FOREIGN DEBT ROLLOVER DURING CRISES

(TURKISH EXPERIENCE)

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(Abstract)

Recurrent financial crises in some of the developing countries have increased the importance of structuring a foreign debt rollover mechanism in line with the international consensus on monitoring short term capital flows to these countries and involving the private creditors in the resolution of financial crises.

In most of the crises, initiating debtor-creditor meetings as well as establishing a Debt Monitoring System (DMS) in the context of IMF supported adjustment programs, IMF has played a crucial role in debt rollover arrangements.

Turkey, have encountered a financial crisis in November 2000 by a recurrence in February 2001 and like other crisis countries, called for rollover of its banking sector external debt. Two consecutive foreign debt rollover arrangements in 2000 and 2001 have produced no positive outcome. As of the end of May 2002 foreign interbank liabilities of Turkish banks have shrinked by 50% comparing with December 2000 level.

In this paper I will discuss the main domestic and external factors leading to unsuccessful interbank debt rollover experience of Turkey with the purpose of contributing to the efforts of structuring an operational debt rollover framework for the countries facing with financial crises.

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1- INTRODUCTION

Private sector involvement (PSI) in developing country debt crises is mainly a post-liberalization period concept.

Until the middle of the 1980's, there were only few regular instruments of external financing for developing countries. Beside the Balance of Payment (BOP) loans and project loans from multilaterals, these were overwhelmingly syndicated bank loans and bilateral country borrowings. The debtor side of a debt negotiation was a developing country government and the creditor sides were a creditor government or international banks. Bilateral official debt negotiations were held through the Paris Club and syndicated debt negotiations were settled between a known number of creditor banks and a debtor government.

After the second half of the1980's, the liberalization of the financial markets and capital accounts have led to huge amounts of capital flows among developed countries and from developed to developing countries. Many sophisticated financial and borrowing instruments tailored to the needs of debtors and creditors were created in this process. Among these, the most popular borrowing instrument was the sovereign/private bonds. In addition to traditional syndicated and bank to bank loans, the developing countries have increasingly borrowed from the international markets through bond issues. The investor base of developing country debt instruments have also diversified as to include banks, securities firms, hedge funds and retail private investors.

In this complex and diversified international financial market, the settlement of debt issues has become more challenging. The increased frequency of developing country crises necessitating further financial support as against the reluctance of private creditors to share the burden of any debt restructuring, have called for further reforms in international financial architecture. There are strong political oppositions from donor countries and regulatory limitations on the official lending as against the increased need for official financial rescue packages. IMF and G-7 are trying to establish a legal and operational crisis settlement framework that

will not waste their monies, will involve private creditors without endangering their benefits and will not exhaust the debtors' repayment capacity.

After years of discussions in G-7 summits and other panels, last year IMF has proposed a draft namely "A New Approach to Sovereign Debt Restructuring" to be criticized by the debtor/creditor parties. However the proposal's near target is bonded debt restructurings, its ultimate goal is deemed to provide a framework that will serve as a catalyst for voluntary sovereign debt restructurings. Except a few countries, developing countries regrettably have not shown any positive or negative reaction to this proposal.

Since the fourth quarter of 2000, the Turkish financial system and the economy as a whole have been suffering from the devastating effects of a crisis. The outflow of capital from the country and especially from the banking sector has contributed significantly to the deepening of the crisis. In the absence of any measures to stop the foreign creditors, they have cut their lines and run out of the country. In this process, Turkey was not able to exploit the option of a rollover agreement for the banking sector debt that would provide some relief to the country by reducing the pressures of foreign exchange demands on the value of the Turkish Lira and hence on the country's foreign exchange reserves.

In addition to creditors' negative expectations about the Turkey's financial situation, the failures of Turkey in its recent debt rollover attempts are closely connected with Turkey's and the IMF's reluctance for a concerted rollover agreement on the banking sector debt as well as the G-7's and IMF's immature standings on the critical issues of the New International Financial Architecture (NIFA).

This paper aims to discuss the issue of PSI as a complementary concept of NIFA and keeping in mind the lessons derived from Turkish experience, looks for appropriate approaches and policies for a future debt negotiation.

2- HISTORICAL BACKGROUND

The first half of the 1980s were the problem years for both developed and developing countries, but especially for the developing countries. Being heavily indebted during 1970s, they were hit by the second oil shock as well as the

repercussions of the restrictive trade and monetary policies in U.S. and other developed counties. The burdens of the interest payments for the existing debt combined with the rising interest rates in the U.S. also contributed to the onset of the decade-long crisis of the 1970s. Refraining from further default risks, private creditors were reluctant either to rollover the existing debt or extend new loans, unless they were satisfied with the policies in these countries, which guarantied repayments. This situation increased the importance of the IMF and converted its function (and also the World Bank's) to the guarantor of developing countries' debts and to the super imposer of the Structural Adjustment Programs (SAP) in debtor countries.

Beginning with Mexico in 1983, a series of sovereign debts were rescheduled by the Paris Club, which were accompanied by some fresh money from the IMF, OECD and WB. The short-term target of the creditors' programs imposed by multilaterals was to enable debtor countries to recover from the crisis through stabilization policies, and to begin paying back their debt when the grace period of the rescheduled debt ended. The longer-term target was to maintain a transferable surplus for regular debt repayments through structural adjustment in these countries. (Şenel, 1999). However, due to ongoing adverse external trade and financing conditions, many of the debtor countries were not able to stabilize their economies and went into deeper recession instead of creating surplus.

In 1985 the U.S Secretary of the Treasury James Baker announced a plan that would provide 29 billion U.S. dollars to most severely indebted 15 countries in return for significant structural reforms. The understanding of the plan was that this new resource would support economic recovery through structural reforms. Of the 29 billion dollars, 20 billion would be involuntary fresh lending by creditor banks, and the remaining 9 billion would come from official creditors. This Plan was a cornerstone in lending a dignity to international private capital flows in the growth process of developing countries, as well as involving private creditors in the resolution of developing country crises. Creditor banks welcomed the plan. They believed that the continuance of the official loans and aids to the developing countries were encouraging them to be irresponsive in their economic policies. On the other hand, private lending was more expensive, and, therefore

it would force the debtor countries to work hard and do the structural changes to reach the capacity to repay their debt (Reed, 1987).

