

The logo features a large '10' where the '0' is a multi-colored ring (red, orange, yellow, green) with 'th' inside. To the right, 'UNCTAD' is in green, and 'DEBT MANAGEMENT CONFERENCE' is in a smaller green font.

# 10<sup>th</sup> UNCTAD DEBT MANAGEMENT CONFERENCE

Geneva, 23<sup>th</sup> – 25<sup>th</sup> November 2015

## Lessons from the Recent Debt Crises

by

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

The logo consists of a blue circle with a white dot inside, followed by the letters 'MFAS' in a blue, sans-serif font.

**UNCTAD**



# Lessons from recent debt renegotiations

**Andrew Powell**  
**Inter-American Development Bank**

**10th UNCTAD Debt Management Conference**

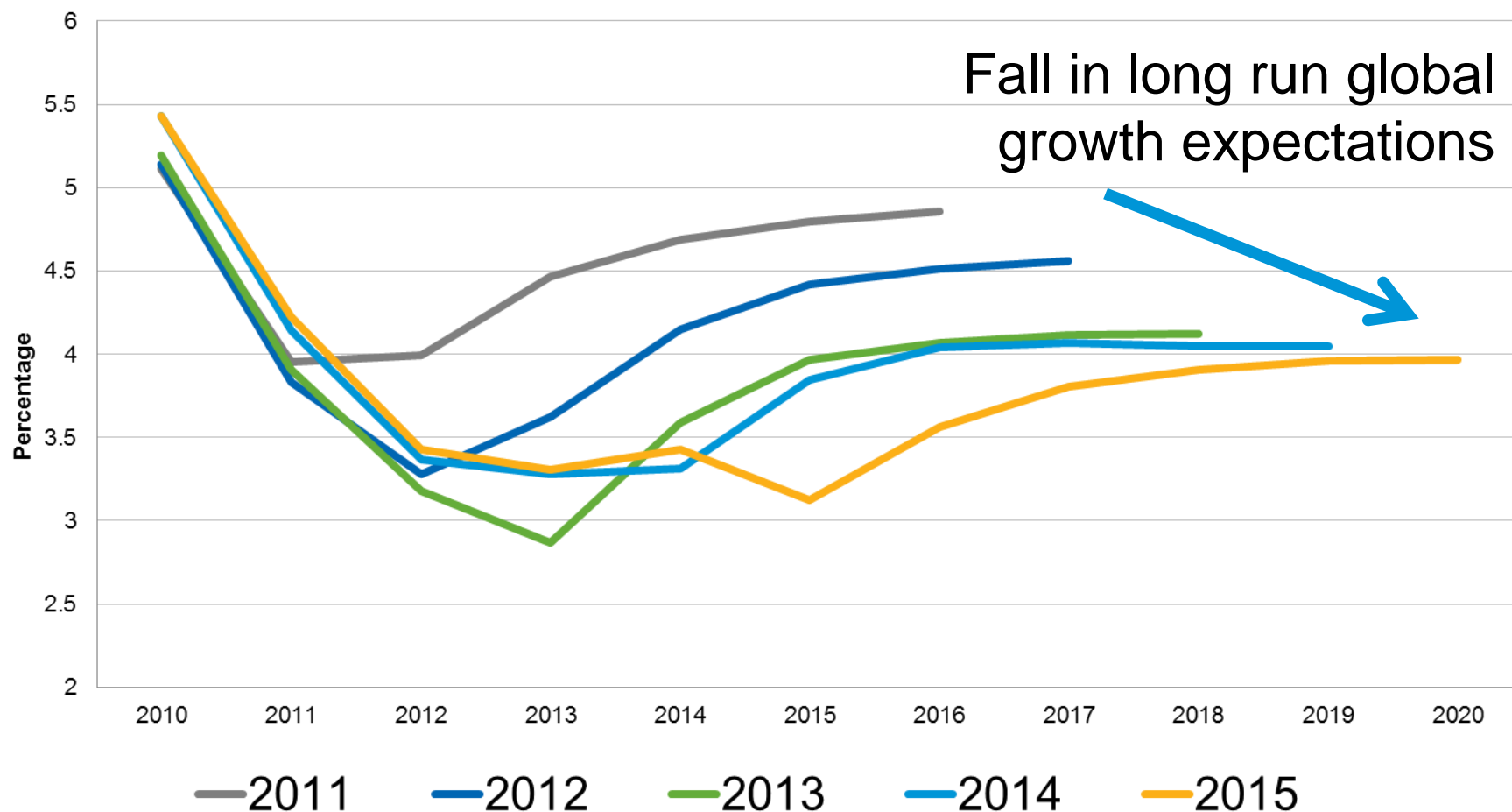
*November 23<sup>rd</sup> – 25<sup>th</sup>, 2015, Geneva*

