Lessons from the Recent Debt Crises

by

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Lessons from recent debt renegotiations

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Disclaimer: Strictly my own views. Not necessarily the views of the Inter-American Development Bank, its Board of Directors, or the countries they represent.
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Global context: growth prospects have been falling

Fall in long run global growth expectations

Source: World Economic Outlook, IMF. October projections for each year
Debt ratios likely to rise..

Source: IMF WEO
Number of required debt renegotiations may rise

Source: Cruces and Trebesch dataset
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One issue has been “delay”

- Date at which situation starts to look unsustainable / loses market access - See IMF (2013)
- Date at which unfortunate country enters default
- Date at which a (first) renegotiation takes place
- Date of a final renegotiation

Time
Types of delay

- Date at which situation starts to look unsustainable / loses market access – See IMF 2013.
- Date at which a (first) restructuring takes place
- Date at which unfortunate country enters default
- Delay
- A final restructuring is when country leaves default for at least 2 years
Many years to a “final” renegotiation

Years from entering default to a “Final Renegotiation” ie: leaves default for at least 2 years

Source: Authors’ calculations based on Cruces-Trebesch database of 187 defaults
Less focus on multiple renegotiations

41% of debt renegotiations are not single renegotiations during a default period.

28 of 68 renegotiations have been “multiple”

Final renegotiations have higher haircuts (Haircut is the reduction in the present value of the debt)

There is higher likelihood of further renegotiations when the first haircut is low

Conditional probability of there being a second debt renegotiation depending on the size of the initial renegotiation haircut

<table>
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<th>Haircut of first debt renegotiation smaller than average</th>
<th>Haircut of first debt renegotiation greater than average</th>
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<td>50%</td>
<td>21%</td>
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Source: Mariscal, Powell, Sandleris and Tavella (2015), data from Cruces-Trebesch
There are two types of debt renegotiation:

- Reprofilings: more frequent, low haircuts
- Restructurings: less frequent, high haircuts


Kernel = epanechnikov, bandwidth = 8.5508
Two types of renegotiation:

**Reprofilings**: Likely zero principal haircut, often pre-emptive, relatively low present value haircuts (avg. 15%), higher likelihood of a re-renegotiation

**Restructurings**: Principal reduction, ex post, relatively higher haircut (avg. 50%), lower probability of a re-renegotiation

Multiple renegotiations by type...

 Nb: there are no reprofilings following after a restructuring.

...there are many multiple Reprofilings, few multiple Restructurings.

Number of countries

Number of years after first reprofile

Number of countries

Number of years after first reprofile

Number of countries

Number of years after first restructure
Effect on debt is quite different: on average Reprofilings have not reduced Debt/GDP

Notes: t=0 is the date of the reprofiling or restructuring, t is in years. Debt is long term. Source: Mariscal, Powell, Sandleris and Tavella (2015), data from Cruces-Trebesch.
3. Explanations and implications…

• Outcomes are not independent of mechanisms!

• Mechanisms have favored the “bipolar view”\(^1\):
  • A) Reprofilings: quick, no principal haircut, relatively low cost, low risk of litigation, BUT high risk of a re-renegotiation
  • B)Restructurings: slower, deeper haircut, higher cost, risk of litigation, lower risk of re-renegotiation

• Close relationship to Buchheit and Daly’s (2014) description of sovereigns as “uniquely vulnerable” but “uniquely protected”
  • Most sovereigns do (A), perhaps as they fear “vulnerability”
  • Those that don’t have counted on being “protected”

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Implications…

• Unfortunate countries with unsustainable debts tend to Reprofile and risk Re-Reprofiling (and hence delays to a final deal) as alternative could be very costly

• BUT if costs change, behaviours may alter:
  • Perhaps IMF is reducing further the costs of reprofiling…
  • And with a trad. *pari passu*, the costs of restructuring may be larger

• But with new “Super-CAC” and revised *Pari Passu*, countries will be “less vulnerable but less protected” , a new world?

• Perhaps now we will see more first debt Renegotiations that solve the initial debt problem

• Should still consider further innovations…
Innovations (examples)

• **Contractual**
  - Automatic stays
  - Contingent debt contracts (e.g.: GDP indexation)

• **Statutory**
  - Anti “Hold-Out” legislation
  - Towards a more statutory approach
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4. A word on fiscal adjustment

• Question posed is whether too much emphasis on adjustment?

• But not enough emphasis on actual policies

• In Latin America reaction to the 2008/9 crisis was on policies that became permanent, not temporary and did not increase growth

• Now the region has had to return to pro-cyclical fiscal adjustment (see Latin American and Caribbean Macroeconomic Report 2015 www.iadb.org/macroreport

• Need to consider the composition of fiscal spending and how fiscal (and other) policies can create growth
4. The importance of the composition of adjustment

A country with Debt/GDP of 70%, Fiscal Expenditure of 25% and that wishes to bring debt down to 60% of GDP

If the fiscal multiplier is 1.0

With a high multiplier path may be unsustainable

A tough path

With lower multiplier adjustment debt is sustainable

If the fiscal multiplier is 0.3

Powell and Salazni (unpubl.) based on Miller and Zhang (2013)
Conclusions

• Debate should be more about the composition of fiscal adjustment, less about the size, unfortunately many countries are cutting public investment

• Focus on fiscal rebalancing for growth and hence create fiscal space not on cutting spending that reduces it

• Multiple debt renegotiations have been common

• Innovations have occurred that may change behaviours, we should seek further improvements to gain efficiency
References

- Mariscal, R., G. Sandleris, A. Powell and P. Tavella (2015) “Sovereign Defaults: has the current system resulted in lasting (re)solutions?” IADB, available from the authors on request
THANK YOU