The problem with the implementation of the plan was that the countries that were severely been beaten by adverse economic environment did not have enough time (approximately 1 or 2 years) or energy to get their economies back on track. Creditors, on the other hand, had institutional problems with respect to different accounting constraints in booking and carrying of these loans in their balance sheets. Another important problem was the capital account constraints in developing countries that were impeding cross currency operations and the entry and exit freedoms of international bank investors. The first problem was solved by the U.S. Secretary of Treasury Nicholas Brady under the framework of so called "Brady Plan" (1989), and the second problem by capital account convertibility along with stable foreign exchange regimes imposed by IMF on member countries. Supported by the new loans from the IMF and WB and new reschedulings by the Paris Club, foreign investors were offered a menu of options to trade in international financial markets on developing countries' securitized debt (the Brady Bonds), which were originally owed to syndicated groups of private banks. This facility, while bringing liquidity to commercial banks' syndicated loan portfolios, also shifted much of the ultimate credit risk from them to guarantor multilaterals. The Brady operation was in a sense the first bailout of the private creditors by multilaterals. In the following years The Brady style restructuring was extensively used especially by heavily indebted Latin American Countries, and the speculative price volatility of these bonds attracted market traders.

In the late 1980s and early 1990s the capital account liberalizations in the developing countries were almost complete. Beginning 1989, developing sovereigns and their private sectors were able to issue longer-term non-Brady type unsecured bonds in the international markets. In the following period, the Brady and non-Brady bonds were traded heavily in the "emerging debt market" by private investors. There was also a surge in rating agencies conducting periodic ratings for economic fundamentals, as well as for longer term issued bonds of sovereign countries. The rating changes and the daily volatility in the

prices of these bonds were considered indicators of the daily creditworthiness of the governments, as would be the case for any corporate issuer.

"Developing countries offered a variety of instruments to satisfy the investors regarding the default risk, transfer risk and liquidity risk.... The increase in bond issues from Latin America in the second half of 1991 and 1992 resulted in oversupply of these securities in the international markets, which together with political uncertainties and rising current account deficits caused concern among the investors. In turn Latin Americans started offering more attractive yields on their bond issues which forced the yield spreads to increase." (Altınkemer, 1996). These developments triggered the typical outcome of events, primarily in Mexico, in 1994: capital outflows, increasing doubts among investors about the adequacy of foreign reserves, inability of governments to rollover their debts, and more capital outflows.

The Mexican crisis was followed by more or less the same type of crises, namely the 1994 Turkish crisis, 1997 East Asian Crisis, 1998 Russian crisis and moratorium, 1999 Brazilian crisis, 2000-2001 Turkish crisis, and 2001 Argentina crisis. In Korea, after the IMF financial rescue package of 21 billion U.S. dollars in 1997, in January 1998 a rollover agreement was reached with the foreign creditor banks. Foreign banks concertedly agreed on holding their lines at the December 1997 level, and the IMF began to monitor the past-rollover developments through its "Debt Monitoring System". The G-7 central banks exerted moral suasion on their banks not to withdraw their exposures. Nevertheless, foreign banks' exposure to Korean banks decreased by 34% between December 1997 and December 1998. Despite a concerted rollover, this decrease was partly due to recoveries in the current account of the country and in the liquidity position of the debtor banks. The IMF and G-7 accepted the Korean rollover agreement as a successful concerted rollover.

In Brazil, after the IMF rescue package of 18 billion U.S. dollars that was made available in December 1998, in March 1999 a rollover agreement was reached with private creditors. The form of the rollover agreement was more voluntary compared with the Korean case. Again in March 1999, the IMF began to monitor the rollover results. The rollover results were better in Brazil than in Korea.

Foreign exposure to Brazilian banks was reduced by about 20%. The Brazilian rollover was also successful.

After the first IMF support package of 10,5 billion dollars, Turkey made its first rollover attempt in December 2000. The agreement with the creditors was on the basis of voluntary PSI. Like in the other countries, IMF began to daily monitor the rollover results after December 2000. Foreign creditor banks, feeling no commitment on their exposures and observing the deteriorating financial conditions especially after February crisis, quickly withdrew their exposures. In June 2001 there was another voluntary rollover agreement, that did not work either. Between December 2000 and December 2001, their exposures reduced by 50%. The IMF and G-7 considered the Turkish rollover an unsuccessful experience.

Argentina was also unlucky in its rollover agreement. PSI component was highly voluntary. The IMF's reluctant USD 14 billion dollar catalytic financing didn't help private creditors to hold their exposures, and they exited freely. By the end of 2000, when the IMF refused to release the committed official finance, Argentina had to declare that it was unable to repay its debt.

2.1. Discussions on New International Financial Architecture (NIFA)

G-7 countries began serious discussions on NIFA and PSI after the 1994 Mexican Crisis. With Mexico on its doorstep, the U.S. took the initiative and urged the IMF to prepare a rescue package. In the end, the rescue package agreed upon, which amounted to 18 billion dollars of IMF funds, turned out to be the largest for a country in history. The Europeans in G-7 signed on reluctantly, believing that Mexico should have accepted stronger conditions from the IMF in return for a support on this scale.

All the G-7 countries were aware of the fact that IMF was not equipped to anticipate or prevent speculative crises on this scale or to rescue countries overwhelmed by such huge financial outflows. The Americans, usually known as most resistant to changes in the IMF and the World Bank—together with Germans—could not ignore the consequences of a Mexican collapse and thus had to promote a reform in international financial architecture. Another important

result of the Mexican crisis and subsequent rescue package was that, it helped to conduct a massive bailout of private creditors and gave ammunition to the G-7 critics to point out the higher levels of risk taking (moral hazards) by private creditors in the following years.

The increasing frequency of the developing country crises in the following period and the subsequent financial rescue packages of the IMF-supported by bilateral sovereign debt restructurings through the Paris Club intensified the debates on the moral hazards of such restructurings and on the increasing financial burden of the crises on the citizens of the G-7 countries, who were claimed to be the ultimate financiers of the IMF rescue packages. Given the physical and regulatory limits of the amount of financing, the burdens of interest payments and the IMF conditionalities on the rescue packages were increased and maturities of the IMF loans were shortened by the time. G-7 urged international financial institutions and private creditors to come up with a concrete and operational plan to get the private sector involved in resolution of crises. Under the framework agreed by IMFC (International Monetary and Financial Committee) in its Prague meeting in September 2000, the IMF began to study on the scale of the financial support it will provide and "if" and "how" of PSI. Although in the 2001 G-7 Genoa Summit official parties (the U.S. and Europeans) came closer to each other, the differences between their approaches to PSI and to the controversy in the design of PSI have not been resolved until now. In November 2001, the IMF staff (mainly the IMF's Managing Director Anne Krueger) publicly proposed creating a formal international mechanism to facilitate the orderly rescheduling of crisis country debts. The proposal was called "A New Approach to Sovereign Debt Restructuring ". Since then, the debate on PSI has been centered on the approach formulated in this proposal.

