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Sovereign Debt Restructurings in Belize: Achievements and Challenges Ahead

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Abstract

This paper examines the causes, processes, and outcomes of the two Belize sovereign debt restructurings in 2006–07 and in 2012–13 that occurred outside of an IMF-supported program. It finds that the motivation for the two debt restructurings differed, as the former was driven by external liquidity concerns while the latter was motivated by a substantial increase in the coupon rates and future fiscal solvency concerns. Despite differential treatment between residents and non-residents, both 2006–07 and 2012–13 debt exchanges were executed through collaborative engagement, due in part to the existence of a broad-based creditor committee and the authorities' effective communication strategy. However, while providing temporary liquidity relief, neither of the debt restructurings properly addressed long-term debt sustainability concerns. Going forward, the success of the 2012–13 debt restructuring will still depend on the country's ability to strengthen fiscal efforts and public debt management framework.

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I. INTRODUCTION

The Government of Belize undertook two sovereign debt restructurings within a relatively short-time span. In 2006–07, facing an acute external liquidity shortage due to high debt service burden, Belize exchanged its various external debt instruments, including both loans and bonds, into one single U.S. dollar denominated bond (“super-bond”) with face value of US\$547 million.² The exchange lengthened maturity and lowered coupon rates.³ Six years later, the Belizean authorities, this time driven mainly by a substantial increase in the coupon rates and future fiscal solvency concern, launched a second external debt restructuring, with a modest face value haircut as well as cash-flow relief through changes in both coupon and maturity structures.

This study has been motivated by two underlying issues. First, this paper attempts to analyze the evolution of the debtor-creditor relationship, including the role of the IMF. Belize is unique in conducting two debt restructurings outside of an IMF-supported program. Second, an assessment of the debt exchanges is needed to understand what has worked well and what has not, as the country’s debt level still remains elevated even after the repeated debt exchanges.^{4 5}

Specifically, this paper focuses on three key aspects:

- *Cause*—why did the country restructure its debt? This question will crystallize what macroeconomic indicators signaled the vulnerability of policies that ultimately led to debt restructurings.
- *Process*—how did the debtor-creditor relationship develop? It includes an analysis of the modalities and length of negotiation and communication with private, official

² Throughout the paper, external debt is defined as debt issued in foreign countries and under the jurisdiction of a foreign court.

³ Though maturity extension and lowering coupon rates over the short term without any face value reductions made it easier for both creditors and sovereigns to reach agreement on a deal, debt repayment burden became prominent over the medium and long term.

⁴ Reinhart, Rogoff, and Savastano (2003) argue that debt “intolerance” is highly linked to the phenomenon of serial default due to a vicious cycle in which default weakens a country’s institutions in turn making subsequent default more likely. Asonuma (2014) theoretically explains that outcomes of previous renegotiation influence the borrowing costs of subsequent bond issuances, making repeated restructuring or default more likely.

⁵ IMF (2013a) provides a preliminary review of IMF policies and practices in light of recent experience in sovereign debt restructuring including Belize (2006–07 and 2012–13), the Dominican Republic (2004–05), Grenada (2004–05), Jamaica (2010, 2013) and St. Kitts and Nevis (2011–12). Jahan (2013) discusses some common features and asymmetries in three prominent debt restructurings in the Caribbean: Belize (2006–07), the Dominican Republic (2004–05) and Jamaica (2010). Diaz-Cassou et al. (2008) also provide detailed case studies on two restructuring episodes in the region: Belize (2006–07) and the Dominican Republic (2004–05) and Erce (2013) examines the role played by the IMF during sovereign debt restructurings in the region: the Dominican Republic (2004–05), Dominica (2004), Grenada (2004–05) and Jamaica (2010). Furthermore, Das et al. (2012) overview restructuring cases in the region: Belize (2006–07), Dominica (2004), the Dominican Republic (2004–05), Grenada (2004–05), and Jamaica (2010).

bilateral and multilateral creditors. Are there any legal and operational characteristics that might have influenced the renegotiation process?

- *Outcomes*— did the restructuring fully address debt sustainability concerns? What was the impact on the liquidity and solvency conditions after each restructuring? What is the creditor loss along with the prospects for future market reaccess?

Even though Belize’s two debt restructurings ultimately achieved preemptive, smooth, and broadly transparent processes, debt sustainability concerns remain. Differential treatment of residents and non-residents did not hamper the collaboration between the government and creditors. Also, although the investor base remained the same over time, the experience gained in the first debt restructuring helped to conclude the second debt restructuring in a relatively expedite way.⁶ However, while both restructurings were undertaken in a collaborative manner, the debt level remains high with potential risks of large contingent liabilities, implying that a substantial fiscal adjustment is still warranted to put the debt level on a sustainable path.

The rest of the paper is organized as follows. Sections II and III investigate the cause, process, and outcomes of the debt exchanges in 2006-07 and 2012-13, respectively. Analysis of the results of the first restructuring includes the question on what led the country to a subsequent debt exchange. Finally, conclusions are presented in Section IV.

II. 2006–07 DEBT RESTRUCTURING

The 2006–07 debt restructuring achieved liquidity relief in a preemptive, collaborative, broadly transparent manner, but left solvency concerns unresolved.⁷ Prior to the debt exchange, Belize embarked on fiscal adjustment effort to address its vulnerabilities in fiscal and external positions. While this policy reduced new financing requirements in the following years, large financing gaps were still projected to remain in 2007 and beyond due to debt service of external commercial debt. In this light, the country undertook the debt restructuring and consolidated various instruments into one single benchmark bond. The deal was concluded in a collaborative manner with high creditor participation and introduced a single external bond with longer maturity than those of the original instruments, thus providing liquidity relief. The restructuring closed with strong creditor support based on the country’s ability and willingness to put in place a strong fiscal consolidation effort.

a. Background

Highly expansionary macroeconomic policies in the late 1990s and early 2000s resulted in serious imbalances in the fiscal and external accounts (Annex Figure). In the aftermath

⁶ Several new legal terms included in 2012–13 debt exchange offer attempted to improve transparency between the committee and the authorities in the event of a future debt distress.