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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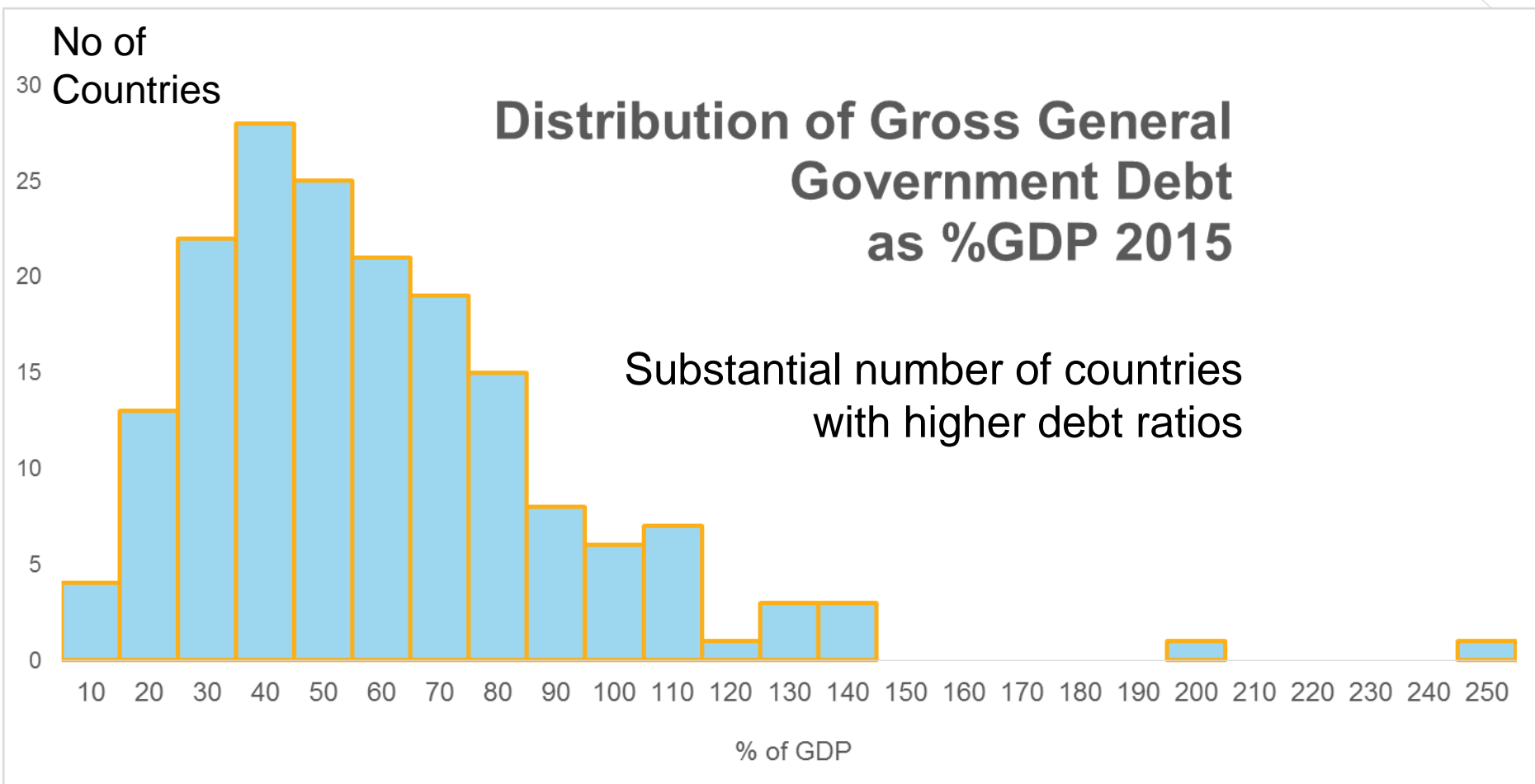
- 1. The current macroeconomic context**
- 2. Evidence regarding debt renegotiations**
- 3. Explanations and implications**
- 4. A word on fiscal adjustment**
- 5. Conclusions**

# Global context: growth prospects have been falling



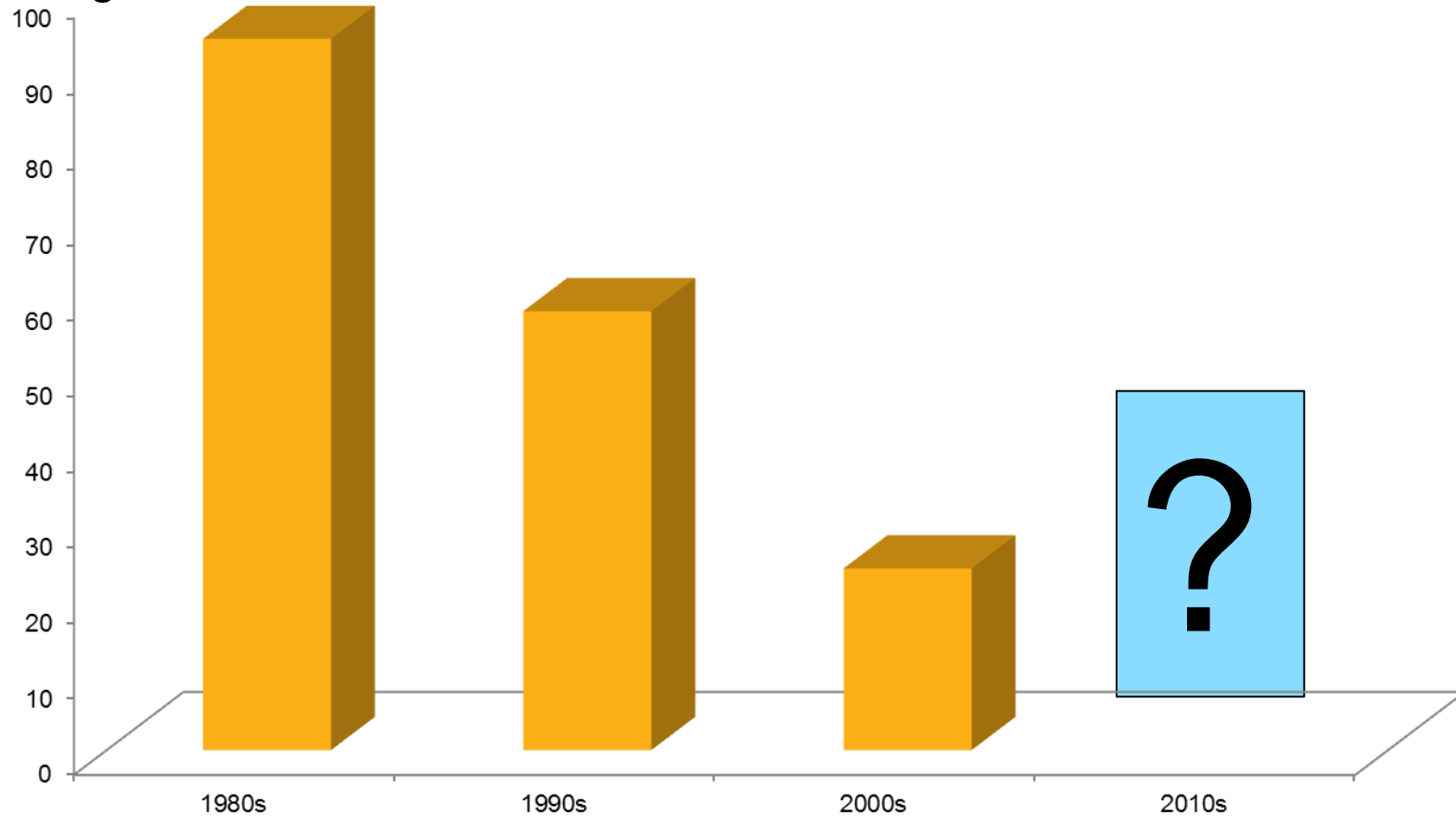
Source: World Economic Outlook, IMF. October projections for each year