2.2. PSI and G-7 Summits

The PSI is mainly a G-7 concept. G-7's relatively reactive approach to private creditors on the basis of moral hazards that followed the surprising Mexican Crisis has been calmed down over time. This was mainly because of the increasing financing costs of the developing country crises. While the limits of the official financing were given, the cooperation among the creditor parties, rather than coercive solutions was more rational to relieve the burden on official

creditors. Private sectors' resistance by means of switching to new techniques enabled them to refrain from being bailed-in and played an important role in this "cooperative" approach. However, the recent unsuccessful PSI in the Turkish and Argentina cases necessitated a well-defined debt restructuring mechanism, even if its PSI component would be considered as more involuntary.

PSI was always on the agenda of G-7 after the Mexican Crisis, but some of the G-7 Summit's are more important than others in shaping the concept and implementation of the PSI.

The 1995 Halifax Summit was a cornerstone in conceptualizing PSI as a complementary concept of NIFA. One of the Summit's recommendations was striking in reflecting the G-7's analogy between insolvent sovereigns and insolvent companies. It stated: "procedures should be explored for 'orderly resolution' if the rescue should fail i.e. procedures for countries which are comparable to those for insolvency for companies" (G-7 WEB).

The first Summit elaborating the New International Financial Architecture (NIFA) and PSI was the G-7's 1998 Birmingham Summit, which was held after the East Asian crisis and before the Russian crisis and moratorium. The Summit called for action in five key areas:

- Enhanced transparency and data dissemination;
- Helping countries prepare for integration into the global economy and for free global capital flows;
- Strengthening national financial systems;
- Ensuring that the private sector takes responsibility for its lending decisions (PSI);
- Enhancing the role of the International Financial Institutions and cooperation amongst them and with the international regulatory fora

Later in 1999, a summit was held in Cologne, Germany, after another crisis (the Brazilian crisis). At the summit PSI was addressed as a building block of NIFA. The summit declared that, there would be no new international financial institutions but the IMF and World Bank as the main institutions of NIFA. It proposed a greater use of market-based tools to involve the private sector in

forestalling, managing, and resolving crises (PSI) and to encourage stronger efforts to broaden the use of collective action clauses in sovereign debt contracts. The summit's advise to emerging countries was to strengthen their financial systems and to adopt a more orderly and well sequenced approach to capital account liberalization. By this advise, the summit was more or less legitimizing the capital controls. It was surprising when the earlier ideas of granting the IMF global jurisdiction for capital account deregulation was recalled.

The latest G-7 summit in 2002 (Kanansakis) approved the action plan prepared by G-7 finance ministers, which was based on the IMF's project of "Sovereign Debt Restructuring During Crises".

3. CURRENT DEBATE ON THE PSI DOCTRINE

The PSI in crisis resolution and the PSI in crisis prevention can be considered as two interdependent aspects of the approach to the crises in developing countries. These two refer to the timing of the PSI in the crisis process. In that respect, some of the proposals for PSI in the crisis prevention such as debt standstills, creditor committees, and voluntary rollovers overlap with the PSI in crisis resolution. Here we shall rather focus on PSI in crisis resolution keeping in mind that PSI in crisis prevention is a hardly attainable target in the present circumstances although it is ideal.

3.1. G-7's and IMF's Approaches

G-7 has been trying to construct the PSI doctrine as a component of NIFA under the following general acceptances.

1- The main reason behind the crises in developing countries is the weaknesses in their financial and supervisory systems.

2- Recurrent crisis in developing countries and contagion risk have converted the function of IMF as a mediator among debtors and creditors, as a disciplinary, regulatory and monitoring body over member countries and as a safeguard for the smoothly operating international capital flows. All these diversified functions require a stronger than before IMF.

3- If there is a crisis, it is likely that there will be an external financing gap preferably to be filled by official financing and private creditors.

4- Severe BOP difficulties due to loss of confidence could, in principle, no longer be resolved without PSI. Although exceptionally large financial support must remain possible in rare cases, it has to be ensured that public funds are not generally used to bailout private creditors.

5- For a smoothly operating international financial system and capital flows, sovereign defaults must be avoided.

6- In the international markets, one type of debt instrument or debt holder can not be privileged over the other types of debt instruments or holders.

With these general acceptances, the Europeans prefer a rule based mechanism or general framework on PSI, but the U.S. favors a case-by-case approach. "U.S. remains wary of standstills, forced defaults, coercive PSI and automatic linking of official financing to concerted PSI. While the Europeans are more sympathetic towards more concerted forms of PSI, use of standstills in some cases and linking large financing to meaningful PSI" (Roubini, 2001)

The IMF's position is closer to the U.S. approach than the European approach. It favors limiting large rescue packages and the cooperative and voluntary PSI, as opposed to semi-coercive and coercive involvement of the private sector in the crisis resolution process. However the problem is that less official money requires more PSI, but since PSI is voluntary and there is no automatic linking of official financing to PSI, it is not clear what the policy of official creditors will be if the private money does not come or is not enough to balance the financing gap.

Another important issue when dealing with PSI is to determine the nature of the debt problem and hence the severity of the PSI. When trying to answer the "if" and "how" of a PSI, the IMF looks at the prospects of the countries that are affected by a crisis to regain access to markets. Therefore,

- the countries with BOP difficulties that are rated as temporary (liquidity crisis) could accordingly be given massive financial assistance if required

(even this means a bail-out). In this case, a voluntary PSI at possible levels should be encouraged,

- if the debtor country is expected to suffer from a deeper crisis of confidence (solvency crisis), the official financial support should be limited and the highest possible PSI (bail-in) with debt reschedulings should be applied.

However in the actual world it is not easy to decide about the nature of a crisis. In many cases the situation is mixed. Even if there is a clear evidence of a liquidity problem only, a bail-in solution preventing the capital outflows (runs) may be superior to bailout. Therefore in practice, as against the theoretical bipolar approach, mix of catalytic financing by the multilaterals and other official sources as well as a partial bail-in through concerted rollovers (Korea and Brazil) are being applied (middle solution) in liquidity crises. In some solvency or mixed cases (Argentina, Turkey), big official rescue packages which are not supported by PSI, have been implemented by the U.S. and the IMF. This double standard or "case by case approach" has been criticized by the Europeans: "However, practice has shown a required priori distinction between liquidity crisis versus solvency crises leave a lot room for political maneuvering which can easily be exploited to continue the strategy of giving large financial packages, thereby ultimately frustrating attempts to enhance PSI." (Deutsche Bundesbank, 2002)

In designing the appropriate approach to a crisis the official creditors should decide on ;

- the type of PSI in different cases: voluntary, semi-coercive, coercive, concerted
- claims to be included: bonded debt, short-term interbank debt, Eurobonds, Brady bonds, domestic bonds
- creditors, foreign, domestic, banks, private bondholders
- the size of external gap to be filled
- financing parties: multilaterals, bilateral official creditors (Paris Club), private creditors
- comparability of private claims and Paris Club claims
- priority of private or sovereign restructuring

- nature of the problem: systemic, illiquidity, insolvency, strategic default, political or mixed case
- timing and rationing of the financing

Because of the G-7's insistence on taking measures to prevent sovereign defaults, the group has favored to equip developing countries' new foreign currency bonds with collective-action clauses in regard to the coordination of creditors' interests. The group also favors the conditioning of the IMF's "Lending Into Arrears" (LIA) of sovereign/nonsovereign debt (i.e., the IMF's lending for a crisis country's bonded debt arrears on the condition that debt rescheduling negotiations have begun in good faith and the country is cooperative in exercising "good practices") as an assurance of the exceptional nature of a moratorium.

