Limit
- Guarantee/ On-lent Fee
- Partial Guarantee
- Debt Repayment Account
- Risk Account
Prudent Macro-Economic Policies

- Fiscal Discipline
  - Law on Public Financial Management and Control

- Strong Institutional and Legal Framework in financial system:
  - Banking Regulation and Supervision Agency (BRSA)
  - Bank Recapitalization and Corporate Debt Restructuring
  - State Banks’ Reform
  - Granting Central Bank Full Independence
  - Ensuring Universality of the Budget
  - Indirect Tax Reform (Special Consumption Tax Law)
  - Public Procurement Law
  - Private Pension Law

- Improvement in coordination between the institutions as well as better separation of the responsibilities
Prudent Macroeconomic Policies and Strong Fundamentals

Strong Debt Management Capacity

Accountability
Increased Financial Stability
Improved Borrowing Conditions

Transparency
Foreseeable Debt Management Policies
Increased Market Confidence

Broader Investor Base

Results
Results

General Government Debt (% GDP)

Year | Debt (% GDP)
--- | ---
2002 | 74.0
2003 | 67.7
2004 | 59.6
2005 | 52.7
2006 | 46.5
2007 | 39.9
2008 | 40.0
2009 | 46.1
2010 | 42.2
Results

Composition of Central Government Debt

2002 2003 2004 2005 2006 2007 2008 2009 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>TL</th>
<th>FX</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>58</td>
<td>42</td>
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<tr>
<td>2003</td>
<td>46</td>
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<td>2009</td>
<td>71</td>
<td>29</td>
</tr>
<tr>
<td>2010</td>
<td>73</td>
<td>27</td>
</tr>
</tbody>
</table>
Results

Ratio of Undertaken Guarantees to Total Guaranteed Payments (%)
Factors for Resilience to the Recent Crisis

- Sound financial System
- Reduced Public Sector debt and borrowing requirement
- Improved Risk Profile of Public Debt
- Timely and effective policy responses
  - Fiscal Policy
    - Expansionary,
    - but taking into account long-term affects on public finances
  - Monetary policy
    - Lower policy interest rate
    - Enhanced liquidity measures
  - Medium-Term Economic Program
    - One of the first countries to declare the exit strategy
DEBT RESOLUTION in TURKEY

THE CREDITOR’S PERSPECTIVE
Outline

- Undertaken Guaranteed Payments
- On-lent loans
- Restructuring of On-lent or Undertaken Guaranteed Repayments
- Conciliation
Repayment Guarantees of Treasury

- Treasury gives guarantee to repay loans of Public Institutions

- Treasury makes repayment if the institution can not make payment due to poor financial conditions
  - Treasury must be notified at least 15 days prior to the date of payment to the creditor
  - Institution can pay back Treasury in 1 to 5 years
  - Grace period up to 1 year
On-lent of foreign debt with the same terms and conditions of the related agreement

- Loans are obtained by the Treasury from any foreign financing source
- Loans are on-lent to the public institutions
- Purpose is to promote development in various sectors of the economy and/or to meet the financial requirement
Onlent of foreign debt with changed terms and conditions

- Proposed by Treasury and Ministry of Development
- With approval of Council of Ministers
- Interest rate or maturities can be adjusted according to the institution’s financial conditions
Restructuring of On-lent or Undertaken Guaranteed Repayments

- Notification to Treasury at least 15 days prior to payment date to Treasury
- Assessed by Treasury & Decided by Minister
- Restructuring only undue repayments
- Rescheduled of the payment up to 5 years
- Grace period up to 1 year
Conciliation

- Overdue payments
- Only conciliated by Law
- Fixing the debt amount
  - Recalculated late interest
- Conciliated two times up to date
  - Law No.4749, Provisional Article 3
  - Law No. 5216 & Law No.5393 (Only for Municipalities)
Thank You!

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