



Eighth UNCTAD Debt Management Conference

Geneva, 14 - 16 November 2011

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



**REPUBLIC of TURKEY
PRIME MINISTRY
UNDERSECRETARIAT OF TREASURY**

DEBT RESOLUTION IN TURKEY

Both the Debtor's and the Creditor's Perspective

November 2011

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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



DEBT RESOLUTION in TURKEY

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**

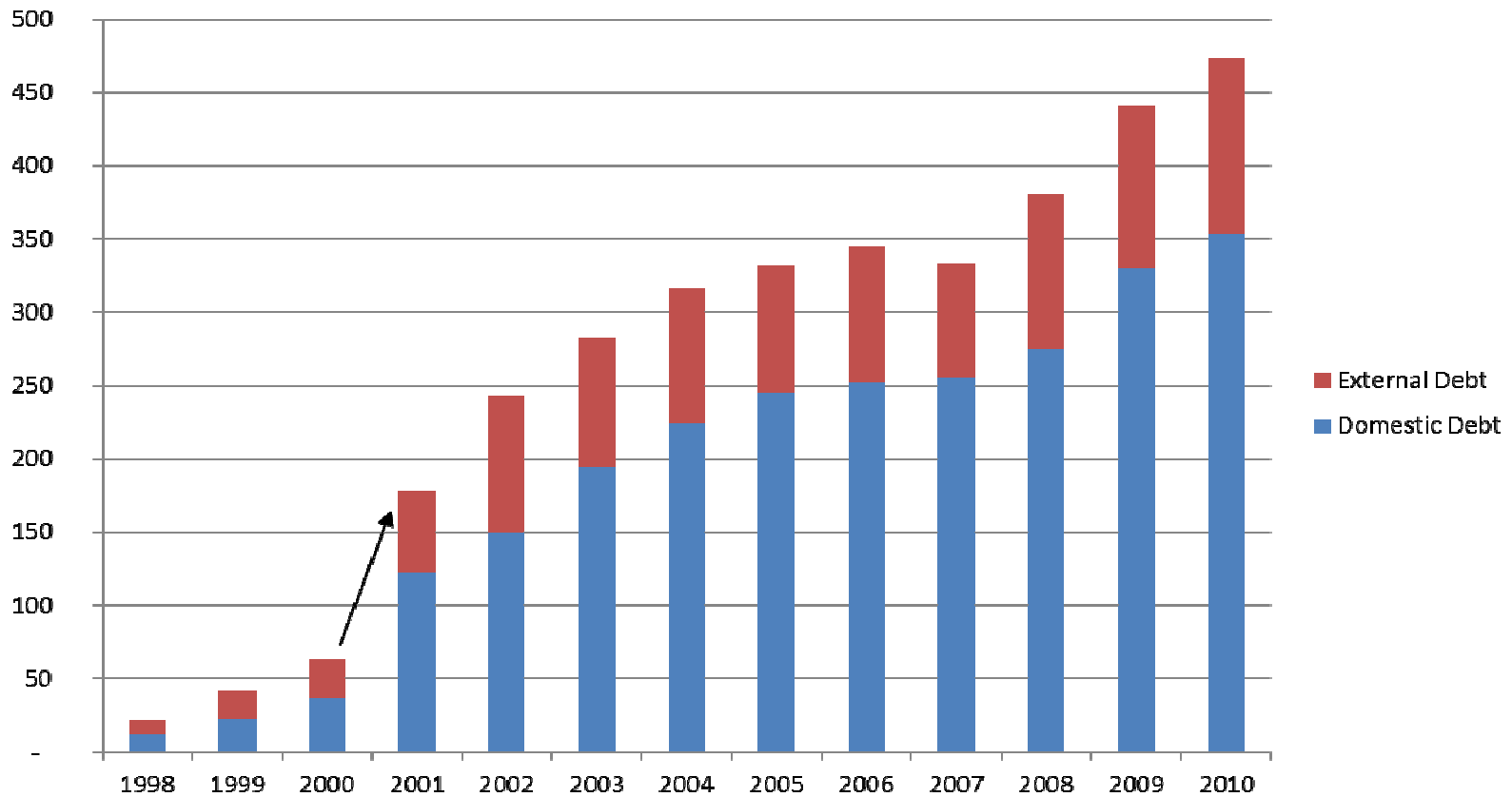


The Financial Crisis of 2001: Effects on Public Debt

