Debt resolution: innovative and secondary-market-based options

G-24 TECHNICAL GROUP MEETING
BUILDING RESILIENCE TO MEET GLOBAL CHALLENGES

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Debt resolution: political economy

- Lender cartels: Paris Club, London Club (syndicated loans), Bondholder Groups, IIF
- Lenders’ law: London, New York

Debt resolution: too little. too late

Directorate of Intelligence

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Cartagena

The Cartagena Group: Politicizing the Debt in Latin America

An Intelligence Assessment

creditors to grant concessions on financing. Moreover, proposals in the group's communiques will still provide guidelines for the member governments to use in their individual negotiations. Although none of the member governments probably expects to receive all the concessions that the group's declarations call for, we believe the members will continue to see advantage in keeping alive the implied threat of collective action.

Opportunities and Pitfalls

Creditor governments, in our opinion, will continue to enjoy opportunities to keep the Cartagena Group from moving toward collusion. Tactically, achieving this goal will require creditors to keep the door open for dialogue with individual member governments. We believe that any sign of willingness to deal with the group as a legitimate regional organization would only encourage the idea that creditors accept the principle of a debtors' cartel.

We believe the key to blocking collective action by Latin debtors is the ability of Latin America's creditors to convince Brasilia and Mexico City that joint negotiations would dilute their superior bargaining power, lessening their chances for favored status. Without either of the two largest Latin debtors on board, any attempt at reaching a common debt strategy would be unlikely to gain the full participation of other group members necessary to threaten the solvency of international banks.

- The Brazilians are consistently pragmatic in dealing with issues affecting their national interests, and they are proud that their economy is stronger than any other in Latin America; a sympathetic hearing by creditors for Brazil's efforts to find growth-oriented answers to its debt problems would reinforce the government's propensity to seek accommodation. We also believe that Brazil—as a creditor of other debt-troubled countries in Latin America and Africa—is mindful of the potentially adverse effects of a debtor cartel on its own position.
- Mexico, on the other hand, probably wants to protect what it perceives as its unique relationship with the United States—a major advantage over other debtors. The preference of Mexico for being treated as a special case is underscored by its longtime resistance to joining such organizations as the Organization of Petroleum Exporting Countries and the General Agreement on Tariffs and Trade. We believe that Mexican policymakers would align the country's fate with that of other debtors only if relations with the United States suffered a major setback.

We believe, nevertheless, that the Latin American sense of victimization by the industrialized nations runs deep and that the debt issue can readily evoke an emotional political response. To preserve the present dialogue, creditors will need to remain sensitive to Latin American government interpretations of how new financial developments help or harm prospects for economic recovery and political stability. In our judgment, a miscalculation by the creditors could quickly galvanize the Latin American governments into a unified position.

Debtor coordination

- Political economy
  - Need borrower coordination
  - For example: OSC CLUB

5 December 2023 - Conferences

Common Leveraging Union of Borrowers (CLUB) press conference

Following the historic establishment of the Common Leveraging Union of Borrowers (CLUB), OSC Secretary-General Manssour Bin Mussallam held a press conference on the world's first union of debtors and borrowers.

The CLUB is an innovative instrument of borrower-coordination for a solidary, equitable, and sustainable international financial architecture which reflects the perspectives and legitimate concerns of the countries of the South.