Sovereign Debt Restructuring Mechanism (SDRM)

In a recent IMF policy discussion paper about SDRM, the authors have summarized the IMF's conflict in dealing with PSI in developing country debt crises as; " As of late, uncertainty on crisis resolution methods and anticipation of high litigation costs have made the voluntary PSI unattractive and involuntary PSI virtually impracticable. As a result, a wide gray area has fallen in between a purely catalytic approach by the IMF and the sovereign default, while the IMF has been put under severe and conflicting pressures. On the one hand, the IMF has been pushed by the private sector and, often, by the sovereign debtor, to defuse the risk of default by extending exceptional financing far beyond traditional access limits. On the other, the IMF has been proposed by its main shareholders to increase PSI by making it, at least, a condition for exceptional financing." (Bossone and Sandralevich, 2002)

IMF managing Director Anne Krueger has outlined a proposal namely, "A New Approach to Sovereign Debt Restructuring" about debt restructuring mechanism in the context of involving the private sector in financial crisis resolution. The proposal, which has become very popular since its announcement, aims to identify the conditions for setting up an appropriate incentive structure for private creditors.

About her proposal Krueger says that, " We have been motivated neither by recent events in Argentina nor by dissatisfaction with the debate on private sector involvement. Rather, we have been motivated by the lack of adequate incentives to bring countries together with their creditors to resolve unsustainable debt problems in a timely and orderly way. … Our goal is to propose a framework that will serve as a catalyst for voluntary agreements, without the need for formal activation ". (Krueger, 2002)

"A New Approach to Sovereign Debt Restructuring" adopts the corporate bankruptcy procedure to bankrupt sovereign. It proposes to give the IMF, the power to impose a temporary stay (standstill) on free-rider lawsuits, upon the request of the debtor and validation of the IMF, in case the debtor (sovereign) is doing its utmost for a solution. After the IMF's initial validation, the creditors' committee will be assembled and will take over the issue. The restructuring mechanism would allow for majority decisions to be legally binding for all of the creditors. The restructuring will probably involve external or internal debt. The targeted debt instrument is bonds but the structure will be applicable for all type of debt. By this scheme, the IMF will have a crucial role in assessing the sustainability of a country's debt and the appropriateness of its economic policies for initial validation of the debtor's request. The IMF, to perform its function on the proposed scheme, will change its Articles of Agreement accordingly. The member countries should also make the necessary legislation changes to give precedence to the international treaties.

The proposal has raised many legal, statutory, practical, moral and cost issues and has been criticized by the IMF members. The Europeans and Canadians have welcomed this proposal but some countries (Brazil, Spain, and Malaysia) opposed it, claiming that it would decrease the availability and increase the cost of capital to developing countries without providing them much benefit.

Some experts emphasized the necessity of accompanying capital controls if such a standstills are going to be exercised. "Naturally, the application of bankruptcy procedures to cross-border debt involves a number of complex issues. However, the principles are straightforward and can be applied without establishing full-fledged international bankruptcy procedures. The most contentious issue is the standstill mechanism since IMF now lends into arrears and it is heavily involved

in debt workouts. Clearly, to have the desired effect on currency stability, debt standstills should be accompanied by temporary exchange controls over all capital-account transactions by residents and non-residents alike" (Akyuz, 2002).

IMF's policy about the countries with unsustainable debt is straightforward. This policy is reflected by Krueger as;" … they need to understand that, the international community is not prepared to throw large sums of money at countries with unsustainable debts to ensure that their creditors are repaid. Unsustainable debts have to be restructured, one way or other". (Krueger, 2002)

In developing countries' perspective, the proposal has potential benefits but also important costs. The availability of temporary standstill may alleviate the destructive capital runs at some degree and binding majority decisions may prevent free riders. However, the proposal, by bringing a legally binding restructuring mechanism, similar to market based corporate bankruptcy procedure, most likely will undermine the social aspects involved, will reduce the availability of official funds, will increase the legal and documentary expenditures more than the expected benefits, will deter the market availability for a prolonged period, and make harder any possible debt rollover for the sovereign debtor.

3.2. Private Creditors' Approach

Contrary to official creditors' claim on the private sectors' responsibilities in the crises, private creditors argues that insistence on PSI has been reducing the bargaining power of the private sector vis-à-vis debtors and reducing the cost of debtor's default. They also claim that the U.S and the IMF are trying to downplay the role of private sector . (Atlanta Associates, 2001) The IMF's efforts to insert collective action clauses to sovereign bond documentations, and therefore allowing potential default resolutions to be legally imposable on the entirety of bond-holders by simple majority vote, not by unanimity, is against the interest of individual bondholders. This operation is planned to crowd out the private investors from the sovereign bond market and to enable the IMF to be the sole leader and negotiator of debt negotiations against the sovereign developing countries. The general idea is to make public creditors' sovereign debt

restructuring at the Paris Club contingent upon the inclusion of privately held international sovereign bonds under any parallel restructuring of privately held sovereign debt. Emerging market liquidity crises of the recent past had all been triggered by the accumulation of short-term bank liabilities, never by the service of bond debt. But in those days, the Paris Clubs' applications of comparability in privately owned sovereign Eurobonds of Pakistan, Romania, Moldavia, Ukraine, Côte d'Ivoire, and especially the Ecuador, are the examples of official creditors forcing the countries to default and to restructure their bonds. The International Institute of Finance (IIF), which represents investors, claims that the proposed IMF bankruptcy procedures will take many years to be operative. Furthermore, it raises concerns about the impact on already depressed investor sentiment. It is better for the IMF to concentrate on BOP adjustment programs and catalytic financing rather than such regulatory issues. When a standstill is necessary, voluntary mechanisms, which have worked in the past, should be the first line of defense. (Worldpaper, 2002)

By this understanding, private creditors now favor new debt instruments that mitigate debtor moral hazard. Banks have shifted to extending short-term interbank loans to developing countries, enabling them to "cut and run" and not to be asked to participate in the crisis resolution. Another instrument used to insure them against debtors' default are sovereign Eurobonds and other structured bonds that have no collection action clauses and hence leave little space to renegotiate due to large number of bondholders and high cost of restructuring.