# Debt ratios likely to rise..



# Number of required debt renegotiations may rise

No. of renegotiations

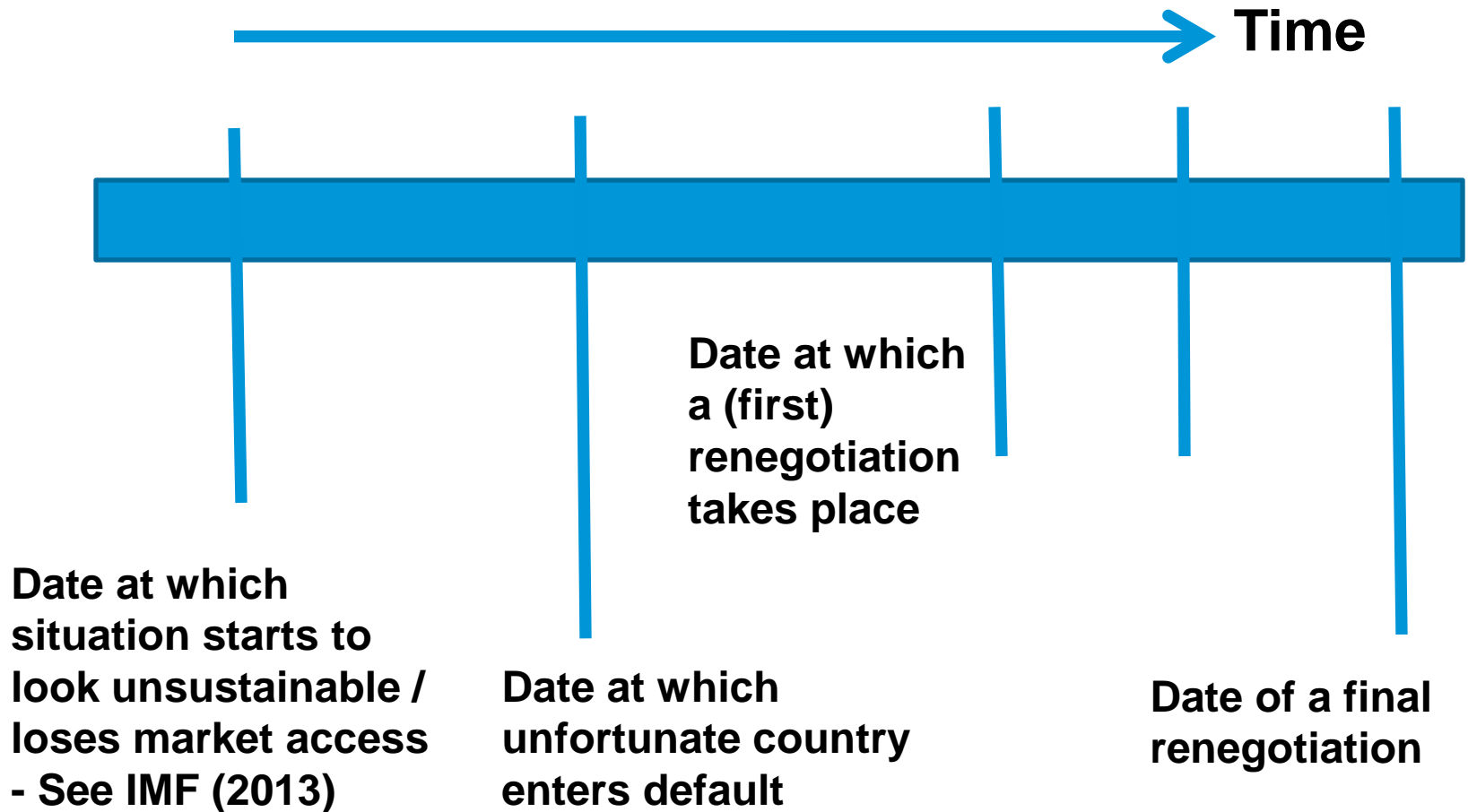


Source: Cruces and Trebesch dataset

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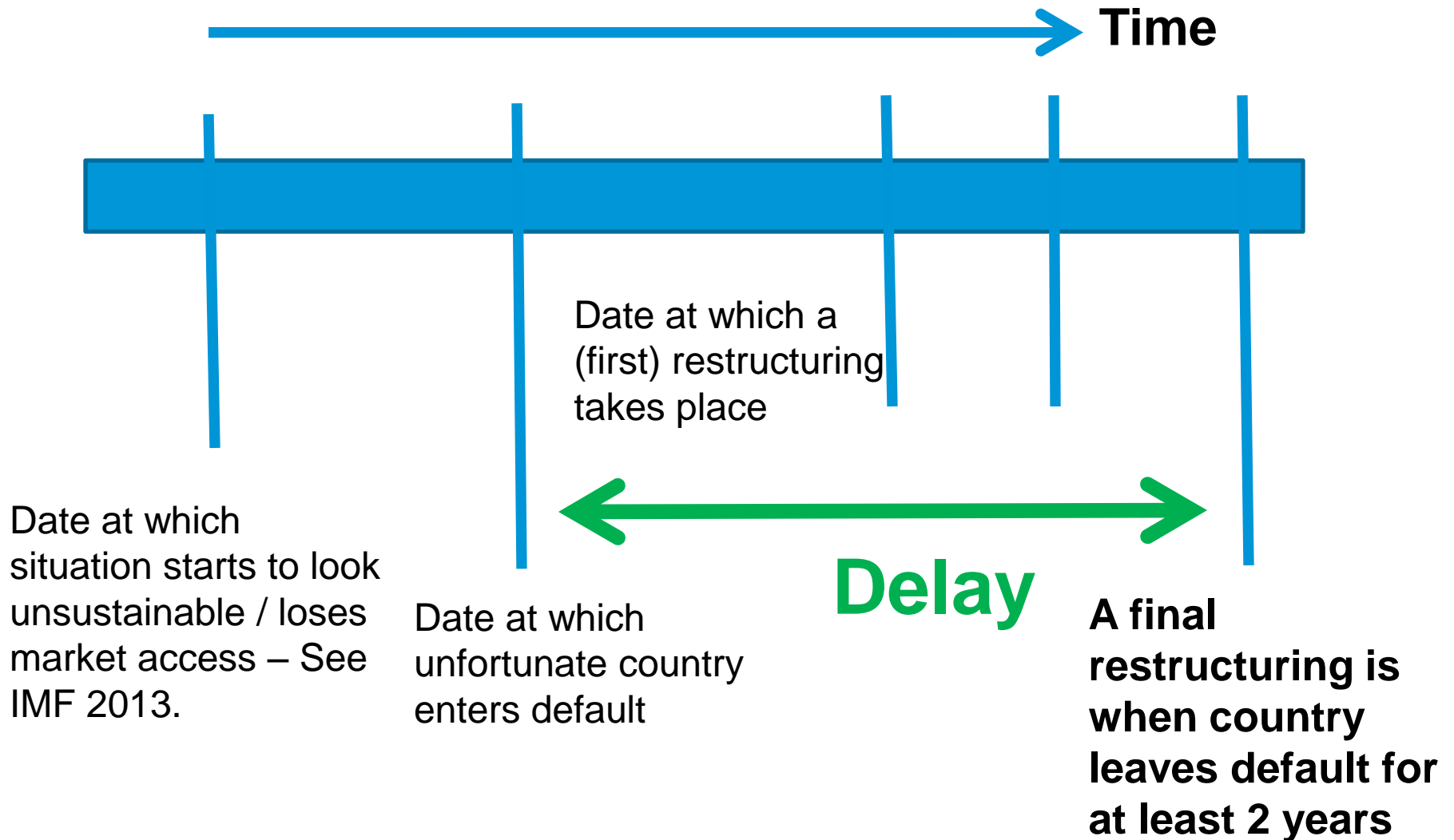
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# One issue has been “delay”