⁷ Asonuma and Trebesch (2013) define Belize’s 2006–07 restructuring as “weakly preemptive” as some payments were missed, but only temporarily and after the start of formal or informal negotiations with creditor representatives (no unilateral default).

of the hurricanes and tropical storms in 2000–02, the government undertook aggressive efforts to stimulate economic growth through higher capital spending and lower taxes. This expansionary policy mix led to a soaring public debt level, high debt service costs, and widening of the external current account deficit. The overall deficit of the central government rose from an average of 3 percent of GDP in 1996–98 to about 9 percent of GDP in 2000–04. In addition, certain external financial transactions by a number of quasi-fiscal institutions contributed to the buildup of foreign liabilities.⁸ To secure financing, the government extensively borrowed from external commercial sources, including loans and bonds, which resulted in public debt surging from 72 percent of GDP in 2000 to over 100 percent by 2003, with 95 percent of the total public debt outstanding held by external creditors. Against this backdrop, Fund staff urged the authorities to implement immediately forceful measures to reduce the fiscal deficit.⁹

At the same time, Belize’s external condition became more challenging owing in part to high world oil prices, declining export prices, and rising external debt service costs.

Trade imbalances, coupled with surging debt service burden, led to significant current account deficits, which averaged 17.3 percent of GDP during the period 2001 through 2005. The large current account deficits were principally financed through a build-up of external public debt, which almost tripled from less than US\$400 million in 1998 to US\$1.1 billion in 2005. As debt service obligations rose and market financing became increasingly difficult to secure, the government resorted to financing from the central bank, whose international reserves fell below one month of import coverage by end-2005. This erosion of reserves left the Belizean economy highly vulnerable to both endogenous and exogenous shocks.

In addition, as a result of repeated refinancing operations the liquidity position deteriorated leading to a consistent rise in borrowing costs. The maturity structure of the external public debt at end-June 2006 exhibited a significantly large share of short and medium-term debt, with 13 percent of liabilities falling due within a year and 25 percent of debt maturing in 1–5 years, forcing frequent refinancing. Since the refinancing was done by borrowing from external commercial markets at high interest rates, the cost of refinancing the external debt rose substantially, with the average effective interest rate at 11.25 percent.¹⁰

⁸ The Government of Belize assumed directly over 20 percent of GDP in external liabilities associated with a government guarantee on failed mortgage securitization scheme, and failed privatizations (IMF, 2006a).

⁹ IMF (2002a).

¹⁰ The rise in external commercial borrowing cost was partly a result of the downgrade of Belize’s sovereign credit rating by Standard and Poor’s and twice by Moody’s in June 2005. S&P’s downgrades and negative outlook reflected mounting liquidity pressures that had been exacerbated by Belize’s impaired market access (both official and commercial) and the government’s worsening debt trajectory. The public sector’s dire liquidity position in 2005 was weakened by massive amortization needs (as compared to available assets) and limited ability to access external financing which continued to suffer due to the unstable political situation. The government debt’s deteriorating profile had been difficult to reverse due to persistent fiscal slippages and the government’s assumption of Development Finance Corporation’s debt as a result of the bank’s financial distress (Standard and Poor’s, 2013). Similarly, Moody’s rating downgrades incorporated an assessment of Belize’s increased external vulnerability and macroeconomic conditions that had not been consistent with fiscal and debt sustainability, as well as indications by the government of its intention to engage creditors in order to explore alternatives to improve Belize’s external debt profile. Moody’s believed that debt restructuring represented a credit event that was increasingly likely to materialize.

In face of the persistent high fiscal and current account deficits, in 2005 the government embarked on a forceful adjustment strategy. As a result of tax revenue measures and primary spending cuts, the overall deficit of the central government fell sharply from 8.6 percent of GDP in FY2004/05¹¹ to 3.3 percent in FY2005/06, while the primary balance shifted from a small deficit to a surplus of 3 percent of GDP. Partly in response to the tighter policy stance, the external current account deficit narrowed from 18 percent of GDP in 2005 to 14 percent in 2006. Subsequently, net international reserves position improved from 0.6 to 1.4 months of imports.

However, even with the adjustment effort, as well as prospective additional official financing, large financing gaps would remain in 2007 and beyond.¹² Debt sustainability was also a major concern in the consultations between the government and Fund staff prior to the 2006–07 debt exchange, which indicated that without sustained primary surpluses the public debt would not stabilize in the medium run. While the debt-to-GDP ratio would initially fall from 98½ percent at end-2005 to 84 ½ percent in 2012, it would shift back to an upward trend thereafter due to a rising interest bill. It was in this context that Belize sought to restructure its debt.¹³

b. Process

The government announced the intention to restructure the country’s sovereign debt in August 2006 (IMF 2006a).¹⁴ In the announcement, the authorities expressed willingness to recognize and work with a formal creditor committee representing holders of at least 51 percent of the affected debt (Buchheit, 2009).¹⁵ Bond prices, which had been declining since January 2006, slumped further after the authorities’ announcement (Figure 1).

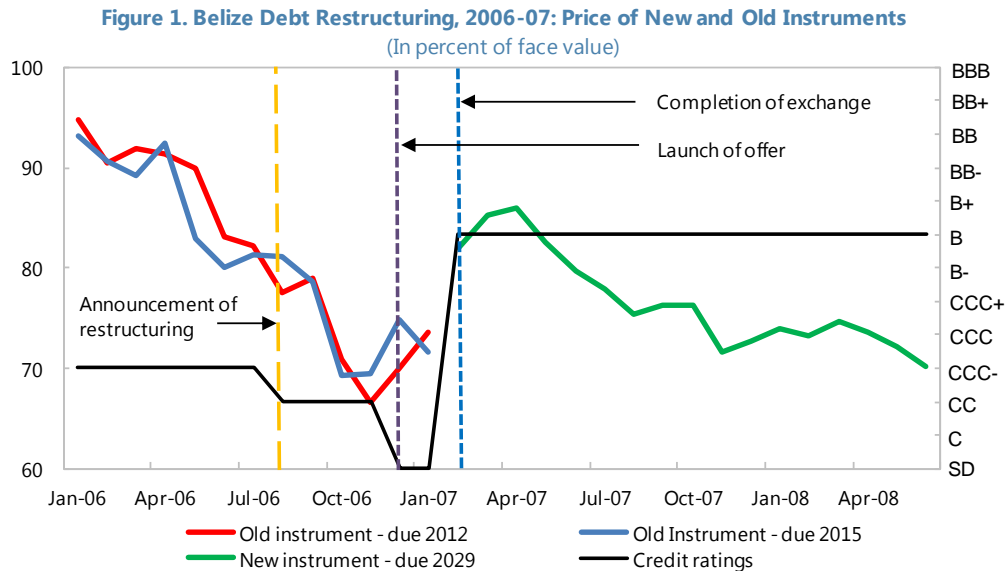
¹¹ Belize fiscal year runs from April to March.

