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COORDINATING DIVERSE CREDITORS TO RESTRUCTURE SOVEREIGN DEBT: THE CASE OF SRI LANKA

Macroeconomic context

- Fragile macroeconomic fundamentals (twin deficits) : persistent primary deficits + current account deficits

- Multiple shocks, external (drought in 2017 and COVID-19 pandemic in 2020) and domestic (political crisis in 2018 and terrorist attacks in 2019)

- Domestic policy missteps : major tax cut in 2019 while government revenues were lower than 13 % of GDP

- Misaligned exchange rate regime (eventually collapsed with a large depreciation in 2022)

“Kicking the can down the road”

- Public debt jumped from 76% (2015) to 147% (2022) of GDP
- Sri Lanka effectively lost market access in April 2020
- Depletion of FX reserves from $7.6 bn to $3.1 bn (2019–2021) to cover external debt payments
- Sri Lanka sought IMF support in March 2022, in the face of an acute crisis and a lack of resources to pay for essential imports
- Default on its external debt in April 2022

Launch of the restructuring process

- Staff-Level Agreement on an EFF program in September 2022 (debt assessed as unsustainable)
- Financing assurances obtained from China, India and the Paris Club early 2023
- IMF program approval for SDR 2.286 bn (about USD 3 bn)
    - ➢ Start of the restructuring process

Domestic debt restructuring to support the IMF program

- 50% of the total public debt (end 2022) : pension funds, large domestic banking sector
- Access to the domestic debt market was maintained after the external debt default
- Domestic debt restructuring is a sovereign decision (IMF assistance on the risk analysis)
- Treatment of the domestic debt taking into account the sovereign bank nexus ("doom loop" - 40% of total bank assets held in government securities)
  - ➢ Important contribution to the program (reduction of yearly GFN by 1.6 % of GDP on average over 2027-2032) and to the restoration of debt sustainability

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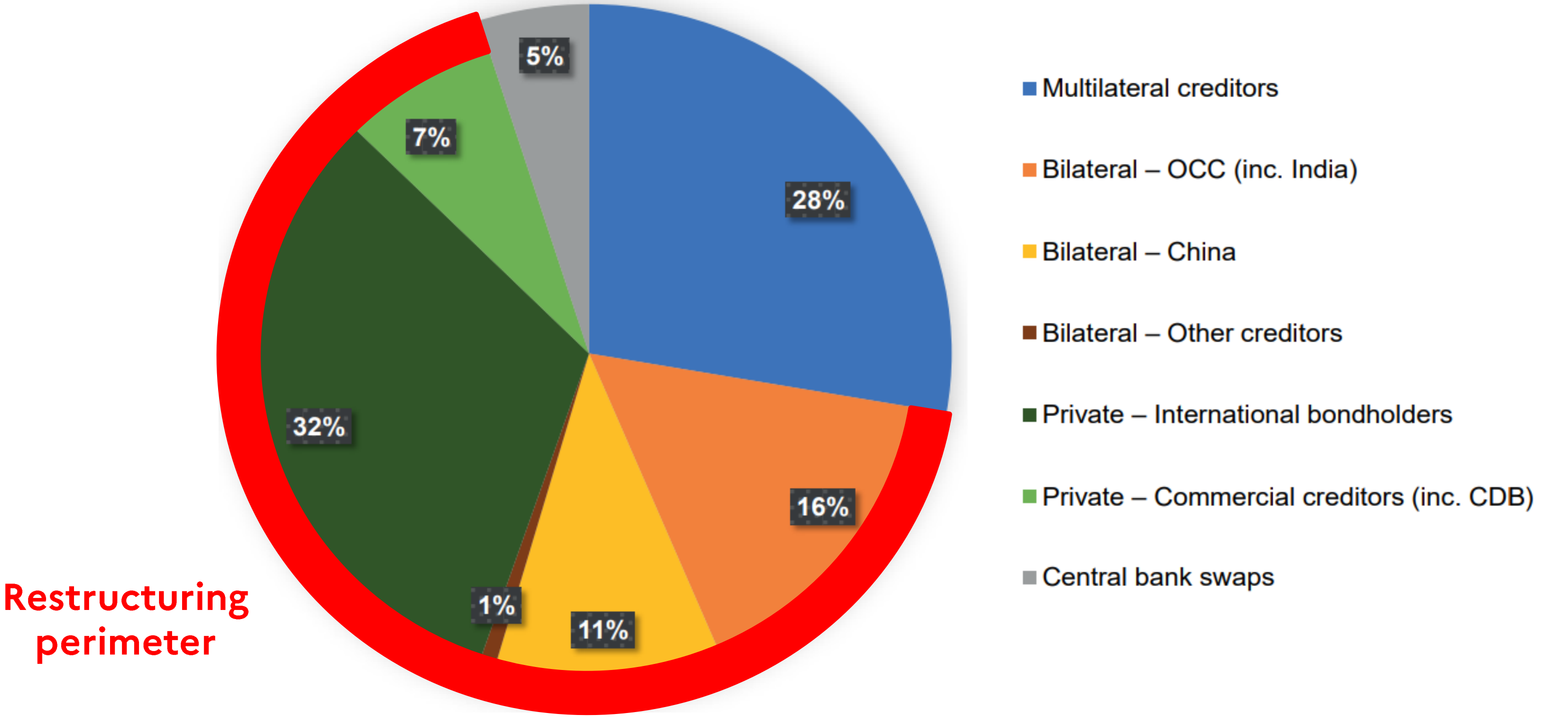
External debt : a diverse creditor base (end 2022)



Coordination of official creditors

- Sri Lanka was not eligible to a G20 Common Framework treatment as a middle-income country
- *Ad-hoc* official creditor committee (OCC) including Paris Club members, India and Hungary (16% of the external debt stock) in April 2023
- Flexible coordination arrangement with China
  - ➢ Agreement on a debt treatment between the OCC and Sri Lanka + agreement with China EXIM (11% of the external debt stock) in June 2024 at the Paris Forum
  - ➢ Useful experience of previous Common framework cases

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Ensuring a fair burden-sharing through Comparability of Treatment

Principle : the debtor country must obtain from all creditors terms at least as favorable as OCC's terms

- Mitigates the risk of moral hazard and delays
- Helps the debtor country in its negotiations by setting an expected effort benchmark
- Essential for IMF financing assurances

See Paris Club methodology for assessing the CoT

➢ CoT applied to other minority bilateral creditors (Iran, Kuwait, Pakistan and Saudi Arabia), to bondholders and to commercial creditors

Bondholders : Macro-Linked Bonds (MLBs)

- Bondholders proposed symmetric GDP-indexed MLBs to reconcile differing growth expectations
  - ↗ payments if GDP > IMF baseline macroeconomic scenario
  - ↘ payments if GDP < IMF baseline macroeconomic scenario
- MLBs complicated the CoT assessment with OCC’s fixed treatment
  - CoT assessed in both baseline scenario and the weighted average of contingent scenarios
  - Criterion ensuring reasonable effort even in the upside scenario (political acceptability)
- Governance linked bond : more coupon relief depending on meeting targets on fiscal governance

Lessons learned for future sovereign debt restructurings

- Importance of a timely debt restructuring
- Extension of Common Framework coordination beyond LICs
- Comparability of treatment remains the anchor for fair burden-sharing
- Contingent instruments can facilitate agreements but are not optimal nor desirable

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Thanks for your attention

Questions ?