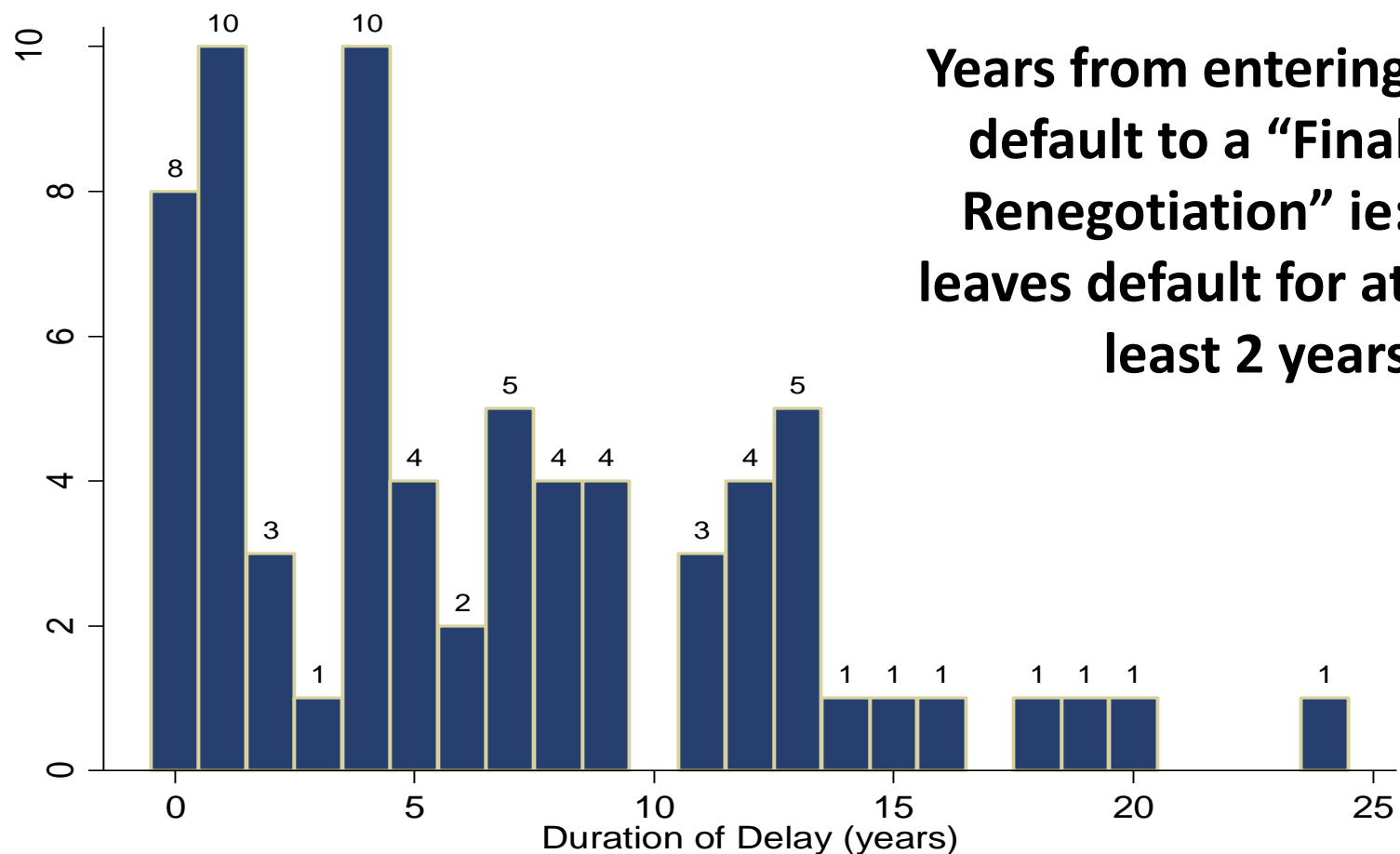




# Types of delay

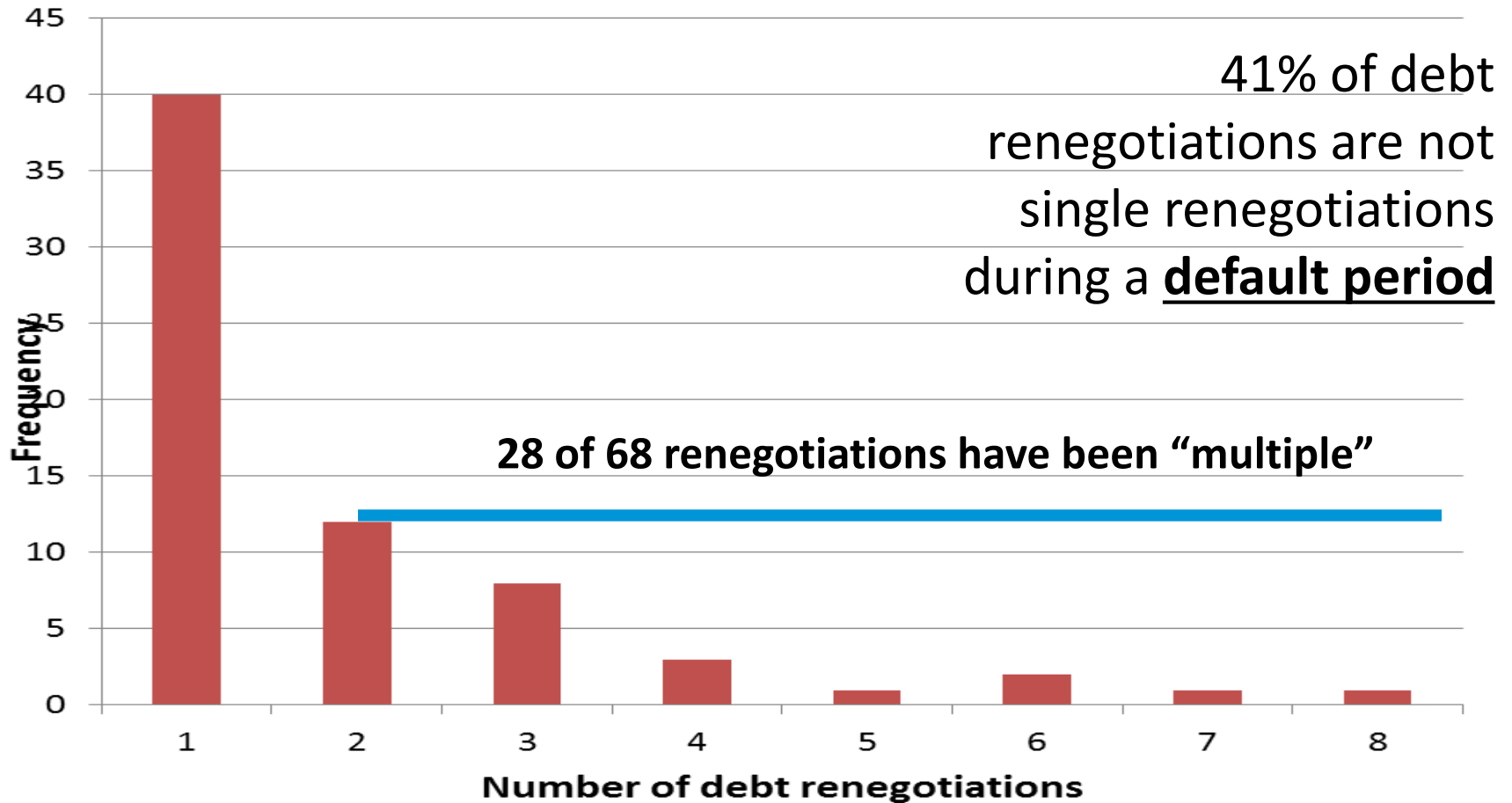


# Many years to a “final” renegotiation



Source: Authors' calculations based on Cruces-Trebesch database of 187 defaults

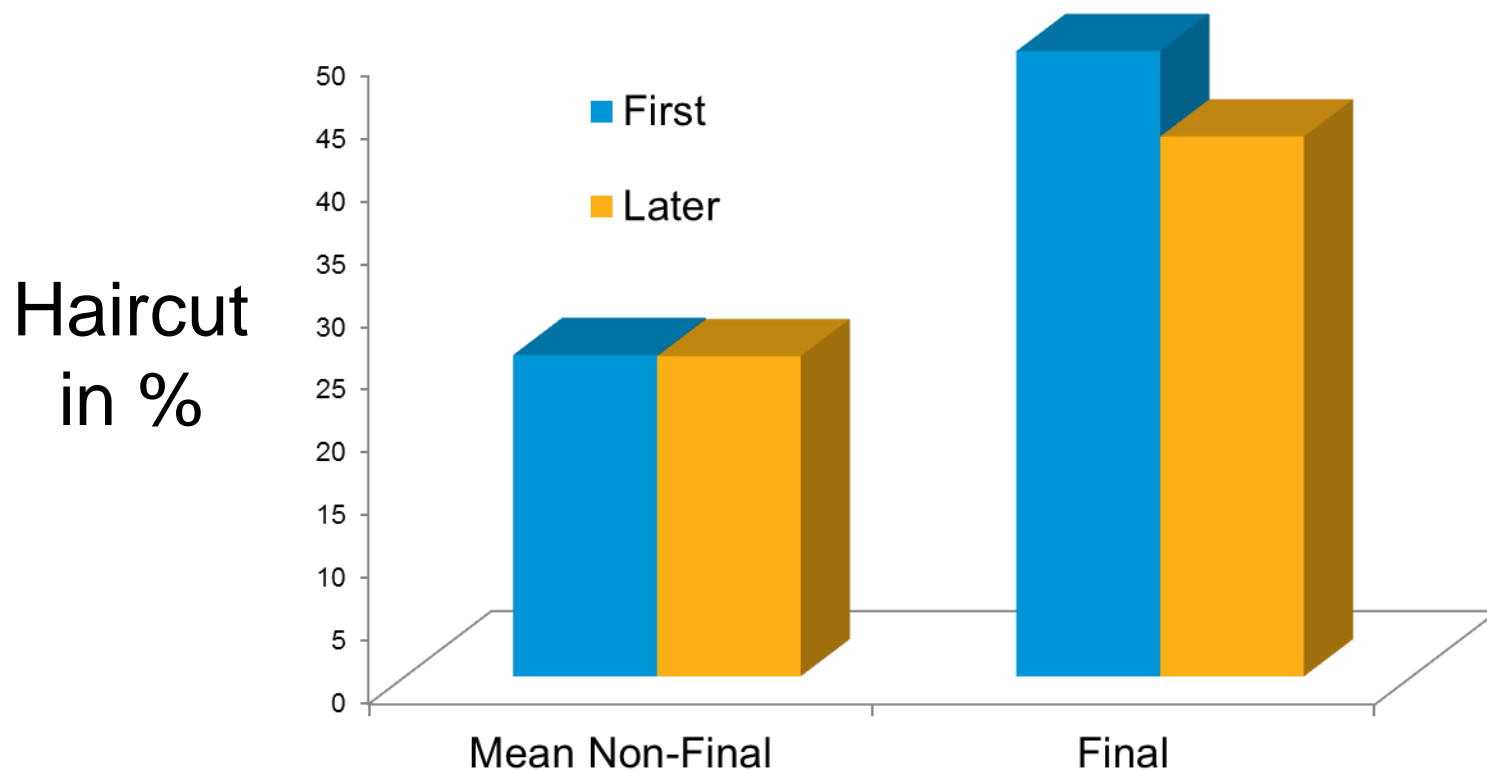
# Less focus on multiple renegotiations



Source: Mariscal Powell Sandleris and Tavella (2015). Data comes from Cruces-Trebesch database. Haircuts are estimated via the *Sturzenegger-Zettelmeyer* methodology

# Final renegotiations have higher haircuts

(Haircut is the reduction in the present value of the debt)



Source: Mariscal Powell Sandleris and Tavella (2015). Data comes from Cruces-Trebesch database. Haircuts are estimated via the *Sturzenegger-Zettelmeyer* methodology