¹² IMF (2006a).

¹³ IMF (2006b).

¹⁴ The Belize authorities appointed Houlihan Lokey, Howard & Zuckin as financial advisors in fall 2005 (Robinson, 2010). At the same time, BroadSpan Securities LLC was acting as a financial advisor to the Committee (Buchheit, 2009) and Cleary Gottlieb Steen & Hamilton LLP was acting as a legal advisor to the government (Buchheit, 2009 and Belize Ministry of Finance, 2006).

¹⁵ Committee members included AIC Finance Limited, British-American Insurance Company, Caribbean Money Market Brokers Limited, First Citizens Asset Management Limited, First Global Financial Service Limited, Guardian Asset Management, Jamaica Money Market Broker Limited, National Commercial Bank (SVG), RBTT Merchant Bank Limited, RBTT Trust Limited, Republic Bank Limited, Sagacor Life Inc, Trinidad & Tobago Unit Trust Corporation (Buchheit, 2009).



The restructuring was undertaken preemptively, with subsequent arrears occurring due to missed coupon payments during the negotiation stage. The authorities had remained current on their debt obligations until its announcement of restructuring in August 2006, but in mid-September they announced that debt service payments to two special purpose vehicles, which formed part of an issuance of insured loans, had not been made.¹⁶ The government explained that this action was driven by the country's acute liquidity difficulties and the need to conserve the very limited pool of usable reserves. At the same time, the authorities reiterated their intention to use their best efforts to continue servicing debt, pending an orderly restructuring of the debt.

The authorities targeted only external commercial debt, discriminating those creditors from domestic creditors and external official creditors. The authorities initially sought to restructure all of the government's bond indebtedness, external commercial loans, and insured loans. However, T-bills, domestic loans, and bilateral and multilateral claims were not eligible in the offer.^{17 18} This may be because (i) the authorities primarily aimed at addressing external vulnerabilities, as argued by Erce and Diaz-Cassou (2010); (ii) T-bills and domestic loans were difficult to restructure since the banks would need to be recapitalized, and (iii) the size of official credits was not large to help mitigate liquidity

¹⁶ The structure of these two insured loan facilities was such that at inception, the government had to prepay six months of debt service into reserve accounts. The government's failure to make the scheduled coupon payments triggered the use of these reserve accounts to make the payments to bondholders.

¹⁷ Belize Ministry of Finance (2006, p. 58).

¹⁸ Multilateral claims are often considered to be senior relative to other claims and are excluded from the exchange.

pressure. Such creditor discrimination did not seem to raise any apparent inter-creditor equity concerns.

The existence of a broad-based creditor committee and the authorities’ effective and broadly transparent communication strategy facilitated the smooth debt renegotiation (Buchheit and Karpinski, 2007, Buchheit, 2009). The creation of the creditor committee differs from those formed in the 1980s and 1990s in certain aspects: establishing certain criteria for formation of committee and its procedural rules and incorporating elements that enhanced dialogue and participation among creditors in past restructurings cases (Buchheit, 2009, Li et al., 2010). The creditor committee was engaged through an open dialogue with the authorities, which attempted to keep transparency in dissemination of all relevant macroeconomic data.¹⁹ The focus of discussion centered on projections of growth, fiscal consolidation, and debt dynamics which were important inputs to assess Belize’s repayment capacity and financing gaps. Details of the government’s indicative scenarios presented to creditors in October 2006 are shown in Table 1 below.

Table 1. Belize Debt Restructuring, 2006-07: Indicative Scenarios

Option	Indicative Scenarios		
	Discount	Discount	Par
Face value haircut	20%	20%	0%
Grace period (years)	8	13	12
Final maturity (years)	18	13	22
Coupon	2.5% until 2010	2.5% until 2010	2% until 2010
	4.5% until 2012	4.5% until 2012	3.5% until 2013
	9% until 2025	9% until 2020	7% until 2029
Repayment Style	Amortizing	Bullet	Amortizing

Source: Belize authorities.

On December 18, 2006, after intensive dialogue with the creditors, the government launched the debt offer. Commercial debt eligible for exchange comprised (i) US\$348 million global bonds (including notes); (ii) bank notes for US\$53 million; and (iii) two insured loans valued at US\$115 million. The restructuring was executed through an exchange, with a single instrument dubbed as “super-bond”. The “super-bond” was a par-bond (i.e., no principal haircut) with a final maturity in 2029, amortization starting in 2019, and a step-up coupon structure (Table 2). With hindsight, this step-up coupon structure

¹⁹ In particular, the authorities maintained close contact with over 40 creditors who held more than 80 percent of the face value of the total restructured debt.

played a role in the authorities' decision to seek the second restructuring, as the government was anticipating increases in debt service by 0.6 and 1.2 percent of GDP in 2012 and 2013 respectively.

The details of financial terms at the exchange were the following (Table 2):

- ***No principal haircut.*** Approximately US\$546 million of new 2029 bonds were issued without face value reduction. ***Coupon rate reduction.*** Due to a step-up coupon structure, coupon rates of the new bond over maturity are lower by 2.1 percent than those of the old instruments on average.
- ***Maturity extension and change in repayment structure.*** Maturity was extended by 16 years on average. Contrary to payments due at maturity for a majority of old instruments (85 percent of total outstanding), the new bond is an amortizing bond commencing in August 2019.
- ***NPV and market haircuts.***²⁰ Using a discount rate of 9.2 percent, the NPV haircut was 24 percent, while the market haircut was 21 percent. NPV haircuts differ across creditors; NPV losses for holders of insured loans were 50 percent higher than those of global bonds and notes due to lower exchange ratio.²¹

²⁰ NVP haircut is defined as $1 - \text{Present value of new debt} / \text{Present value of old debt}$ as in Sturzenegger and Zettelmeyer (2006, 2008). Present value of new debt and old debt is computed with the same discount rate. On the contrary, market haircut is defined as $1 - \text{Present value of new debt} / \text{Face value of old debt}$.