- 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

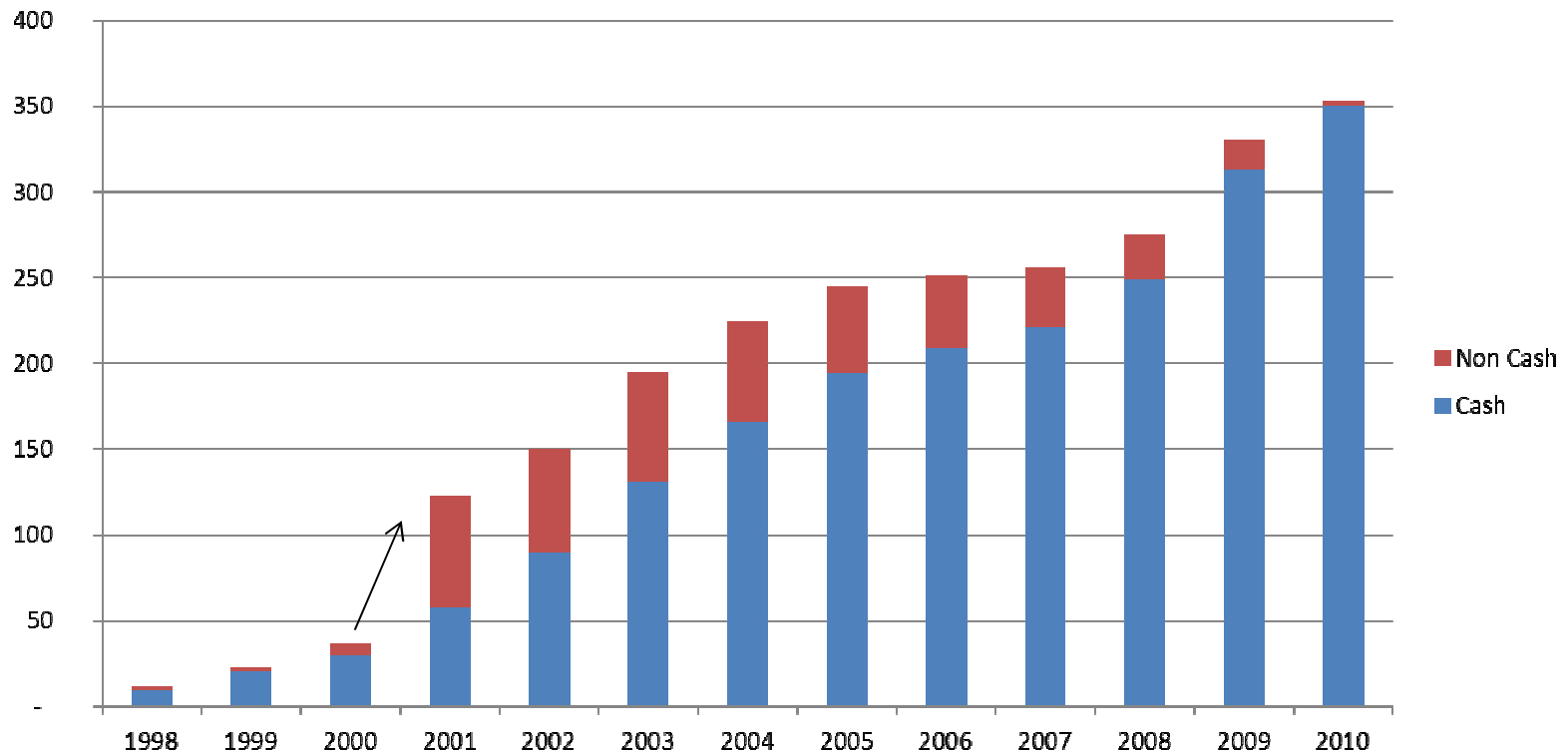
The Financial Crisis of 2001: Effects on Public Debt

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**

Creation of Regulatory Authorities and Adoption of International Practice

- **Electricity Market**
- **Natural Gas Market**
 - **Sugar Market**
 - **Tobacco Market**
- **Telecommunication**
- **International Arbitration**

Financial Sector Reform

- **Closing down of Unviable Banks and a thorough Overhaul of the System**
 - **Bank Recapitalization and Corporate Debt Restructuring**
 - **State Banks' Reform**