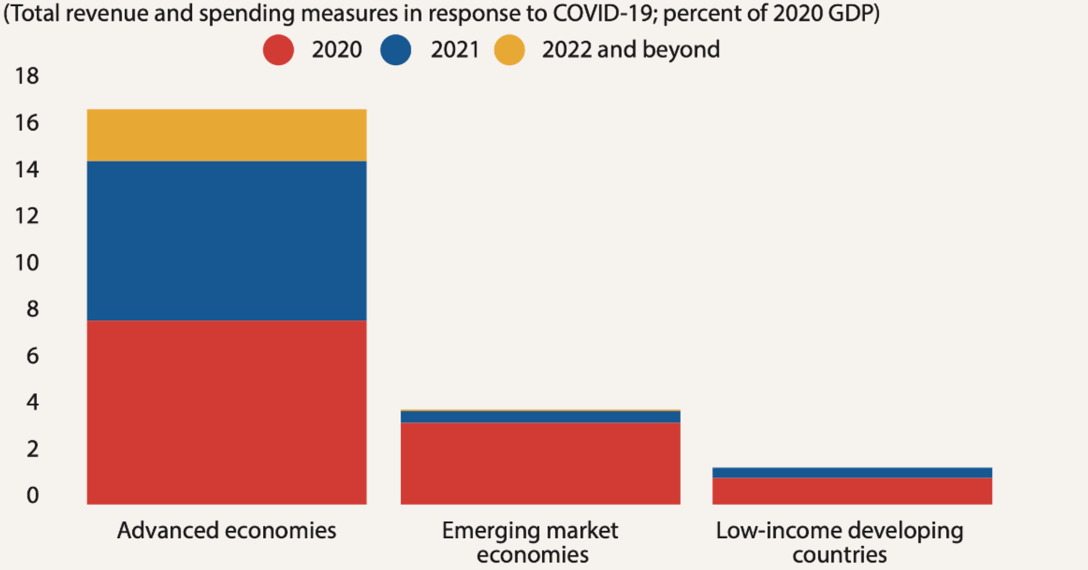
Debt resolution: too little, too late

- Common Framework is Paris Club +
    - Small haircuts and incomplete participation (eg DSSI)
    - Failure to include private finance, failure to include MDBs

- Global Sustainable Development Roundtable
    - Does not take into account Sustainable Development Goals
    - UNCTAD $3 trillion SDG financing gap for EMDEs ignored

SDRs for debt relief

Figure 1. Divergences in policy support[1]



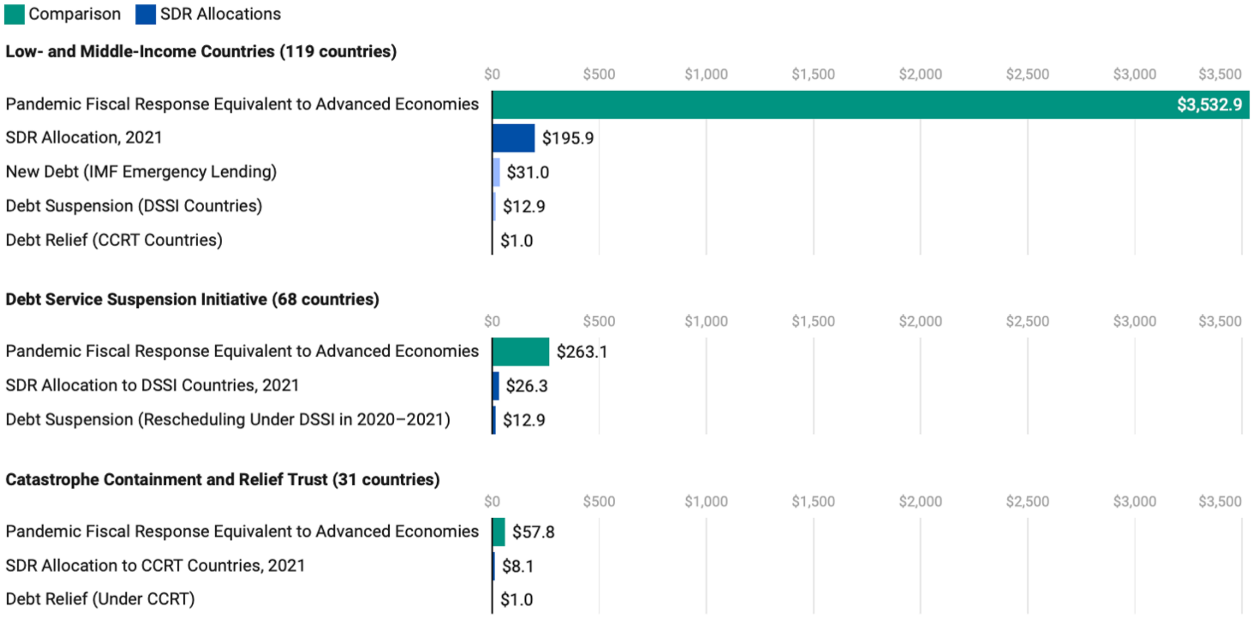
Sources: IMF Fiscal Monitor database of Country Fiscal Responses to COVID-19; and IMF staff calculations