²¹ Exchange ratios define the principal amount of new bonds “Superbonds” to be exchanged for each of the eligible claims identified in Table 2.

Table 2. Belize Debt Restructuring, 2006-07: Deal Structure

Instruments	Old Instruments			New Instrument
	Global bonds/notes	Bank loans	Insured loans	Super-bond
Face value (US\$ mil.)	348	53	115	547
Face value haircut 1/	0%	0%	0%	-
Maturity	2007-15	2008-12	2010-15	2029
Grace period (years)	N/A	N/A	N/A	12
Remaining maturity (years)	6.2	4.4	5.8	22
Coupon	Fixed 8.95-9.95%	Fixed 9.25-10%	Fixed 10%	4.25% until 2010, 6% until 2012, 8.5% until maturity
	Amortizing			
Repayment style	/ Bullet	Bullet	Bullet	Amortizing
Present value on 2/2007 2/ 3/	104%	103%	105%	79%
NPV haircut 4/ 5/	21%	26%	32%	-
Market haircut 5/ 6/	18%	23%	29%	

Sources: Belize authorities, Bloomberg, and authors' calculations

1/ Each instrument was exchanged based on "conversion factor" that varies from 0.85 to 1.1 with cash payments, without face value haircut. If the face values of the existing instruments were multiplied by the respective conversion factor, they match with the face value of the super-bond.

2/ Discount rate of 9.2 percent which was exit yield at completion of exchange (on 2/21/2007 - the first transaction day when yields were recorded after completion of exchange).

3/ Weighted average of all instruments following in the category based on outstanding as of 2/2007.

4/ NPV haircut is defined as $1 - \text{Present value of new debt} / \text{Present value of old debt}$ as in Sturzenegger and Zettelmeyer (2006, 2008). Present value of new debt and old debt is computed with the same discount rate.

5/ Weighted average of all instruments following in the category based on outstanding as of 2/2007.

6/ Market haircut is defined as $1 - \text{Present value of new debt} / \text{Face value of old debt}$.

The debt exchange achieved 98 percent participation rate after the exercise of the collective action clause (CAC) (Box 1). The CAC was triggered on the 9.75 percent note due 2015 (85 percent threshold of outstanding principal under New York law) on February 5, 2007 after the offer was closed. This raised the percentage of total eligible claims subject to exchange from 87 to 98 percent and facilitated the exchange.²² To this date, the remaining 2 percent of bondholders were not identified and did not take a significant legal litigation even without receiving debt service payments. Further, despite a large variety of restructured instruments with variations in NPV haircuts, the consolidation to one single bond did not seem to raise any significant inter-creditor equity issues.

²² Buchheit and Karpinski (2007).

Box 1. Collective Action Clause in Belize 2006-07 Restructuring

Belize employed collective action clause (CAC). This Box illustrates key characteristics of these instruments.

CACs

CACs can be classified into two broad categories (see IMF, 2002b):

- “Majority restructuring” provisions, which allow a qualified majority of bondholders of an issuance to change the bonds’ financial terms (principal, interest, and maturity) and to bind in all other holders of that issuance, either before or after default. For most recently issued bonds with CACs, a supermajority is reached when bondholders holding a certain percentage of total outstanding debt agree (e.g., 75 percent).
- “Majority enforcement” provisions, which can limit the ability of minority bond holders to enforce their rights following a default. In practice, this means that a qualified majority can prevent individual bondholders from (i) declaring the full amount of bond due and payable (“acceleration”), and (ii) commencing litigation against the sovereign.

In the Belize’s case, the authorities issued a 9.75 percent bond with face value of US\$100 million due 2015 under New York law in the 1st half of 2003 that included “majority restructuring” provision with a written consent of holders owning at least 85 percent of the notes. Holders of 87.3 percent of the bond accepted Belize’s exchange offer, thereby consenting to the amendments, which included matching the terms of the old bonds with those of the new bonds.

Two key features of CAC used in Belize 2006–07 restructuring (Buchheit and Karpinski, 2007) include:

- While in most countries the required threshold to amend the terms of the bonds containing majority restructuring clauses has been 75 percent of the aggregate principal amount of the outstanding bonds, Belize is the only country that has required 85 percent.
- Belize was the first sovereign in more than 70 years to use a CAC to amend the payment terms of bonds in sovereign debt restructuring.

Creditors accepted the offer despite concerns about future debt distress. The offer memorandum for the 2006–07 debt exchange acknowledged the possibility of future debt exchanges in light of vulnerabilities and risks.²³ However, creditors accepted the offer in the end, likely because (i) they thought the return profile was rewarding enough based on risk-adjusted assessment given global environment; (ii) it was more economically sensible to accept the offer rather than take legal actions that may entail significant costs; and (iii) the original bonds were illiquid and thus the outright sales were not easy.

The Fund played its role as an independent party to provide debt sustainability assessment and cash flow analysis. It maintained close contact with both authorities and financial advisors, but not with creditors during the restructuring process. The 2006 Article IV consultation highlighting projected large financing gaps over the medium term provided essential inputs into an adjustment scenario that the authorities were preparing with their

²³ Belize Ministry of Finance (2006, p. 16).

financial advisors (IMF, 2006a). At the request from the authorities of Belize, the Fund issued an assessment letter to the international financial community on December 20, 2006, right after the launch of the deal (IMF, 2006b). The letter noted that a high participation by private creditors would help support the authorities’ “orderly macroeconomic adjustment, restore fiscal and external sustainability, and establish the conditions for strong economic growth.”