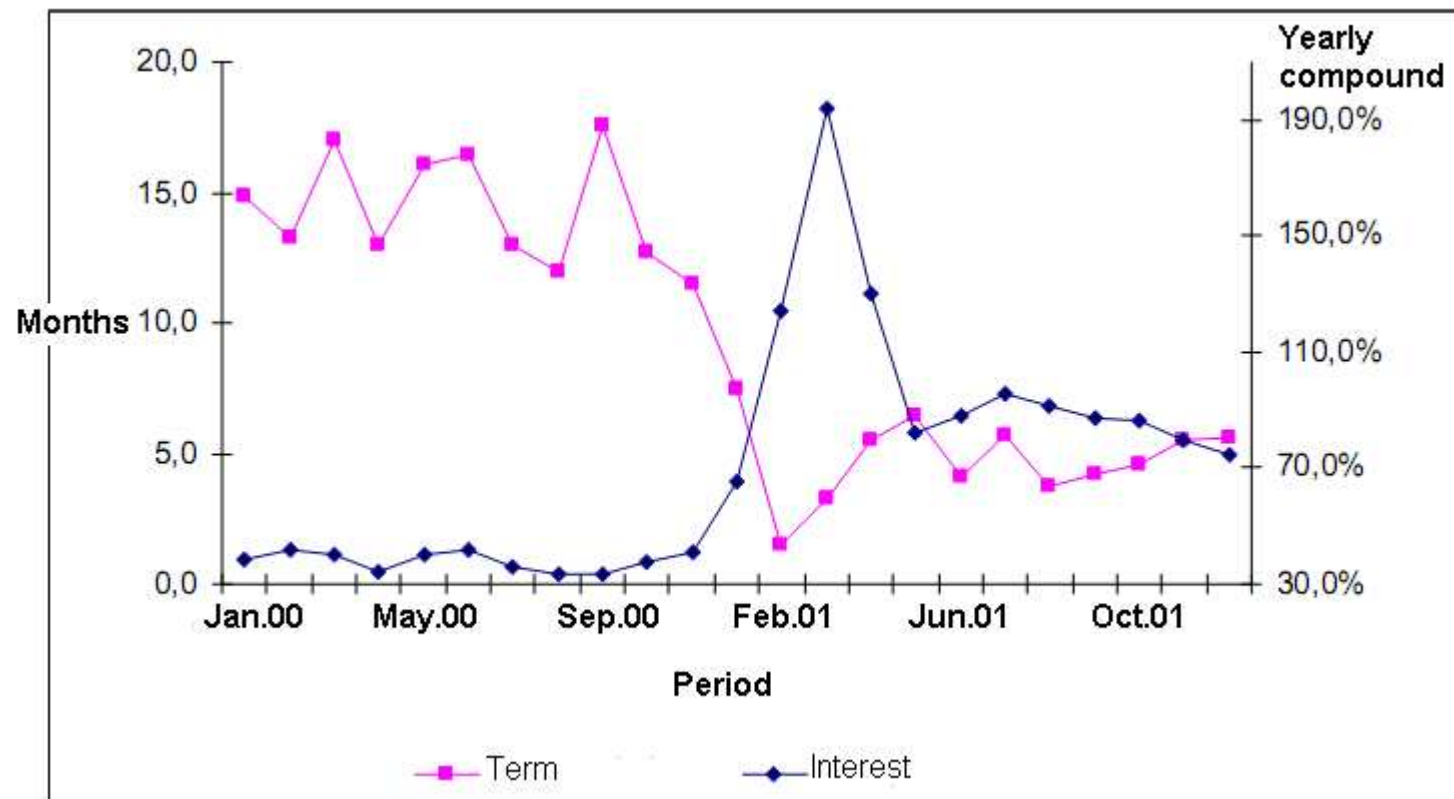


Debt re-structuring operations of 2001

Debt re-structuring operations of 2001

Preceding process

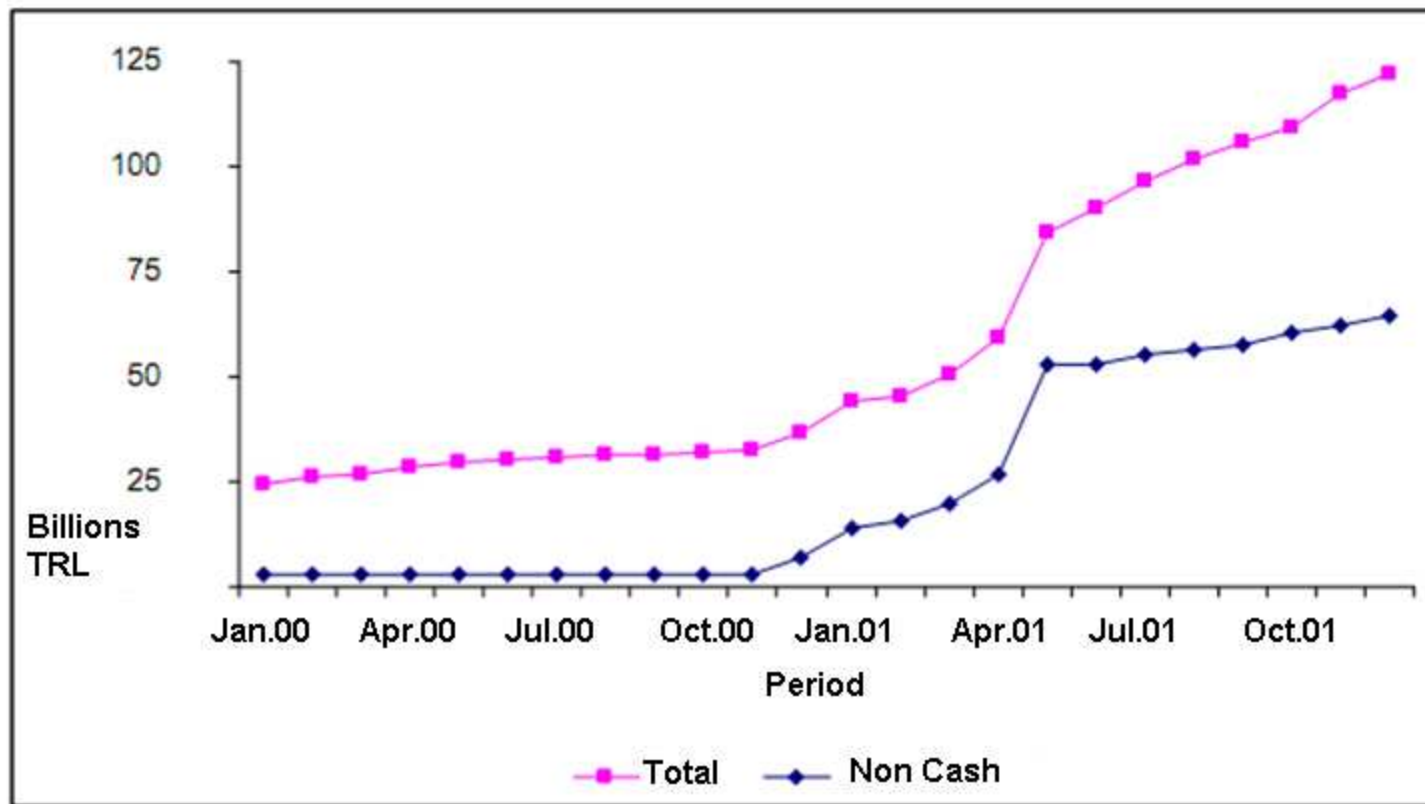
Average Term and Cost of the Domestic Debt (2000-2001)