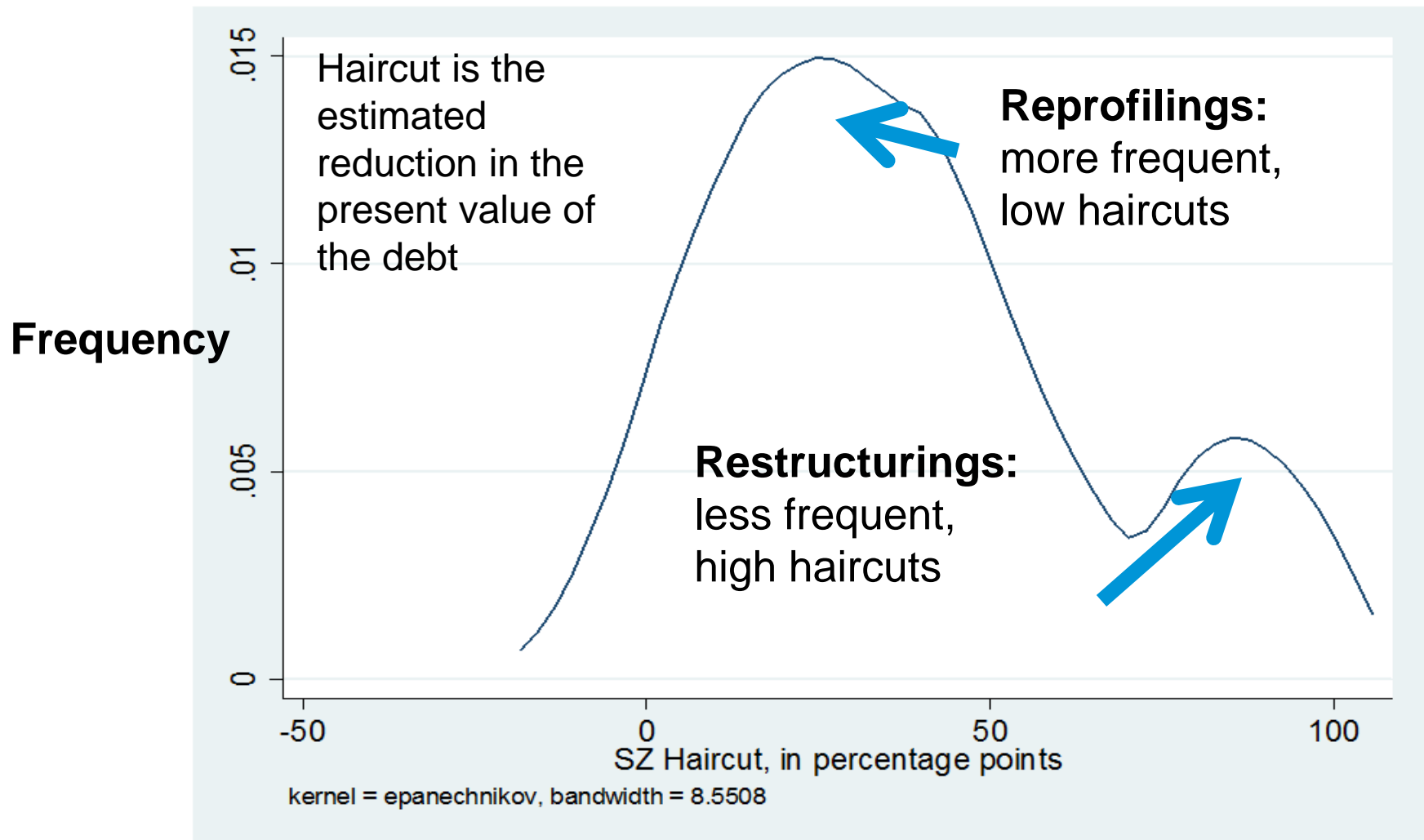
# There is higher likelihood of further renegotiations when the first haircut is low

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

| Haircut of first debt renegotiation smaller than average | Haircut of first debt renegotiation greater than average |
|--|--|
| 50%  | 21%  |

Source: Mariscal, Powell, Sandleris and Tavella (2015), data from Cruces-Trebesch

# There are two types of debt renegotiation



Source: Powell (2011). Data comes from Cruces-Trebesch database. Haircuts are estimated via the *Sturzenegger-Zettelmeyer* methodology

# Two types of renegotiation:

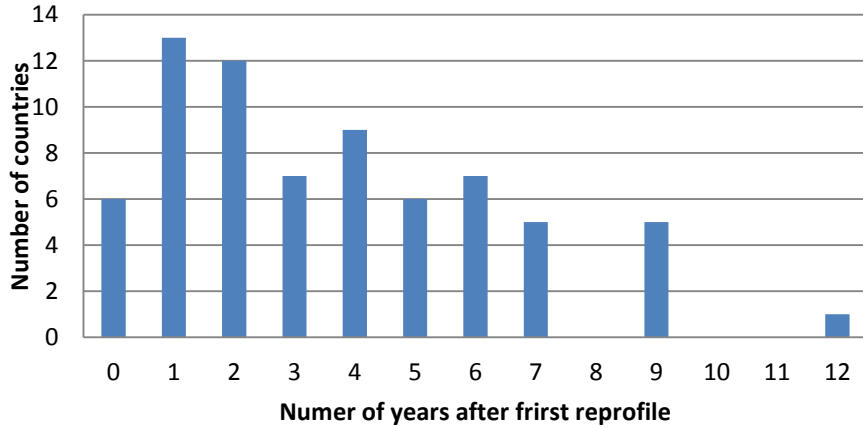
**Reprofilings:** Likely zero principal haircut, often pre-emptive, relatively low present value haircuts (avg. 15%), higher likelihood of a re-renegotiation

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

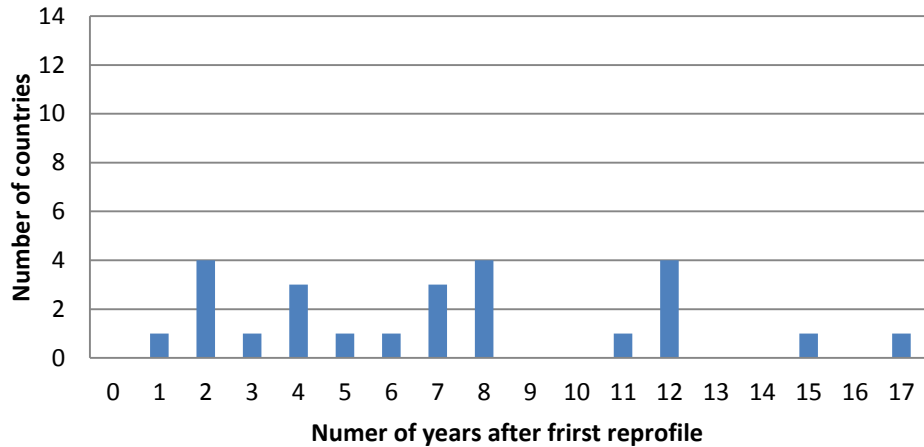
See “**Bipolar Debt Restructuring: Lessons from LAC**” Powell (2011) VOX LACEA <http://vox.lacea.org/?q=node/61>, **IMF (2014)** for a discussion and Mariscal, Powell, Sandleris and Tavella (2014) for a theoretical model and including possibility of multiple debt renegotiations.