The Belizean authorities also engaged with official multilateral and bilateral creditors to lend additional support to Belize. Although the official sector loans were not restructured, the authorities received substantial new concessional financing from the regional development banks, such as the Inter-American Development Bank (US\$25 million) and the Caribbean Development Bank (US\$25 million), as well as from official bilateral creditors, particularly Taiwan (US\$30 million) and Venezuela (US\$50 million).

c. Outcomes

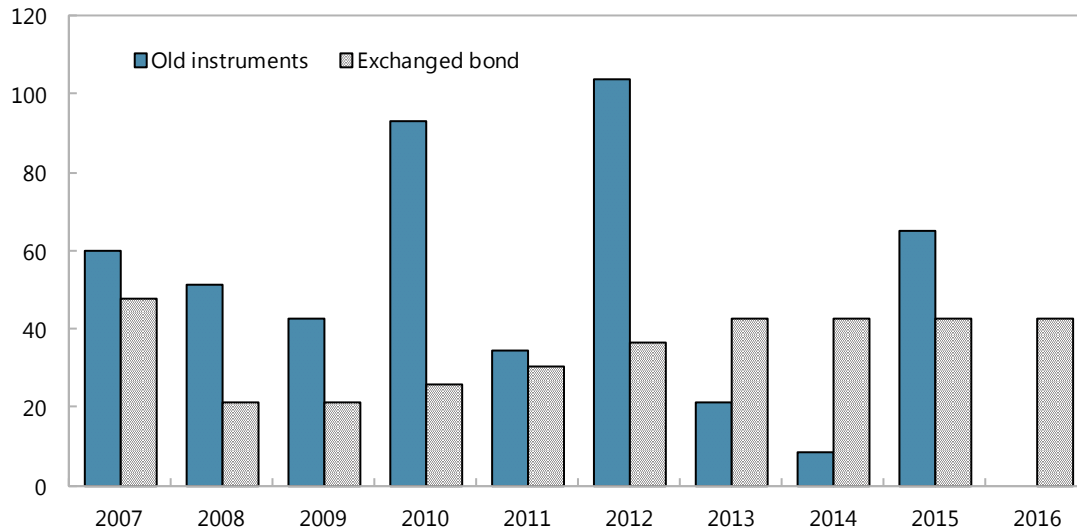
The debt restructuring provided a significant liquidity relief, but solvency concerns remained unresolved. The average maturity of public external debt was extended from 5.7 years before the exchange to 22 years, which resulted in a substantial decline in debt service in the short run (Figure 2).^{24 25} Debt service relief amounted to US\$12 million (including the missed interest payments) in 2007 (1 percent of GDP) and about US\$38 million (2.6 percent of GDP) per year from 2008 to 2012. However, with no nominal haircut, the outstanding debt remained high at 86 percent of GDP in 2007, declining only gradually to 77 percent of GDP by 2012.

²⁴ Cash payments at the closing of the transaction were equal to the unpaid interest on tendered claims accrued up to the closing date.

²⁵ Projected debt service schedule was similar to that of Argentina 2005 global debt restructuring: small debt service over the short term and substantial increase in debt payments over the medium and long terms due to amortization and step-up coupon structures.

Figure 2. Belize Debt Restructuring, 2006-07: Debt Service of Old Instruments and Exchanged Bond 1/

(In millions of U.S. dollars)



Sources: Belize authorities; and authors.

1/ Debt service to the exchanged bond in 2007 includes cash payments at the closing of the transaction.

Belize enjoyed an immediate improvement in its credit ratings. Standard and Poor's (S&P) raised Belize's credit rating on both its long- and short-term debt from CCC- to B immediately after the exchange. Moody's subsequently followed with an upgrade of Belize's sovereign debt to B3. By completion of exchange on February 15, 2007, the bond price recovered from 70 to 80 percent of the face value, close to the pre-announcement level (Figure 1).

After the completion of debt exchange, Belize did not access international capital markets. Although its emerging market bond index (EMBI) remained fairly low after the debt exchange (below 400 basis points for the next four months), Belize continued to rely on official project financing from both bilateral and multilateral creditors. In addition, the global financial crisis that occurred right after the debt exchange raised the risk sensitivity of creditors, preventing new external commercial debt issuances.²⁶

No formal debt management and investor relations program was established after the restructuring. The debt restructuring in 2006-07 consolidated different debt instruments into one single bond, which would have facilitated regular interaction with foreign creditors. However, the government did not launch a formal debt management program and thus a regular and rigorous communication channel was not maintained after the completion of the first restructuring until start of negotiation on the second debt restructuring.

²⁶ Excluding T-bills, Belize had not issued any domestic bonds at the local market.

III. 2012–13 DEBT RESTRUCTURING

The second debt restructuring followed a similar path to the previous one—preemptive and orderly process that achieved only a temporal liquidity relief.²⁷ Notwithstanding the improvement in Belize’s fiscal and external positions after the 2006–07 debt exchange, the country embarked on a new debt restructuring mainly driven by both a prospective increase in the debt service and medium-term debt sustainability concern—largely associated with potential compensation to the former shareholders of two nationalized companies. While negotiations did not proceed smoothly at the beginning, direct communication between high level officials and the head of the creditor committee accelerated the process and eventually both parties reached an agreement. However, similar to the 2006–07 episode, the exchange provided only a substantial cash-flow relief over the near and medium terms, while debt sustainability concerns remain unaddressed.

a. Background

Following the 2006–07 restructuring, Belize’s debt service burden and external position improved, liquidity pressures also softened relative to the financing needs (Annex Figure). Debt servicing costs significantly tapered off as the central government interest payments dropped to about 16 percent of current revenues on average in 2007–11 compared to the average 25 percent in the preceding 5-year period. Gross financing needs declined to about 7½ percent of GDP in 2007–12, compared with 25 percent of GDP in 2002–06.

The discovery of oil in mid-2005 provided temporary headroom for fiscal maneuver to service external debt and rein in the fiscal deficit. Oil-related revenues increased from 0.2 percent of GDP in 2006 to 2.9 percent in 2011, boosted by peaks in production at the main commercial well, elevated world crude prices, and an additional tax. Rising oil exports also bolstered Belize’s external position, as the current account deficit narrowed to 4.7 percent of GDP on average in 2007–11 compared to the average 13.3 percent in 2002–06. Combined with steadily-increasing substantial FDI inflows, gross international reserves went from 2.1 months of imports in 2008 to 3.2 months on average in 2009–11.

Meanwhile, Belize’s growth performance was lackluster, due mainly to structural vulnerabilities and exogenous weather shocks. Real growth declined in the period between the two debt exchanges—averaging 1.9 percent in 2007–11 compared with 5.4 percent on average in 2002–06—when growth was spurred by expansionary fiscal policies. While oil production boosted output growth, traditional sectors of the economy decelerated, reflecting structural weaknesses and the impact of severe weather-related shocks, which contributed to output losses, mostly in agriculture, and damaged infrastructure. In 2008, two tropical storms caused direct economic losses estimated at about US\$75 million (5.4 percent of GDP), with a negative balance of payments impact of US\$46 million.