Debt re-structuring operations of 2001

Preceding process

Domestic Debt (2000-2001)





Debt re-structuring operations of 2001

Table: Effects of the Swap Operation

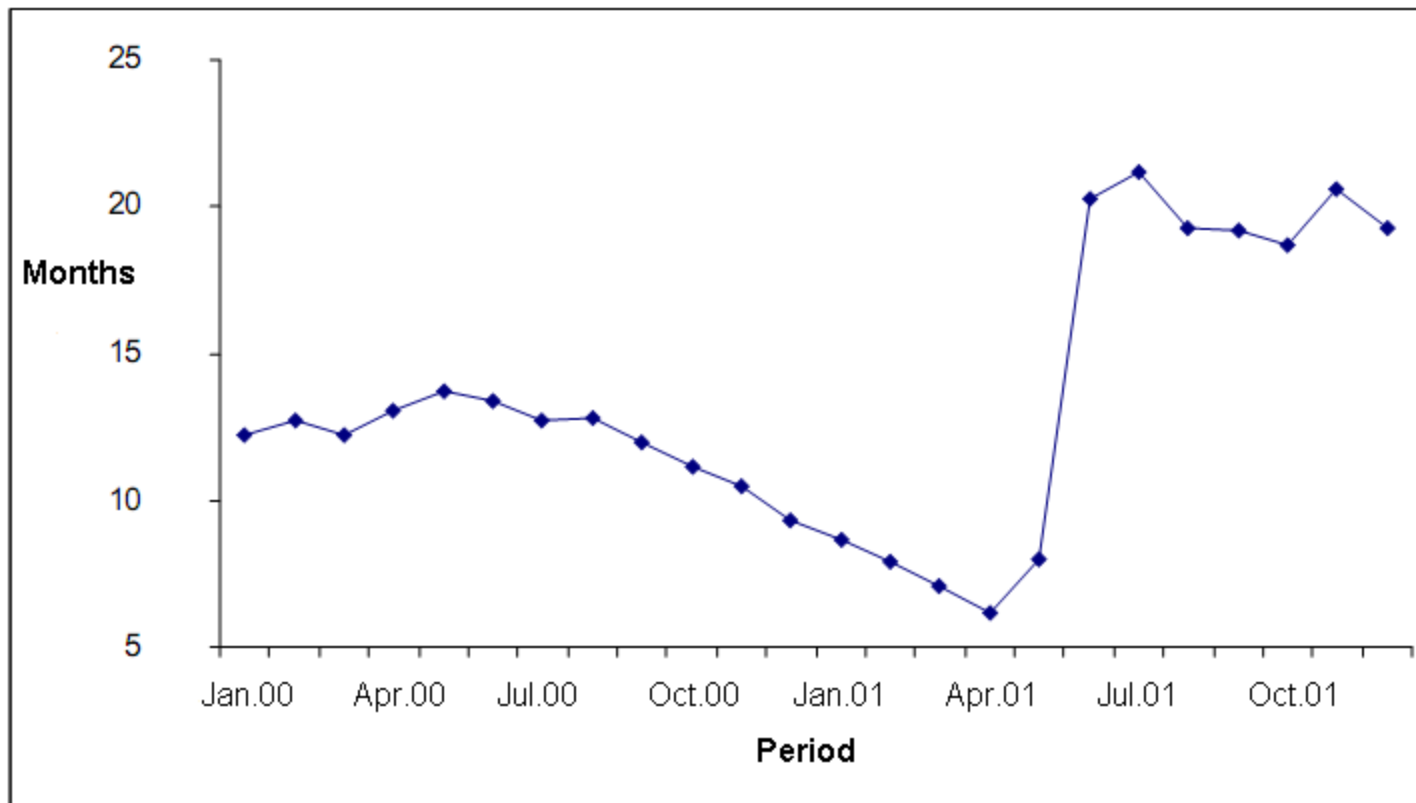
| | |
|---|---|
| Amount of Bonds Exchanged | TRL 9.3 billions (net) |
| Bonds Repurchased | Lira-denominated short-term bills with an average day to maturity of 6 months |
| Bonds Issued | 1 and 2-year TRL-denominated bonds with quarterly coupons 3 and 5-year floating-rate US dollar-indexed bonds with six monthly coupons Average maturity: 37.5 months |
| Increase in the Maturity of the Debt Stock | from 8 months to 20 months |
| Direct Reduction in Redemptions for 2001 | TRL 6.4 billions |