3.3. G20/24/33's Approach

The approach of this group of countries is mainly a reflection of the approach of developed countries taking place in G20/G24/G33. The developing countries in the group are the debtors, and they usually are not in a position to refuse creditor countries' demands. However there are some elements in the G20's approach that favor the official creditors' finance to be available first, prior to debtor countries approach their creditors for a restructuring. This is an approach of "being on the safe side" by guaranteeing the official money against bad reputation and loosing market access.

They usually confirm to continue to work on appropriate exchange rate regimes, prudent liability management, and orderly liberalization of the capital account and declare that these efforts would reduce susceptibility to financial crises. In the 1999 Berlin meeting of the G-20, they have stated: "Steps to address excessive risk-taking by the private sector include; eliminating implicit or explicit government guarantees for external borrowing by private firms, which contribute to excessive foreign borrowing" (G20 WEB, 1999). However, during the crises of Korea, Brazil and Turkey these governments have been advised by the IMF and creditor countries to declare government guarantees for private external debt. Interestingly, except for a few weak statements in opposition, developing countries do not seem much interested in the IMF's sovereign debt restructuring mechanism.

4. TURKEY

The general characteristics of Turkey's recurrent crises were not much different from those of other developing countries. However, because of its long-standing strategic regional and political status and as an early stepper into a BOP crisis in 1978, Turkey was luckier than others in obtaining three successive Paris Club reschedulings in 1978, 1979, and 1980, totaling to 5.5 billion dollars, as well as a fresh money of about 3 billion dollars from multilaterals in the first half of the 1980s. In this period Turkey was also able to restructure its external debt that originated from its banking and commercial sectors and totaled 4 billion dollars and a bilateral sovereign debt around 6 billion dollars to its neighbors Meanwhile, the debt originating from banking sector that was rescheduled in 1979 under Convertible Turkish Lira Deposits (CTLD) Rescheduling Scheme, was structured for the second time in 1982 for an extension of the grace period of its repayments.

The reschedulings and the fresh money created a breathing space for Turkey at the expense of an ever-increasing debt burden and surplus transfer from the country.

After a 20-year period of mini and maxi crises, Turkey's recent experiences in debt rescheduling was in the form of debt rollovers and the negotiation panel with the creditors was informal meetings (road shows). The first attempt was

made in December 2000, and the second one came six months later in June 2001. The subject of these last two debt rollover attempts was foreign interbank lines to Turkish Banks, unlike the sovereign debt reschedulings of 1978 through 1982.

4.1. Debt Monitoring System

In December 1998 the IMF requested CBTR to establish a "debt monitoring system" for the Turkish banks to follow up on the weekly foreign interbank flows. The reason behind this was the possible contagion effect of the preceding crises on the ever crisis-prone country. The system was similar to the debt monitoring systems that were established in Korea and Brazil during the East Asian and more recent Brazilian crises. It was designed as an integral part of the IMF's early warning system and was aimed to foresee a crisis if maturities were shortening, spreads were rising, and lines were getting smaller in interbank flows. An important particular of the reporting was to determine the ultimate creditor bank (parent bank) of each borrowing beside immediate creditors. This would help to determine the ultimate beneficiary and hence the ultimate negotiating party and country in a potential rescheduling.

The weekly reporting of foreign interbank debts to IMF began in January 1999. Due to the November crisis, beginning with December 2000 the reporting frequency was increased to daily. After the first PSI attempt for rollover in December 2000, the G10, being the holder of roughly 80% of the interbank debt, initiated telephone conferences between CBTR and G10 central banks in order to strengthen the monitoring of interbank debt. Simultaneously, the IMF began to send daily summary reports to G10 central banks on the exposure of G10 creditor banks to Turkish banks.

4.2. First Rollover Attempt

Despite the November crisis, there was a net foreign interbank inflow to the banking sector during November and December 2000. The first attempt for rollover (PSI) in December 2000—though not publicly announced—was made. The rollover panel was mainly organized by the IMF and a few big creditor banks. The Turkish government, probably being relaxed after the November crisis and

advised by IMF, was not in a position to claim a restructuring for any debt because of the fear of bad reputation, loosing market access, litigation costs, and potential output losses. It only aimed to persuade those who might run from the country by telling them that the November was a stumble that caused CBRT to sell 5 billion dollars of its reserves and that the IMF was standing by the program. The IMF's catalytic financing would be accompanied by an appropriate PSI. "In both Turkey and Argentina the multilaterals made a judgment that the government was committed to keeping current on its external obligations if the immediate liquidity crisis could be surmounted. They therefore adopted the catalytic approach" (Eichengreen, 2001)

Accordingly, the IMF committed 10.4 billion dollars under SBA and SRF and released 2.8 billion dollars in December 2000. Eight hundred million dollars were made available by WB under FSAL. The Treasury also borrowed 1 billion dollars by international bond issue. (CBRT, 2001). The IMF's approach consisted of a voluntary commitment by foreign banks to maintain their aggregate exposure to the Turkish banks at the 11 December 2000 level. In order to persuade the creditors, Turkish officials made banking community meetings in the form of "road shows" in a few important financial centers, and, more importantly, the Turkish Government extended a guarantee on all liabilities of Turkish banks. Creditor banks orally agreed to hold their credit lines at the 11 December 2000 level. However, the G10 central banks, especially the Americans and Germans, were unwilling to exert any "moral suasion" on their creditor banks to maintain their exposure on the agreed levels. This understanding was reflected in the conference calls between G10 and CBRT. Accordingly, the rollover results detorierated in the following period. In February the IMF released 1.4 billion dollars to Turkey under SBA and SRF for the support of adjustment program and reserves. After the February crisis, it became possible to stop the outflows. In February in two days CBRT had to sell a total of 4 billion dollars to the market to prevent the bleeding, but this was ineffective, so the Turkish lira was left to float. Following the decision to float, the rating agencies downgraded Turkey's long-term credit ratings. The main creditor banks especially the German, U.S. and U.K. banks reduced their lines to Turkish banks. The IMF released an additional 3.8 billion dollars in May.

4.3. Second Rollover Attempt

In June, with the continuing outflows, a second, and publicly announced, rollover attempt was made. By that time the total outflow from banks reached about 6 billion dollars, by a percentage decrease of 27% from its December 2000 level. Again, two more "road shows" were staged in June and the Turkish government gave a more explicit guarantee for Turkish Banks with foreign liabilities. On the "road shows" creditor banks reaffirmed that they would hold their exposure at least at the June 2001 level. The commitment was again on a voluntary basis. With the problems and delays in the release of committed IMF loan and the decrease in the foreign loan demand of the banks, outflows further accelerated in June and July. It was not any earlier than August the outflows slowed down. In July and August the IMF released 3 billion dollars. For the remaining part of the year the IMF's lending has reached a total of 11 billion dollars. Meanwhile, because of the financially adverse effects of the 11 September 2001 attack on Turkey and because of Turkey's strategic importance, the IMF committed a further 12 billion to Turkey to be disbursed in 2002. As of the end of December 2001, there was a net outflow of 10,5 billion dollars from the Turkish banking system, which was 45% of the December 2000 external debt. The G10 had withdrawn approximately 50% of its loans during the year.