1 Drawing Further Apart: Widening Gaps in the Global Recovery. IMF. July 27, 2021. https://blogs.imf.org/2021/07/27/drawing-further-apart-widening-gaps-in-the-global-recovery/

SDRs for debt relief

SDR Allocation in 2021, and Other Sources of Support, by Country Groupings (USD billions)

The 2021 allocation of Special Drawing Rights represented the best source of economic support for countries overall but falls short of what is needed



The exchange rate used is SDR 1=1.4 USD. Countries in the sample are the 119 low- and middle-income countries included in the World Bank's International Debt Statistics database. The pandemic fiscal response equivalent to advanced economies is the amount of fiscal support this set of countries would have if it were proportional, by GDP, to the amounts that advanced economies created in response to the pandemic. Thirty-one countries received support under CCRT; at least 48 received support under DSSI.

Source: Authors' analysis, World Bank (2022b, 2022f), and IMF (2021f, 2021g).

SDRs for debt relief

- Improve external position (reduce need for FX debt)
- Improve fiscal position (reduce need for public debt)
  - Legal and accounting arrangements for fiscal use of SDRs
- Can be used to directly settle obligations with the IMF
  - Thus are a form of <u>debt relief</u>
- If used, principal need not be paid
- Accounting controversy (equity vs liability)
  - Only net interest should be counted as liability, but present value of net interest would be zero or negative due to the fact that the discount rate of discounted cash flows is higher than the SDR rate.

SDR allocation accounting controversy

BPM6 CHANGES IN TREATMENT OR CLASSIFICATIONS IIP Items			
BPM6 International Investment Position: Standard Components and Selected Other Items Items in italic are supplementary	Remapping	*BPM5* International Investment Standard Components and Additional Detail Items in italic are supplementary	Comments on Change in Treatment or Clarification
Special drawing rights (AF12)			* In *BPM6*, the allocation of SDRs to IMF members is recorded as an incurrence of a liability; see *BPM6 8.50*. In *BPM5*, the allocation of SDRs is not recognized as a liability; see *BPM5 440*.
Reserve-related liabilities (memorandum item)			* In *BPM6*, reserve-related liabilities are introduced as memorandum items to the IIP; see *BPM6 6.115 - 6.116 and Box 6.5.*

*[5] Preferably assets and liabilities reported separately, but otherwise a net figure for liabilities less assets, included, by convention, under assets.

*[6] If available for publication.

*[7] Assets and liabilities combined and reported as a net figure for assets less liabilities, included under assets.

440. SDRs are international *reserve assets* created by the International Monetary Fund to supplement other *reserve assets* that are periodically allocated to IMF members in proportion to their respective quotas. SDRs are not considered liabilities of the Fund, and IMF members to whom SDRs are allocated do not incur actual (unconditional) liabilities to repay SDR allocations. The Fund determines the value of SDRs daily by summing, in U.S. dollars, the values—which are based on market exchange rates—of a weighted