Debt re-structuring operations of 2001

Result

- In terms of debt sustainability:

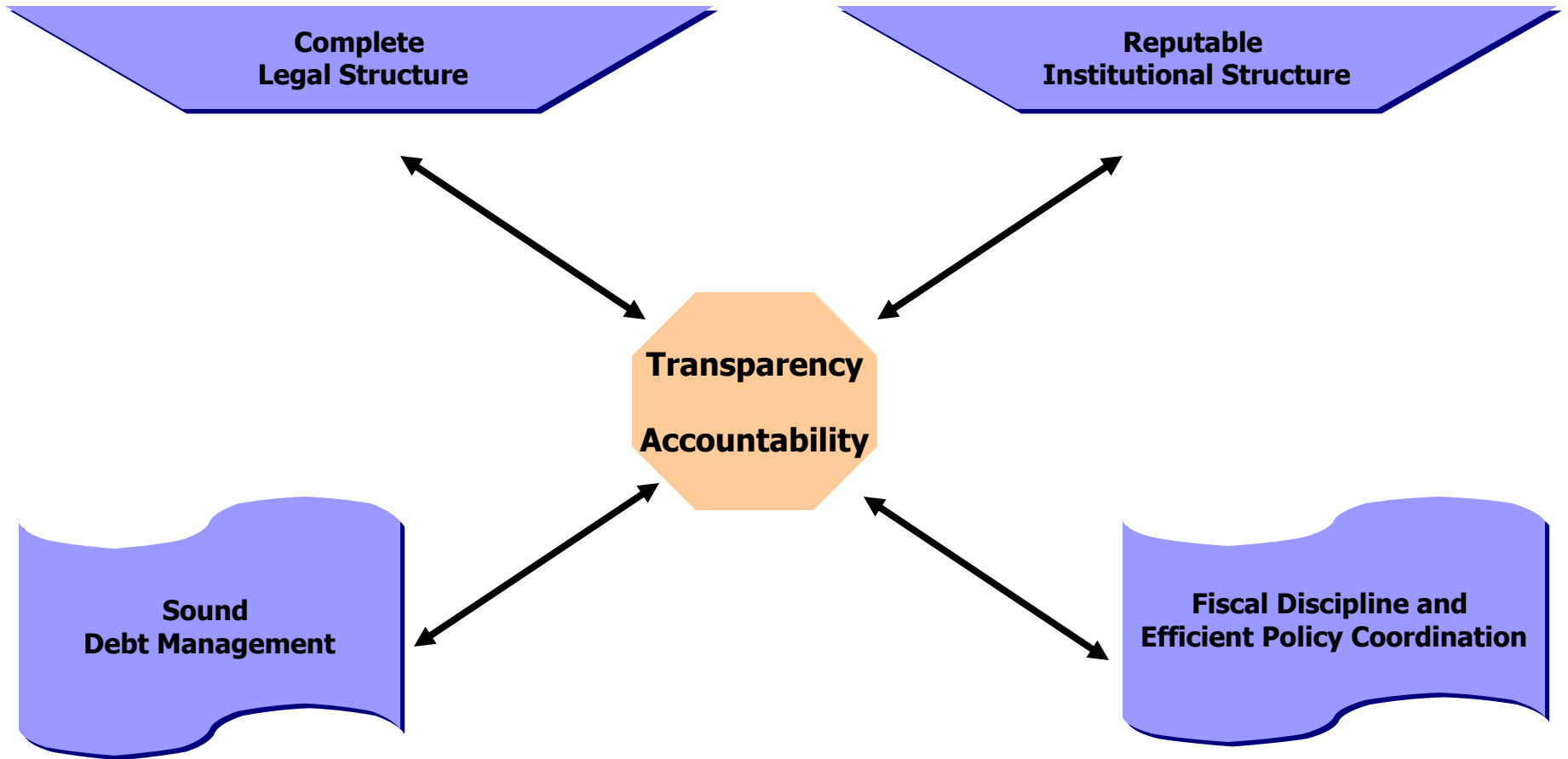
Time to Maturity of Cash Domestic Debt Stock (Months)





Structural Reforms after 2001

Areas of Reform





Legal Framework

- Define objectives of debt management
- Set basis for authority
- Describe the main principals
- Re-structures 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