²⁷ Asonuma and Trebesch (2013) define Belize’s 2012–13 restructuring as “weakly preemptive” as some payments were missed, but only temporarily and after the start of formal or informal negotiations with creditor representatives (no unilateral default).

The authorities continued to face spending pressures, including those associated with the “super-bond” step-up coupon. According to the authorities, the economic slowdown, increased poverty, a surge in crime, and the associated need for increased citizenry security constrained their efforts to engage in a more aggressive fiscal consolidation. Moreover, while Belize faced lower interest payments over the period 2008–12 than anticipated after the 2006–07 restructuring (2.8 percent of GDP vs. 4.6 percent of GDP, respectively), the authorities started to be concerned about the step-up coupon structure, as it was due to rise to 8.5 percent in 2012 (from 4.25 percent in 2007 and 6 percent in 2010), implying about 0.6 percent of GDP in additional interest payments in 2012 and 1.2 percent in 2013.

In addition, Belize faces significant additional claims associated with the nationalization of two public utility companies and the enforcement of several arbitration awards. The government nationalized the Belize Telemedia Limited (BTL) in 2009 and Belize Electricity Limited (BEL) in 2011.²⁸ While the government is required to pay the compensations to former owners of these companies, no agreement has been reached yet between the government and the former owners on the amount of compensation. The valuation of the companies ranges from 6 percent of GDP (government valuation) to 30 percent of GDP (former owners’ valuation), and depending on the court’s ruling regarding the compensation amount, would amplify the debt-to-GDP ratio, which at end-2012 stood at 79 percent. In addition to these claims, several arbitral awards related to land acquisition, overpayment of taxes, and non-observance of tax agreement have been delivered against the government and are pending enforcement.²⁹ While Fund DSA in 2011 did not explicitly raise debt sustainability concerns over the medium term, it alerted that the debt ratio would be elevated by 17 percent of GDP if fiscal contingent liabilities materialize.³⁰

Prime Minister Barrow made the restructuring of the “super-bond” an electoral issue in the March 2012 general election. Similar to the 2006–07 debt exchange, the authorities targeted only external commercial debt, while the creditors did not raise inter-creditor equity issues. Some market participants viewed that the debt restructuring was driven by lack of the “willingness” to service external liabilities, not the lack of “ability”, given no expected immediate liquidity shortage.³¹ The bond price plunged to 40 percent of the face value, while no immediate outright sales occurred likely owing to the lack of liquidity in the secondary market.

²⁸ In 2009, the government started to negotiate with BTL on how to address a series of allegedly illegal agreements between the BTL and the previous administration. Following failure of such efforts, it enacted legislation to acquire the shareholding in BTL. In 2011, the government nationalized the BEL to ensure continuous electricity supply to the public, following the company’s proclamation that it would execute rolling blackouts in the country in response to its financial difficulties.

²⁹ Central Bank of Belize (2012) extensively discusses the additional liabilities.

³⁰ IMF (2011).

³¹ In February 2012, S&Ps downgraded twice Belize’s long-term foreign-currency rating to CCC- (three notches in total) noting, first, the lower political willingness to service the country’s external commercial debt and, second, the increasing likelihood that Belize would seek to restructure its sovereign external debt.

b. Process

After securing his re-election in March 2012, Mr. Barrow announced the appointment of a debt review team to conduct a comprehensive review of external public debt and contingent liabilities.³² At the same time, the authorities also engaged the financial advisors for restructuring.³³ The Belizean authorities explicitly identified the additional liabilities associated with the nationalization as one of the driving forces of debt restructuring, along with the onerous step-up coupon. However, as negotiations with previous owners of nationalized companies stalled, the government focused on debt burden stemming from high coupon rate, effectively de-linking the debt restructuring and the additional liabilities issues. On June 20, 2012, the authorities published an economic and financial update, showing that despite active engagement with multilateral partners, Belize was facing sizeable financing gaps from 2013 onwards.³⁴

The reaction by investor community was swift and well-organized, while the authorities' initial approach was not viewed as collaborative. Prior to the authorities' economic and financial update, a group of bondholders announced the creation of a creditor committee representing US\$200 million of the “super-bond”.³⁵ ³⁶ This swift reaction by the bondholders stemmed from growing ‘readiness’ for sovereign debt restructuring and debt negotiation, owing to their accumulated experiences from a series of smooth debt negotiations in the Caribbean region, including the first Belize’s debt restructuring. However, the authorities and the creditors were pursuing different strategies in negotiating the terms of the debt exchange. While the authorities aimed to reduce debt service via substantial face value reduction, the creditors targeted a long-term coupon reduction with no steep step-up. Due to this difference in restructuring strategies, the creditor committee rejected the authorities’ first indicative scenarios published in August 2012 that implied substantive face value and NPV haircuts with coupon reduction and maturity extension (Table 3).

A partial coupon payment opened ground for extending debt exchange negotiations. On August 21, 2012, the Government of Belize missed a US\$23 million coupon payment on the “super-bond” resulting in S&P’s downgrading the country to a default rating. Then, on September 20, 2012—one day after the expiration of the 30-day grace period of missed

³² Belize Press Office, Government of Belize Initiates External Public Sector Debt Review, March 19, 2012, <https://www.centralbank.org.bz/news/details?newsid=23>.

³³ BroadSpan Capital LLC and Blitzer Consulting acted as the Committee’s financial advisers, while Arnold & Porter LLP was retained as the Committee’s legal advisor. White Oak Advisory LPP was the financial advisor for the Government of Belize, and Cleary Gottlieb Steen & Hamilton LLP, Houlihan Lokey Howard & Zuckin was acting as the government’s legal advisor (Belize Ministry of Finance, 2013b and Coordinating Committee of Belize, 2013).

³⁴ <https://www.centralbank.org.bz/news/details?newsid=29>.

³⁵ Belize Coordinating Committee Announces Formation, Press Release, June 13, 2012.