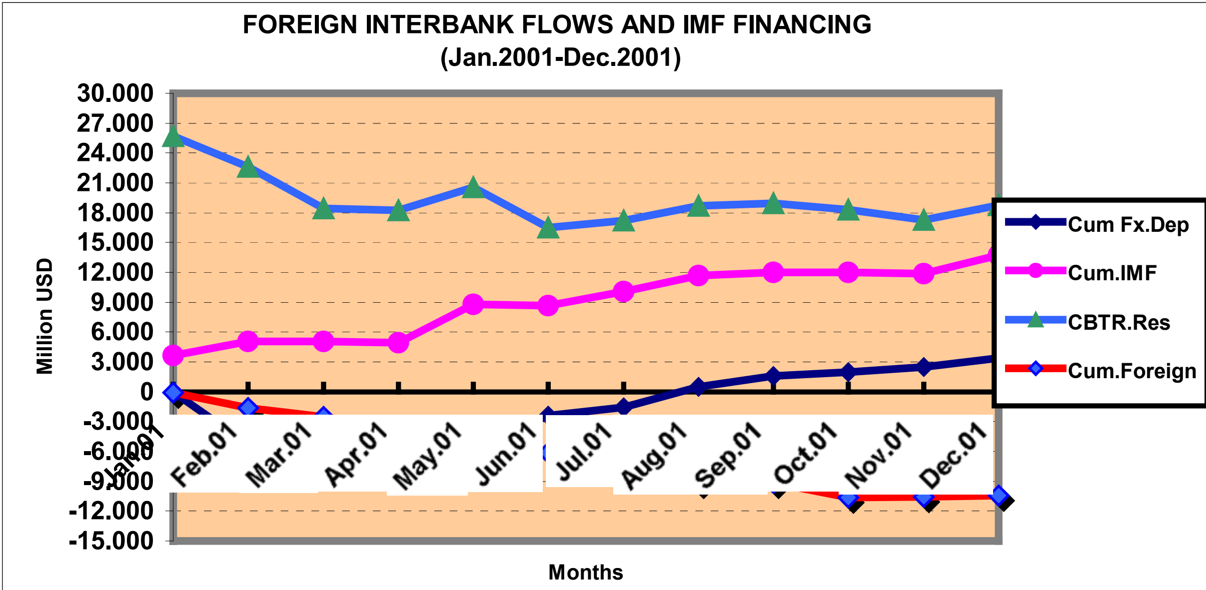
In the beginning of 2002, most of the shorter-term foreign interbank lines had been withdrawn and there was less incentive for domestic banks to borrow and lend inside the country. When its ineffectiveness on rollover performance became obvious, the conference calls were terminated with the mutual consent of the G10 and CBTR after February 2002. As of June 2002 foreign interbank debt of the Turkish banking system fell around 11 billion dollars, which was 52% less than its December 2000 level.

5. DISCUSSION ON THE TURKISH CASE

5.1. A Full Bail-out?

After the tension of the crisis was over, the G-7, the IMF and some foreign academics (e.g., Roubini, 2001) commented that the Turkish case was a full bailout of the private interbank creditors. They said that the IMF money was

large enough to create a moral hazard for the creditor banks that want to withdraw their funds from the Turkish banking system. There was an outflow of about 10,5 billion dollars from the banks and inflow of about 13,7 billion dollars from the IMF during 2001. They based their arguments on this parallelism between outflows and official credits.



Actually, looking at the cumulative inflow from the IMF and the cumulative outflow from banks in the above chart, we can see that they move in the opposite directions, as if there was a continuous bailout during the year.

Keeping in mind that during 2001 loans from IMF was the main source of official reserve accumulation, full bail-out thesis requires that during 2001 the IMF money was transferred to banks for their repayment of external obligations. The banks' total net principal repayment is USD 10,5 billion dollars in 2001. They have also paid an estimated interest of USD 1,9 billion for the new borrowings and an estiamted 0.9 billion of interest (totalling an estimated repayment of USD 13.8 billion) on existing debt in 2001. However in 2001, they have bought only a total of USD 6.5 billion from TCMB through foreign exchange sell auctions (TCMB,2002). In addition to CBTR money, they also had to reduce their foreign assets by USD 4 billion (BIS,2002), they borowed from interbank market by a

net USD 0,5 billion and they have benefited from the increasing foreign exchange deposit (by a net USD 3.5 billion during 2001) for debt repayments.

Since the economy is highly dollarized, there are other sources of foreign exchange than official money and also there are othe uses of foreign exchange than debt repayments. It can only be said that the banks may have used 6,5 billion dollars of IMF money for the partial financing of huge outflows during 2001. Therefore at least for the Turkish case, the full bailout of foreign creditors through official creditors is not a matter of fact and cannot be put forward as a justification of reducing further official financing support.

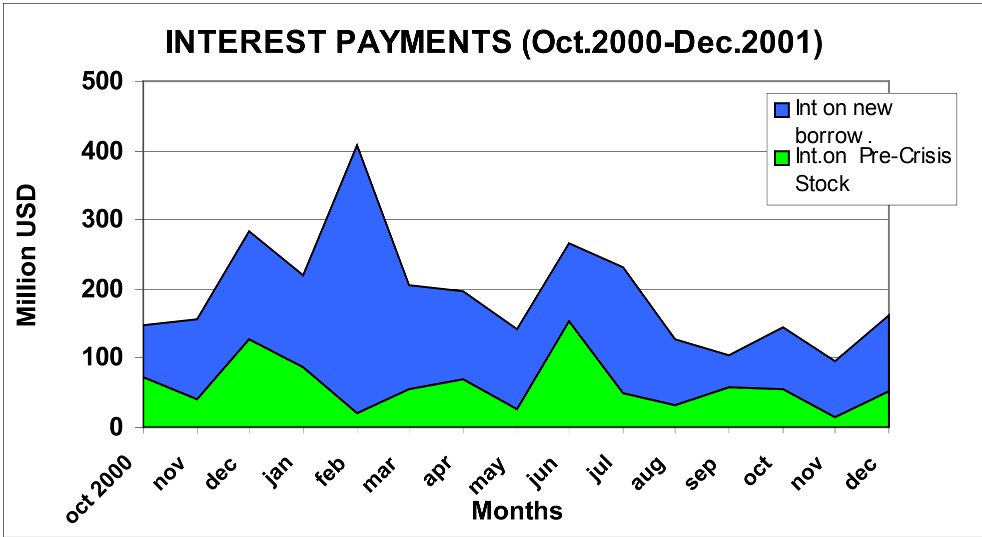
5.2. Moral Hazard?