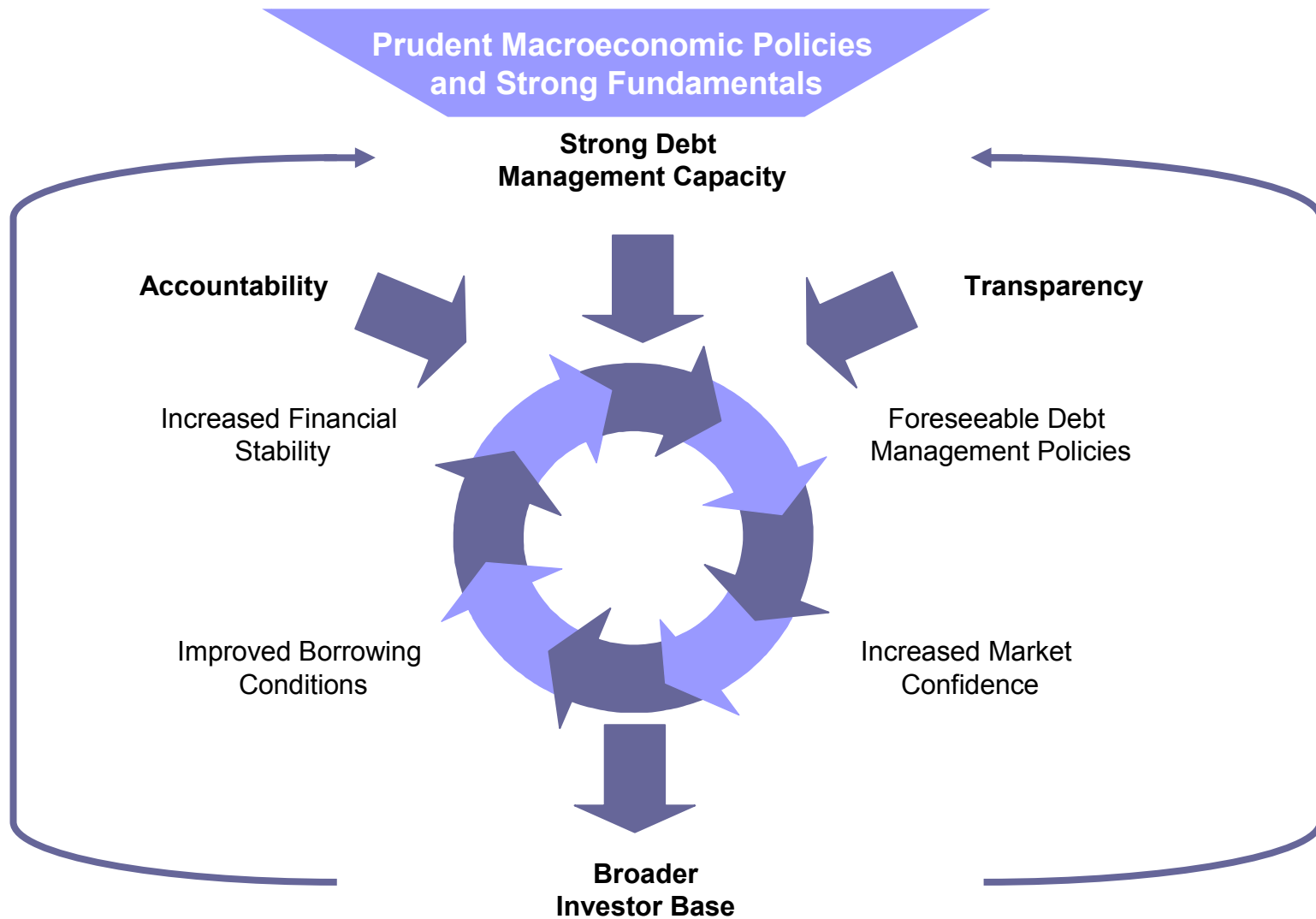
- Guarantee and On-lent Loan Limit
- Guarantee/ On-lent Fee
- Partial Guarantee
- Debt Repayment Account
- Risk Account