³⁶ The Coordinating Committee and an ad-hoc group of bondholders which consists of 20 additional institutional members represented over US\$338 million, i.e. about 62 percent of the US\$547 million of bonds outstanding.

payment—the authorities made a partial coupon payment of US\$11.7 million and the creditor committee agreed to give Belize 60 more days to conclude debt restructuring negotiations.

Negotiations between the government and the creditor committee started in earnest in early October 2012.³⁷ The focus of the negotiations included growth projection, potential amount of the additional liabilities associated with the nationalization of the two utilities companies, and availability of external official financing.³⁸ These three elements were essential ingredients to determine the financing gaps and the associated creditor loss to be agreed. Subsequently, on November 21, 2012, the creditor committee made a counter proposal, which included par bonds with more modest creditor loss in NPV terms than the authorities' original indicative scenarios. This proposal was followed by the authorities' revised indicative scenarios that entailed lighter face value haircut and higher coupon rate than the original proposal. These revised scenarios were, however, also rejected by the creditor committee. Details of the government's indicative scenarios are presented in Table 3 below.

Table 3. Belize Debt Restructuring, 2012-13: Initial and Revised Indicative Scenarios

Option	Initial Indicative Scenarios (Aug 9)			Revised Indicative Scenarios (Nov 29)	
	Par	Discount	Discount	Par	Discount
Face value haircut	0%	45%	45%	0%	33%
Grace period (years)	15	0	5	10	5
Final maturity (years)	50	30	30	40	30
Coupon	2%	1% until 2019 2% until 2026 4% until 2042	3.50%	2.75% until 2018 4.5% until 2053	4.5% until 2018 6.75% until 2043
Repayment Style	Amortizing	Amortizing	Mortgage	Mortgage	Mortgage

Source: Belize authorities.

The high-level intensive discussion after the rejection of the revised indicative scenarios helped both parties to reach an agreement on the terms of the exchange offer. After refusing the revised indicative scenarios, the committee expressed its view that both sides would be missing the window for a timely resolution of the impasse. Right after the rejection, the direct communication between the authorities and the creditor committee, including direct dialogue between Mr. Barrow and the co-chair of the committee, started, leading to a framework agreement between both parties. However, the underlying considerations of the participants in assessing the offer cannot be readily ascertained.³⁹ The anticipated execution of the bond exchange pushed up the bond price to the pre-exchange announcement level. The exchange offer was launched on February 15, 2013 and the CAC (75 percent threshold under New York law) was executed to raise the participation rate from 86 percent to a full participation. The debt exchange operation was closed on March 20, 2013.

³⁷ <https://www.centralbank.org.bz/news/details?newsid=51>.

³⁸ Belize Ministry of Finance (2012).

³⁹ <http://edition.channel5belize.com/archives/79952>.

The restructuring financial terms were the following (Table 4):

- **Principal haircut.** Approximately US\$530 million of new 2038 bonds were issued. The original “super-bond” was subject to a 10 percent face value haircut, but overdue interest was added to the face value of the new bond (approximately 7 percent of the original principal).⁴⁰ As a result, the “net” face value haircut was about 3 percent.
- **Coupon rate reduction.** The new bond will pay a step-up coupon of 5 percent without grace period through 2017 (for 4.5 years) and 6.767 percent thereafter, compared with the original 8.5 percent through maturity.
- **Maturity extension.** The final maturity will be February 2038 (instead of 2029 under the original “super-bond” terms), with the first amortization falling due in August 2019.
- **NPV and market haircuts.** Using a discount rate of 9.2 percent, the NPV haircut was 29 percent, while the market haircut was 33 percent.

Table 4. Belize Debt Restructuring, 2012-13: Deal Structure

	Old Instrument	New Instrument
Instruments	2029 US bond	2038 US bond
Face value (US\$ mil.)	547	530
Face value haircut	3% (10%) 1/	-
Maturity	2029	2038
Remaining maturity (years)	16	25
Coupon	4.25% until 2010, 6% until 2012, 8.5% until maturity	5% until 2017, 6.767% until maturity
Repayment profile	2019-29	2019-38
Present value on 3/2013 2/	94%	67%
NPV haircut 3/	29%	-
Market haircut 4/	33%	-

Sources: Belize authorities; and authors.

1/ Face value haircut was 10 percent. Adding the missed coupon payments to the face value, the net face value haircut is 3 percent.

2/ Discount rate at 9.2 percent which was exit yield at completion of exchange (on 3/28/2013 - the first transaction day when yields were recorded after completion of exchange).

3/ NVP is defined as $1 - \text{Present value of new debt} / \text{Present value of old debt}$ as in Sturzenegger and Zettelmeyer (2008). Present value of new debt and old debt is computed with the same discount rate.

4/ Market haircut is defined as $1 - \text{Present value of new debt} / \text{Face value of old debt}$.

⁴⁰ The missed coupon payments (August 2012 and February 2013) amounted to about US\$35 million.

The debt exchange offer included several new legal terms, most notably a committee engagement provision (Box 2). In contrast to recent sovereign debt restructurings, the government of Belize and the creditors' committee agreed to a more extensive bondholders' committee engagement provision to augment, among others, contract enforceability.⁴¹ Given the circumstance where no IMF-supported program is in place, both parties agreed to maintain a close engagement if the government experience difficulties to service its debt obligations.

Other new terms included a contingency account for trustee indemnification, principal reinstatement in the event of a future default, and a most favored creditor provision. In addition, Belize clarified the *pari passu* clause to mean equal ranking in the legislation authorizing the exchange together with the exchange offer.⁴² Also, the government has committed to improve data transparency, through its "best effort" to begin to subscribe to the Special Data Dissemination Standard (SDDS).

⁴¹ The most notable examples of creditor engagements were those of Hungary in its late 2004 and early 2005 offerings. The 2004 English law offering document disclosed the usual industry-model engagement clause; however, less than a year later, Hungary's New York law issue included an engagement clause without an undertaking to pay the committee's expenses.

⁴² Rather than modifying the terms of instruments, the authorities used a new technique to clarify the meaning of the clause in disclosure documents.

Box 2. Legal Terms in 2012-13 Exchange Offer¹

The 2012–13 exchange offer includes various legal terms, in addition to the CACs that were used in the 2006–07 debt exchange.² Among others, the committee engagement provision was newly introduced and unique to Belize case.