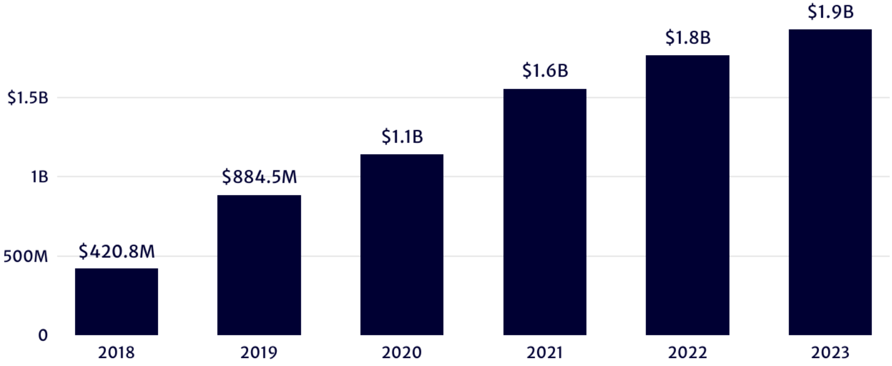
tinyurl.com/bpm5bpm6

SDRs for debt relief

- Donation of 25% of rich countries' unused SDRs is enough to strike out 100% of the world's debts to IMF ($135 bn)
  - CCRT procedure
  - If drawdown at SDRD ledger, net interest can be paid with recurrent allocations of SDR worth five years of interest
- Rich countries' unused SDRs can subsidize interest rate caps for variable rate MDB loans
- SDR lending via is more conditionality (+ too little, too late)
- We need a new issuance of SDR

Debt relief: Eliminate surcharges

Total Surcharge Payments in USD (2018-2023)



Note: Using average monthly SDR-USD exchange rates.

Source: IMF (2024) and Federal Reserve Bank of St. Louis (2024)

CEPR

Accumulated Charges and Interest Payments and Surcharges in 2024–2028, in USD millions, excluding Prospective Credit

Country	Charges and Interest	Surcharges	Surcharges, as percentage of C&I
Argentina	$9,861	$4,634	47.0%
Ecuador	$1,505	$584	38.8%
Egypt	$1,566	$370	23.6%
Ukraine	$1,800	$348	19.4%
Angola	$776	$160	20.6%

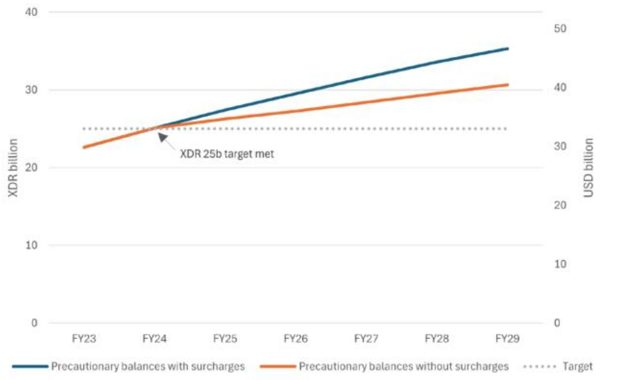
Note: SDR to USD exchange of 1.33 as of January 2024. "Charges and Interest" refer to conventional lending charges from the General Resources Account.

Source: IMF (2024)

CEPR

IMF Precautionary Balances with and without Surcharges

In XDR and USD billions



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Source: International Monetary Fund (2023)

Secondary market

- Bond contracts must be crafted to allow secondary market operations
- Debt buybacks
  - Use new liquidity (eg SDRs)
  - Management of rational expectations
  - Participate in CDS auctions

Secondary market

- Default is an option: bondholders internalize this risk
  - Plurilateral coordination is key
  - Especially against
    - vulture-friendly legal frameworks
    - illegitimate debt
    - offshore round-tripping and conflict of interest
  - Also against ISDS awards
    - New forms of (contingent) debt

Beneficial owner transparency

- Beneficial bondholders are behind many veils of secrecy
- Central Security Depositories, Custodians, Trust Funds, Hedge Funds, Managed Portfolios, Offshore Legal Personhood
- Intentional opacity that hides conflicts of interest and insider trading
- Credit default swap market usually outside of purview of national policymakers
- Need strong beneficial owner transparency in any debt restructuring process

A comment on IMF DSA and ESA

- IMF External Sector Assessment is very weak at projecting BOP financial account flows and international investment position stocks
- FX debt is mainly driven by external (ie balance of payments) position and not by fiscal position
    - Fiscal consolidation without fixing balance of payments imbalances does not fix the debt problem: development, trade and industrial policy once again

Conclusions

- Set up debtors' club
- Debt relief
  - Fix SDR allocation accounting
  - More SDRs
  - Eliminate surcharges
- Secondary market operations
- Beneficial owner transaprency of bondholders
- ESA (EBA) methodology needs to take into account capital (financial) flows