Prudent Macro-Economic Policies

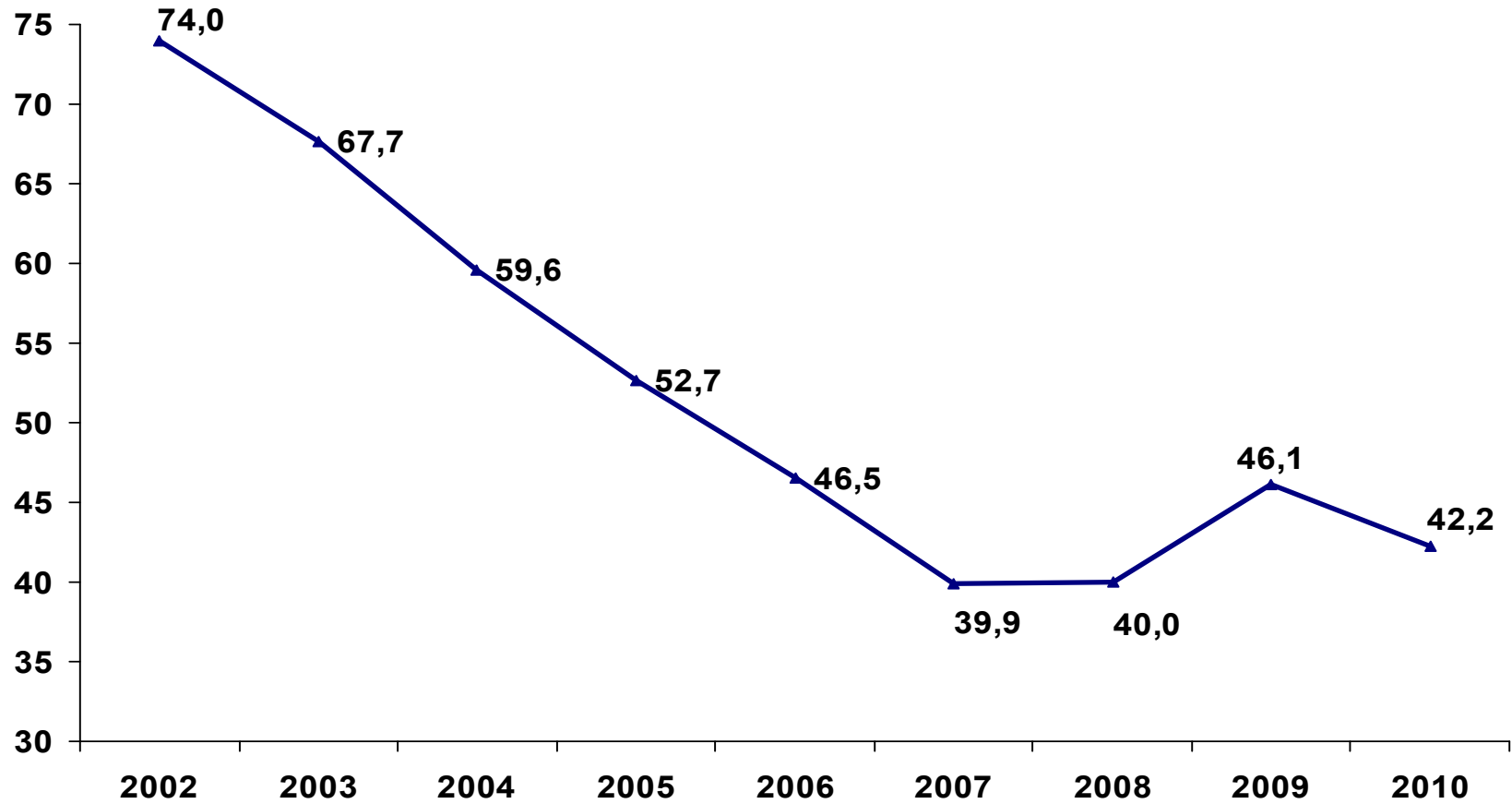
- Fiscal Discipline
 - Law on Public Financial Management and Control
- Strong Institutional and Legal Framework in financial system:
 - Banking Regulation and Supervision Agency (BRSA)
 - Bank Recapitalization and Corporate Debt Restructuring
 - State Banks' Reform
 - Granting Central Bank Full Independence
 - 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