# Multiple renegotiations by type...

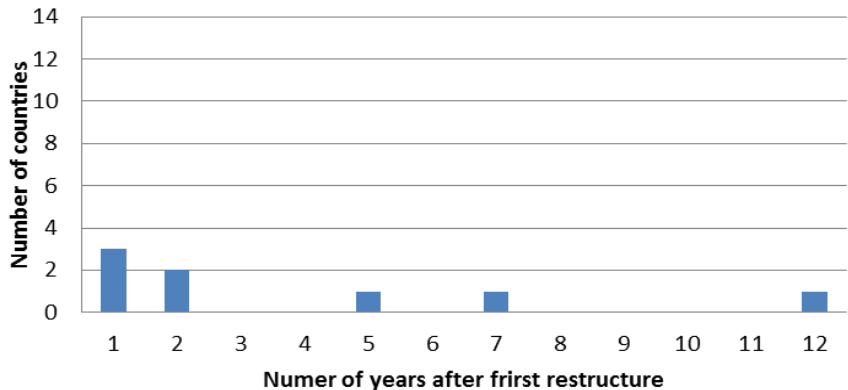
## Reprofile-Reprofile



## Reprofile-Restructure



## Restructure-Restructure



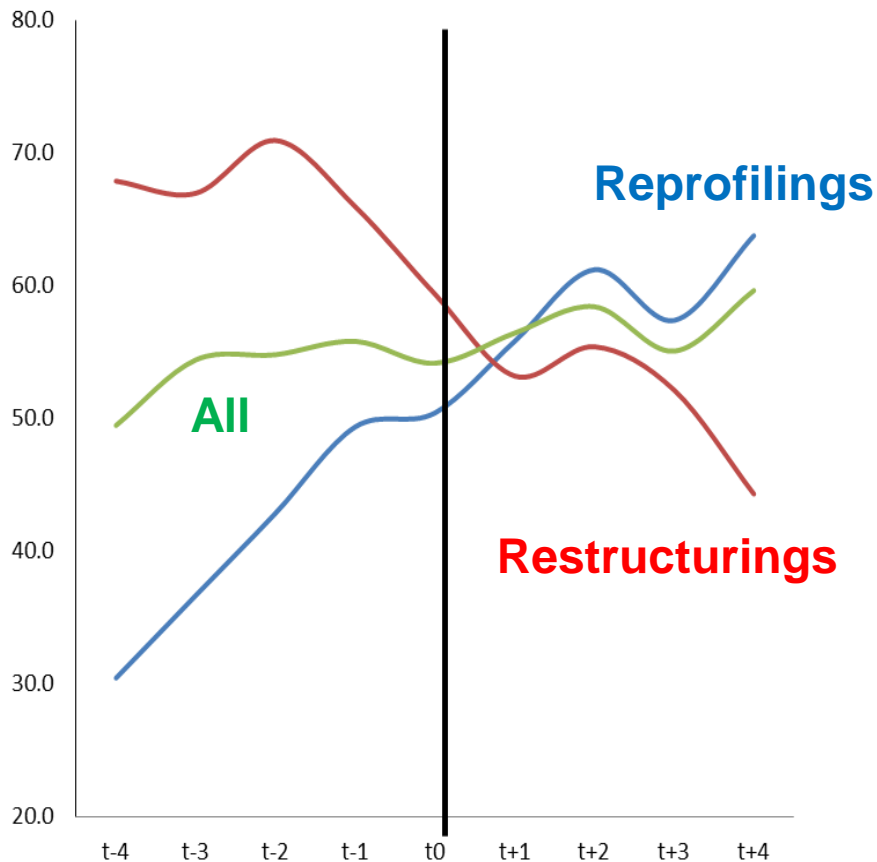
**....there are many multiple Reprofilings, few multiple Restructurings.**