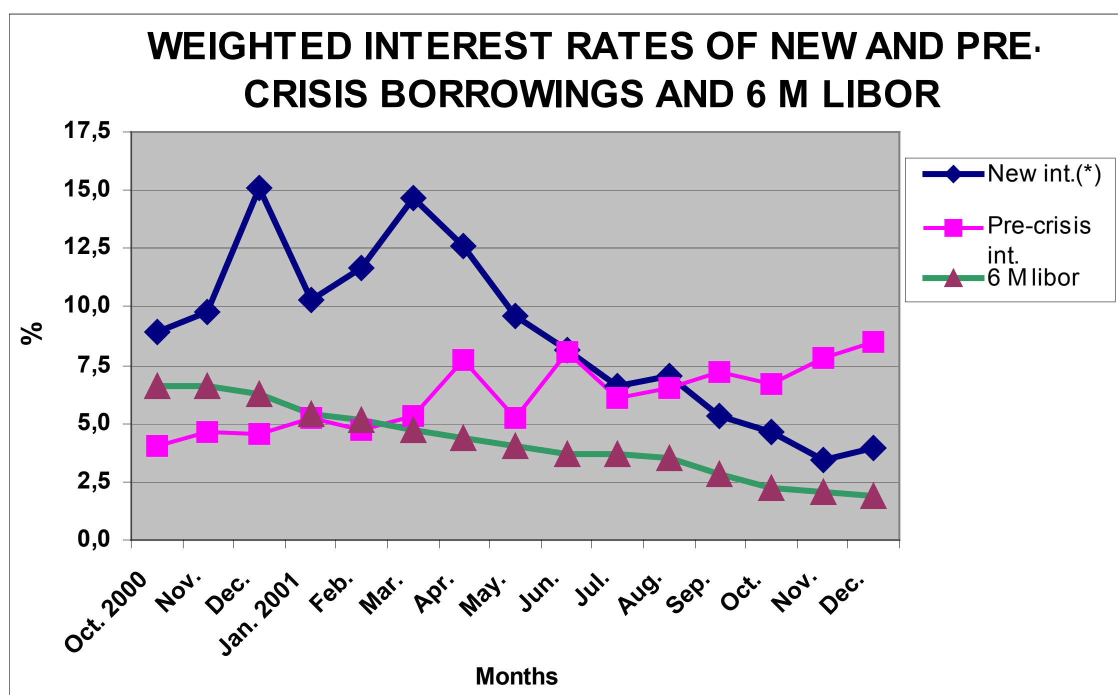
About the Turkish case, there were some comments about the threat of moral hazard due to big official rescue package. "Lending threatened to fuel moral hazard but not lending exposed the world economy to risks too great for the politicians to countenance. Moral hazard, they ultimately concluded was the lesser of the two evils" (Eichengreen, 2001).

In the Turkish case, moral hazard on the creditor's side (i.e. irresponsive and expensive lending by creditors, with the expectation of new official lending that will bailout them) bail out was also not straightforward. The money withdrawn from banks was short term in nature. This is obvious from weighted average maturity of banks external debt stock. Before the outflows in 2001, the maturity of the stock was around 1 year and as of December 2001 it is more than 2 years. Creditors didn't need to wait for the official finance to cut and run or to be bailed-out. They withdrew their monies before and after the official financing were released. But it is also undeniable that, in the absence of any involuntary PSI scheme and sufficient foreign exchange reserves, official financing made the further withdrawals easier. As against the "moral hazard" in the so claimed form, the moral hazard problem on the foreign private creditors side can be put forward on two other grounds. First, for huge short-term lending to refrain from a potential bail-in. Second, for speculative high interest rates demanded during the crisis period.

On the other hand, moral hazard problem for the Turkish government can be accepted on the grounds of irresponsively accumulated public debt, which required foreign official financing and a costly internal debt swap in the summer of 2001.

One of the G-7 central bank claimed: "... in view of the massive IMF assistance, Turkey had an interest in reducing the relatively expensive interbank loans, which ultimately served to finance its budget" (Bundesbank, 2001). This interpretation seems "attractive" at a first glance. Because the officially announced average interest rate of the IMF money during 2001 was an average 6% being considerably smaller than the higher interest plus spreads paid by Turkish banks to foreign creditors. However the Bundesbank ignored the fact that Turkish banks had to pay even greater interest to foreign creditors due to their liquidity needs during crisis. Their interest payments for short term borrowing for liquidity needs were about two times higher than the pre-crisis period despite decreasing debt stock.





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(*) Interest rate excluding TL external borrowings.

Furthermore, if outflows did not happen the banking sector would not be wounded so heavily and government would not issue additional costly internal debt to rehabilitate some of the public banks.

It should also be noted that, during the crisis period German banks were very aggressive on reducing their lines and shifting to expensive very short term lending to Turkish banks. Bundesbank's view seems to be based on a superficial knowledge of Turkey's financial conditions during the crisis and cannot be a justification for limiting the availability of official finance.

5.3. Liquidity or Solvency Crisis? Middle or Corner Solution?

When the November crisis broke out, the IMF and the Turkish government decided that this was a short-term liquidity crisis, because Turkey was already implementing an IMF program, notwithstanding some delays in required structural reforms. Therefore, extending the official IMF loans was the accepted procedure to deal with the crisis. In December 2000 an IMF loan of USD 3 billion dollars was released to support the CBTR reserves, and the tension was temporarily calmed. However during that period, the risk premium of the external loans to Turkish banks had been increased thereby creating a pressure on banks' repayment ability. Therefore, in December a foreign debt rollover

attempt made based on voluntary PSI. As explained before, voluntary PSI did not work and after February, line cuts accelerated. Therefore, Turkish banks lost their credit market access to a greater extent and the solvency problem under the liquidity crisis became more apparent. The only benefit that was derived from not loosing the export market access was an export increase of 4 billion dollars for the whole year. Even this was mostly due to the big devaluation of the Turkish lira. Whereas the cost of non-existence of a rollover was enormous.

If there had been a more coercive PSI but not necessarily a debt restructuring, or some form of bailing in the private foreign creditors in December, the Turkish financial system might not have suffered from the pressure of a run of 10.5 billion dollar principal plus interest on the value of the Turkish lira, on the government borrowing, on the domestic interest rates, on the banking sectors' equity, and size and on the economy as a whole.