Results



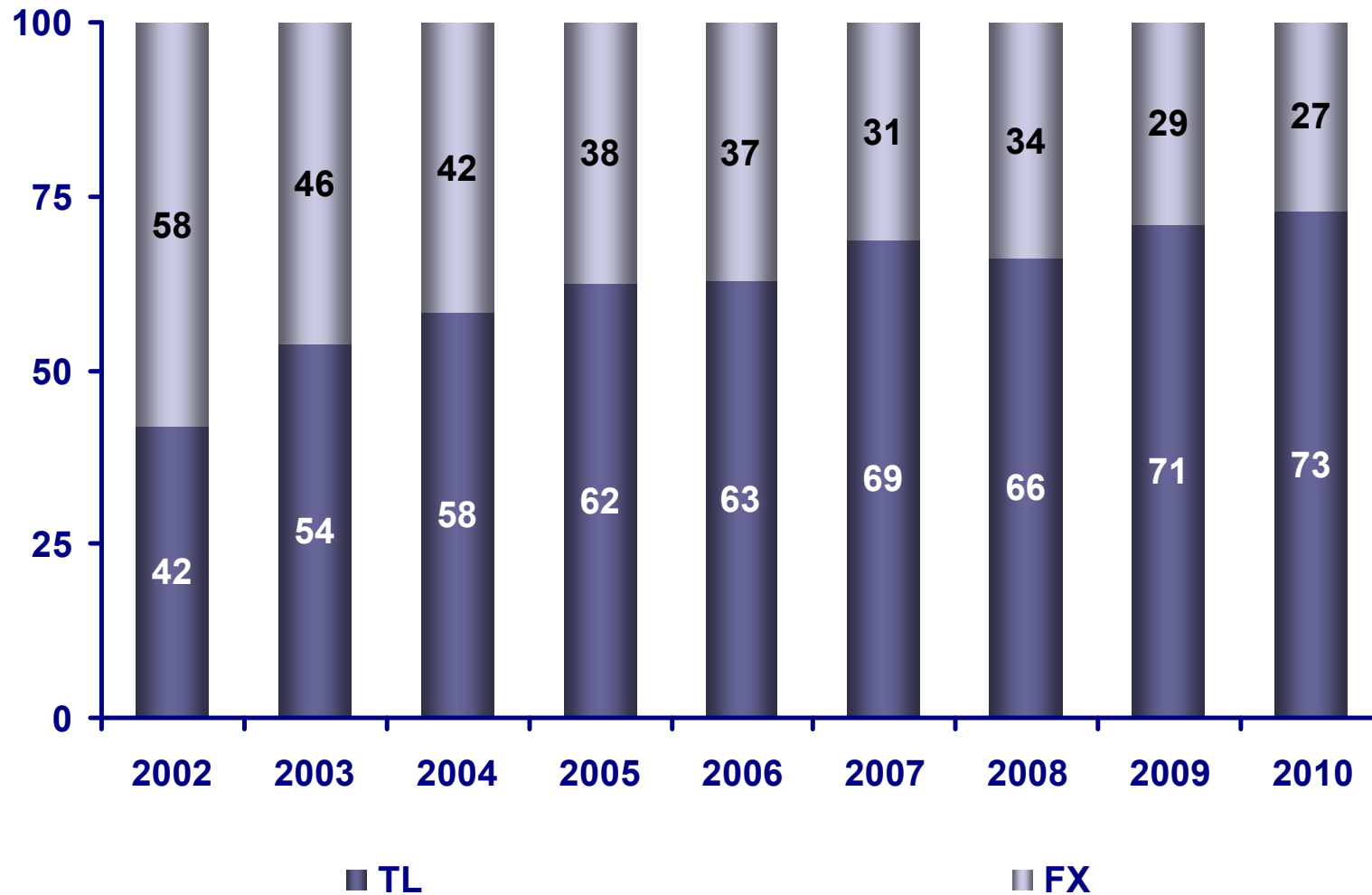
Results

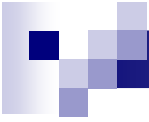
General Government Debt (% GDP)



Results

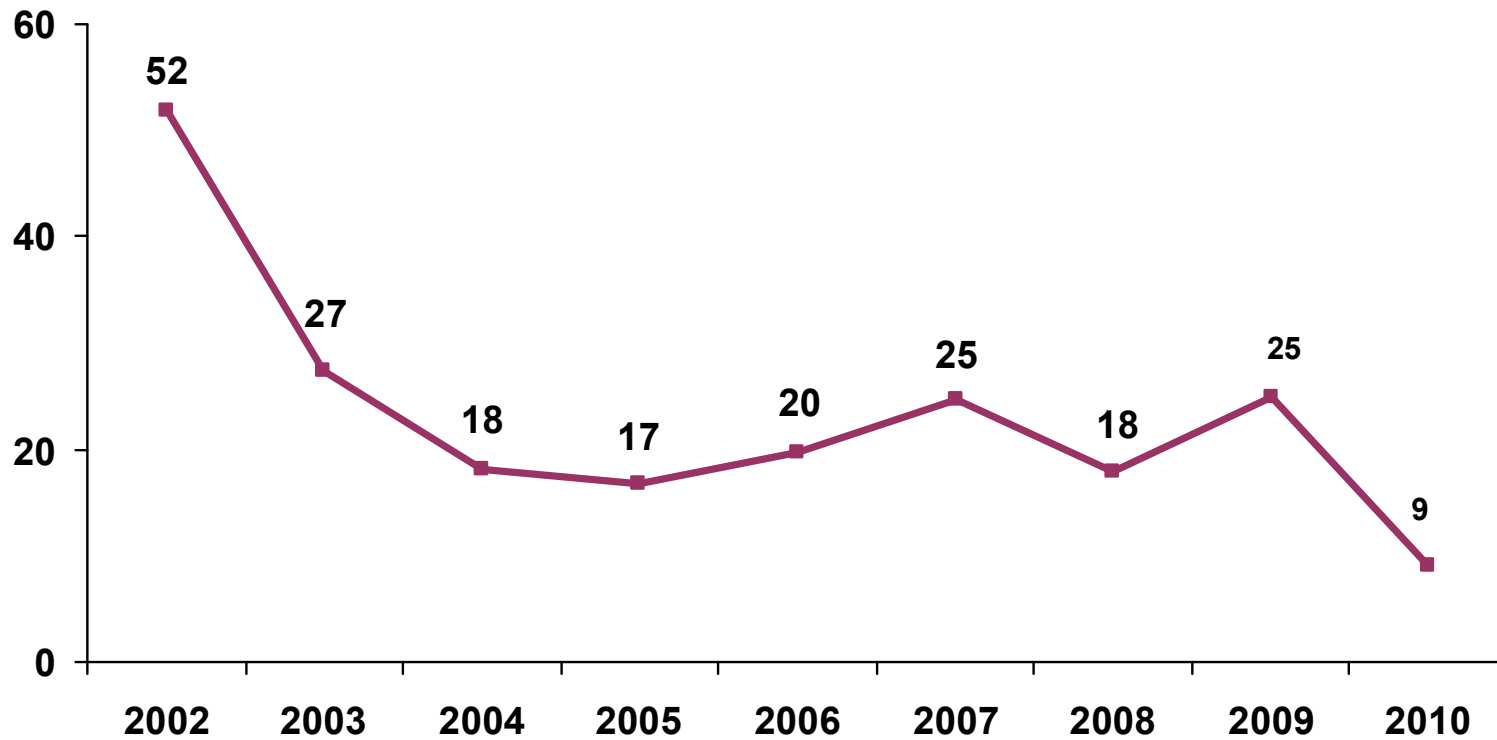
Composition of Central Government Debt





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 effects 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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