Nb: there are no reprofilings following after a restructuring

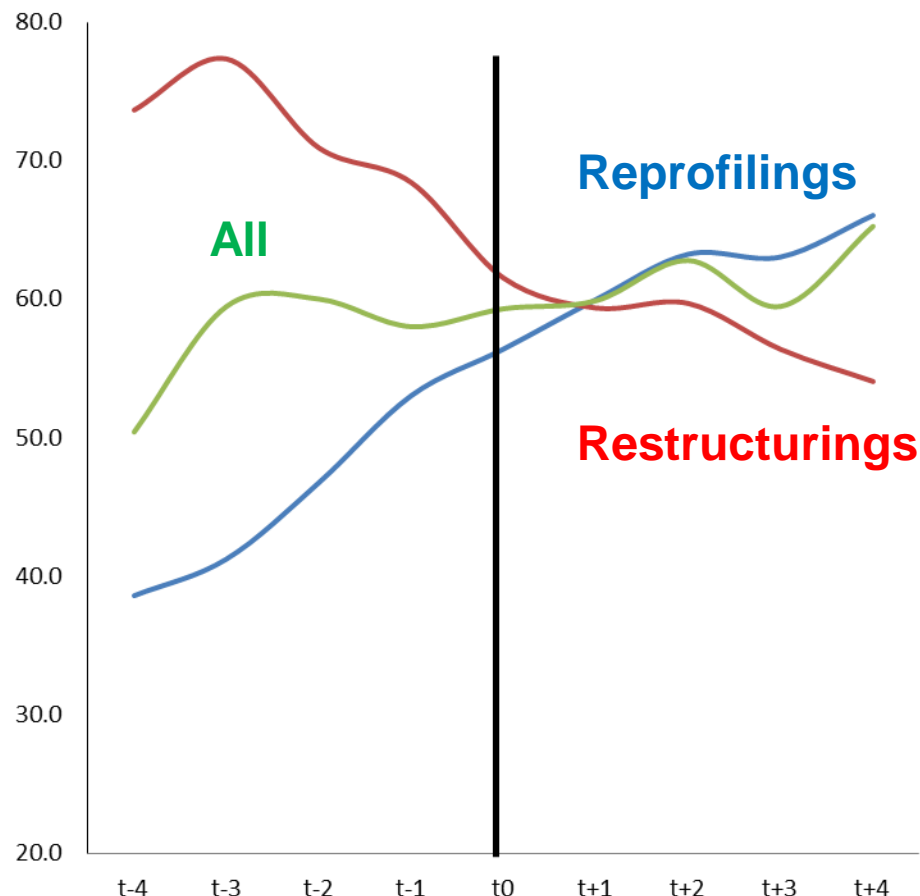


# Effect on debt is quite different: on average Reprofilings have not reduced Debt/GDP

## External Public Sector Debt



## External Debt



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-Trebeşçh

### 3. Explanations and implications...

- **Outcomes are not independent of mechanisms!**
- **Mechanisms have favored the “bipolar view”<sup>1</sup>:**
  - 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”

1) “Bipolar Debt Restructuring: Lessons from LAC” Powell (2011) VOX LACEA <http://vox.lacea.org/?q=node/61>

## 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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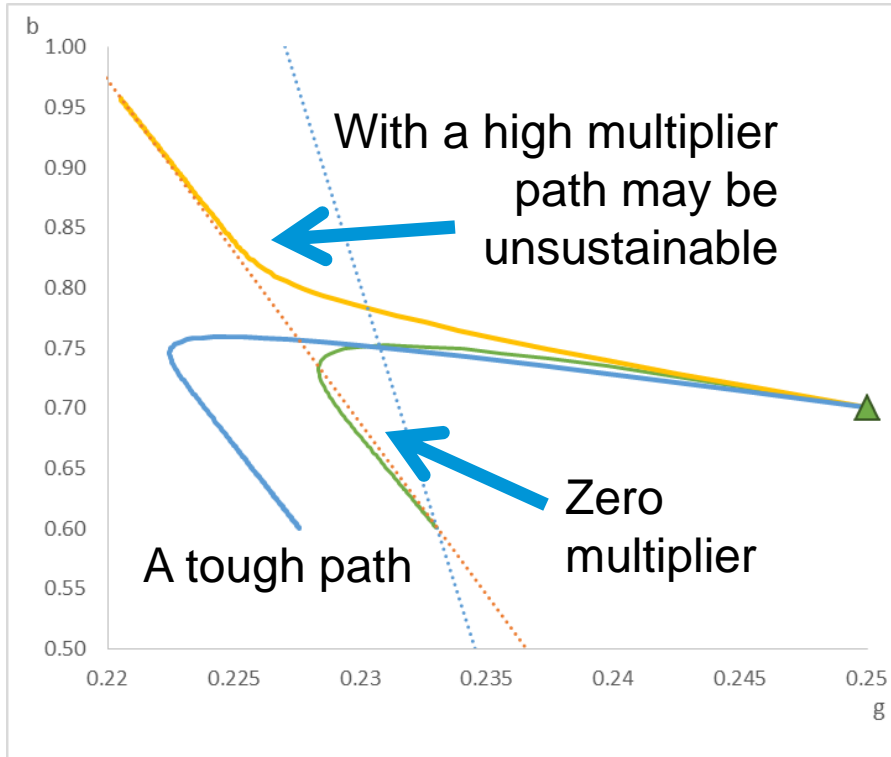
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## 4. A word on fiscal adjustment

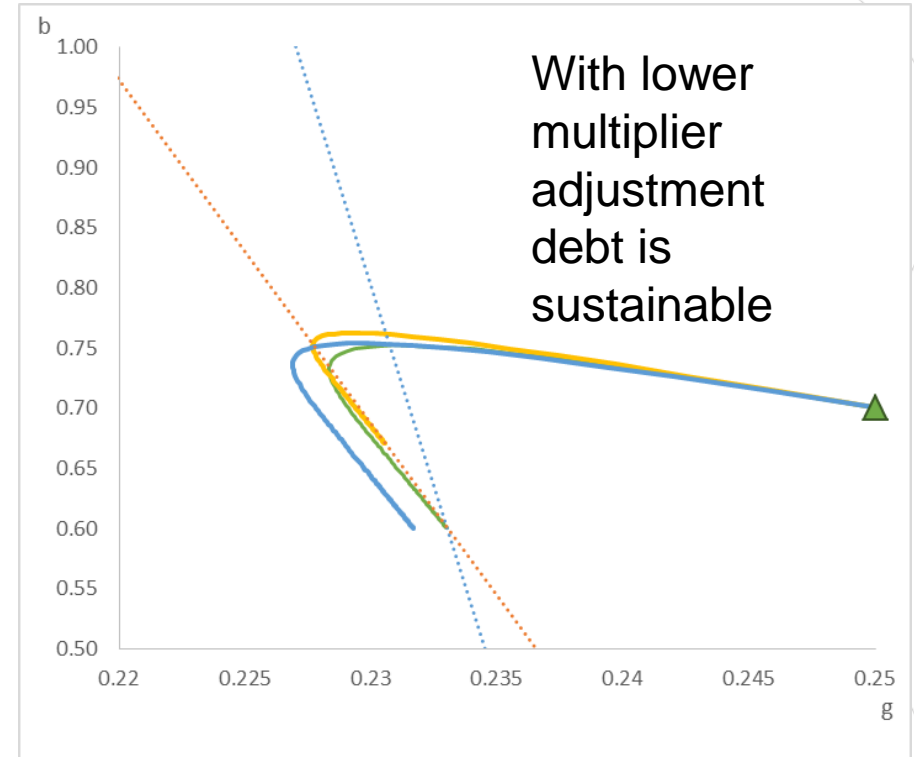
- Question posed is whether too much emphasis on adjustment?
- But not enough emphasis on actual policies
- In Latin America reaction to the 2008/9 crisis was on policies that became permanent, not temporary and did not increase growth
- Now the region has had to return to pro-cyclical fiscal adjustment (see Latin American and Caribbean Macroeconomic Report 2015 [www.iadb.org/macroreport](http://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



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

- Buchheit, L. and E. Daly (2014) Chapter 1 in “Sovereign Debt Management” eds. Buchheit, L. and R. Lastra. Oxford University Press 2014
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- Miller, M. and L. Zhang (2013) “Fiscal consolidation: Dr Pangloss meets Mr Keynes” Warwick University Working Paper, #159
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<http://vox.lacea.org/?q=node/61>

**THANK YOU**