Following the February crisis, despite the deteriorating conditions, the second rollover request was again on voluntary basis. Again it did not work, and between June and July Turkish banks had to make an additional 2.3 billion dollar debt repayment. After July, the markets turned out to be more stable due to the declined share of short-term funds in the debt stock and a soared domestic demand. Turkish Banks' external funding demand decreased accordingly. Therefore, even if there were a concerted rollover of the interbank debt in June, Turkish banks would not rush on fresh loans in the following period. So, the rollover attempt in June was useless, in a sense.

Therefore, in the Turkish case, the nature of the crisis was mixed. The liquidity crisis in November 2001 was a sign of a deeper solvency crisis. If the IMF financing hadn't come, the country probably would have to request a restructuring due to the deteriorating official and banking reserves.

Unless a more or less involuntary PSI or some other forms of bail-ins were provided, the most likely outcomes would be either an insolvent crisis country or official rescue package. Thus in the Turkish practice the situation is more closer to a corner-solution than a middle solution. The lack of PSI has led to the closing of financing gap by official money and more official money eased to cut and run. "In the case of Turkey, the IMF expressed disappointment in the markets lack of

support for the catalytic approach. In July 2001, the IMF's First deputy Managing Director went so far as to conduct a conference call with journalists in which he argued that the Turkish authorities are not getting the credits they deserve. This points up the intrinsic difficulty of the catalytic approach and the need for institutional alternatives" (Eıchengreen, 2001).

6. CONCLUDING REMARKS

In the Turkish rollovers the crucial point was that neither the IMF nor the Turkish government was prepared for a meaningful PSI. First, there was no formal discussion panel with the creditors other than the two road shows. There was no negotiator group of government and banking representatives. Necessary information about the types (syndications, short term banking loans or trade related credits), maturities (repayment schedule for the existing debt) and currency composition of the banking sector were known The only request of Turkey from the creditors was to maintain their existing levels of exposures for an indefinite future period. In such a vague scheme, the creditors, being allowed to rollover voluntarily, felt no commitment to hold their exposure especially after the February crisis.

The debt monitoring system, which was established to monitor the rollover results, did not help improve the performance; instead it discouraged the G-10 central banks. Some of the central banks, approaching more favorable to exerting moral suasion on their creditors, turned to be unwilling to do it by monitoring the exposure cuts from other G-10. Therefore, in the absence of moral suasion on creditor banks and more direct means of inducing compliance with the rollover agreement, the value of the debt monitoring exercise of the IMF became questionable.

Another factor leading to poor rollover performance was the considerable amounts of very short-term (1-2 days maturity) funds in the composition of banks' external debts. Behind these loans, there were small to medium size investors looking for short-term overnight profits in the high yielding Turkish interbank market. After November and February, these funds had quickly run away. It should be noted that, even if there were a concerted rollover agreement

with big creditors, there would be practical and legal problems with the holders of these funds.

Unlike Korea and Brazil, the vested interest of the creditors in Turkey was not large enough to come together for a concerted rollover. Before the crisis, the foreign international banks' exposure to Korean banks were about 67 billion dollars, and to Brazilian banks about 27 billion dollars (both were higher than the exposure to Turkey, which was 23 billion). So especially in in Korea creditors had important interests to preserve the solvency of debtor banks to preserve the value of their claims.

The IMF's hesitation in June in releasing its credit trench also invoked the further line cuts, and despite a second rollover agreement attempt in June the outflows increased. The soaring domestic demand also added to these outflows. In creditors' point of view; the eroded creditor confidence to the viability of Turkish banks after the BRSB's takeovers and subsequent rating downgrades by the rating agencies were factors for quick runs and the poor rollover performance. Public debt sustainability, governments' program ownership, and structural reforms were other questions in their minds.

In the Turkish case, there is not enough evidence supporting the "full bailout" thesis. Neither there is a justification for "moral hazard" on the foreign creditor's side.

The following lessons can be derived from the recent rollover experiences of Turkey and other countries;

- The poor performance of rollover agreement and the poor performance of the IMF's debt monitoring system have proved that, the international organizations and creditor countries are not necessarily right in their diagnosis and cures for crises. The crisis management task must be borne by the respective governments of the crisis country not by the official or private creditors.
- The prompt and concerted reaction to any liquidity trouble may save the country from insolvency. Turkey's first rollover option had to be exploited seriously by the government to stop the bleeding of country's foreign

exchange reserves and hence to stop the pressure on the value of the Turkish Lira, which led to big economic and social losses in the following period.

- A concerted debt rollover does not mean losing credit or export market excess. The Korean and Brazilian cases are examples of these. Furthermore, if the international trade environment and country's capacity to export were examined, it could be understood that if a concerted rollover had accomplished, that would have saved a lot more resources than the trivial increases in exports.
- To ensure private creditor's rolling over, some degree of coercive PSI and some forms of bail-ins are necessary. In voluntary PSI schemes every creditor waits for each other not to step into bail-in first.
- The actual policies and practices during the crises don't overlap with the "bailout" or "moral hazard" thesis. Therefore, these thesis should not be used as a justification to cut the official financial support for the crisis countries.
- The availability of official finance does not necessarily means that the banks' external debt to private creditors will be paid by the IMF or WB. The ultimate payer of all the official and private loans plus interests is the crisis country.
- A successful rollover agreement must be the one that reduces the cost of an existing debt. For this end, the crisis country must have strong negotiators. They must be well endowed with the information about its amount of debt; the breakdown of its debt by type, by creditors, and by maturity; and the interest burden of its debt. They must also have enough information about the international financial architecture and standings of the developed and developing countries in this architecture. These factors were absent in Turkey's rollover experiences. Whereas in the Korean rollover experience, apart from the supportive factors of foreign creditors' bigger interests in the Korean finance and economy, and the more concerted PSI scheme, the Korean authorities being well informed about the structure of their debt, haggled about the repayment schedule and the interest burden of their debt during the debt negotiations.

- Official financing is used to be cheaper than the private money and even if a successful PSI is obtained, official financing must be available for the crisis country.
- Short-term irresponsive borrowing by the credit institutions is always a threat on the viability of financial system and makes these institutions vulnerable to internal and external shocks.
- Up to date, Turkey has not defaulted in its debt, but the government has about USD 22 billion of sovereign bonded debt as well as a huge amount of internal debt. In any future case of debt crisis, the government may face with the IMF's sovereign debt restructuring mechanism. This mechanism's potential costs and benefits must be evaluated and actively negotiated from today. The proposal has potential benefits but also important potential costs. The availability of temporary standstill may alleviate the destructive capital runs at some degree and binding majority decisions may prevent free riders. However, the proposal, by bringing a legally binding restructuring mechanism similar to market based corporate bankruptcy procedure, most likely will undermine the social aspects involved, will reduce the availability of official funds, may increase the legal and documentary expenditures more than the expected benefits, may deter the market availability for a prolonged period, and may make harder any possible debt rollover for the sovereign debtor.

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