- **Committee engagement provision.** It represents commitment from the sovereign debtor “to recognize and to engage with a Creditor Committee” (i) in the event of a future default, (ii) any event or circumstance which would, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfillment of any other requirement, constitute an event of default, or (iii) any public announcement by the debtor to the effect that the debtor is seeking or intends to seek a restructuring of the securities (whether by amendments, exchange offer or otherwise).
- **Minimum participation threshold.** It ensures that a high number of bondholders agree on exchange offer. Sovereigns reserve the right, in its sole discretion, to cancel the proposed offer in the event that the level of participation in the proposed offer would not exceed the threshold. These clauses have been used to reassure tending bondholders that they would not be left out holding a smaller and illiquid claim in the event that most bondholders chose not to accept the offer. In Belize’s case, this minimum threshold was set at 75 percent of the aggregate principal amount of the eligible claims.
- **The Most-Favored-Creditor provision.** It lets creditors know that the sovereign debtor will not settle, by negotiation, any other outstanding claim on better terms that it has offered holders of the old bonds.
- **Principal reinstatement provision.** It states an automatic upward adjustment in principal in the event of a future default. Specifically, upon a default, the authorities shall issue to each holder of the exchanged bond within 5 business days after the principal reinstatement date an amount of additional exchange bond equal to 11.11 percent of the outstanding principal amount of exchange bond as of the date of original issuance of the new bonds.
- **Pre-funding of a Trustee Contingency Account.** It specifies that a sovereign debtor pays the funding of Contingency Account which is available for reimbursement of expenses of the Trustee of New Bonds.
- **The Pari Passu clause.** It ensures that the borrower does not have, nor will it subsequently create, a class of creditors whose claims against the borrower will rank legally senior to the indebtedness represented by the loan agreement (Buchheit and Pam, 2004).

¹ Belize Ministry of Finance (2013a).

² Although CACs can play an important role in facilitating debt restructurings, their presence is no guarantee for a quick exchange with high participation. Other legal vehicles and exchange characteristics, in particular exit consents, aggregation clauses and minimum participation thresholds can play a role as well (Das et al, 2012).

As in the 2006–07 restructuring, the Fund did not participate directly in the restructuring process through an adjustment program. However, while maintaining neutrality during the debt exchange process, Fund staff was in close contact with both the authorities and the financial advisors. A Fund mission visited Belize from November 1–15, 2012 to conduct the yearly review of the country’s economy, in the context of the IMF’s Article IV consultations. However, in light of ongoing negotiations with bondholders on the restructuring of the “super-bond”, further discussions with the authorities were required to complete the consultations. Discussions resumed in April 2013 and were completed in June 2013. In parallel with the Article IV consultations, a technical assistance mission assessed the current framework for debt management and helped the authorities build relevant institutional capacity.

While no credit enhancements were formally offered to bondholders, the authorities initially considered an operation with the IDB to fund a partial guarantee.⁴³ Similar guarantees were used for recent debt restructuring cases: guarantees of US\$10 million were provided to Seychelles in 2010 by the African Development Bank and of US\$12 million to St. Kitts and Nevis in 2012 by the Caribbean Development Bank. In both cases, guarantees not only complemented part of interest payments of new discount bonds, but also played a catalytic role in assuring confidence in the country’s macroeconomic adjustment program. In Belize’s case, the authorities approached the IDB at the early stage of the debt exchange negotiations and discussed the possibility of provision of a partial guarantee by the IDB. However, as negotiations between bondholders and the government intensified toward the end of 2012, the IDB and the Belizean authorities began discussion on alternative ways to support the country.⁴⁴

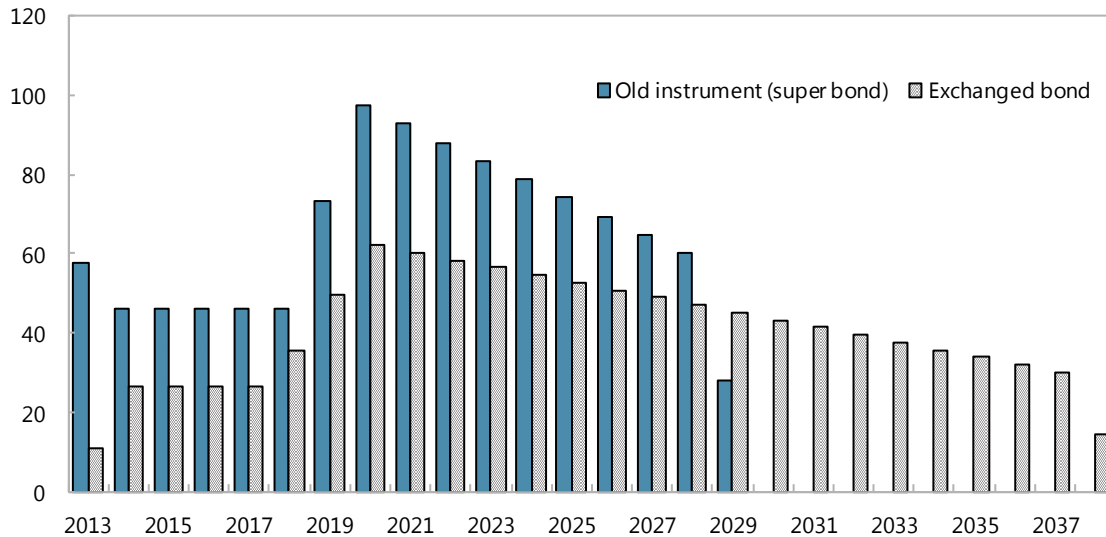
c. Outcomes

The deal provided substantial cash-flow relief over the near term (Figure 3). The reduced coupon, along with the modest face value haircut, would result in debt service relief of US\$47 million (including the missed interest payments) in 2013 (2.9 percent of GDP) and about US\$20 million (1.1 percent of GDP) per year from 2014 to 2017. Over the remaining 16-year life of the original “super-bond”, total cash flow relief will be US\$384 million. On the contrary, Belize will face continuous liquidity needs over the long term until 2038, indicating the need for frontloaded macroeconomic adjustment policies.

⁴³ Central Bank of Belize, 2012 Annual Report and Statement of Accounts, pp. 44–45.

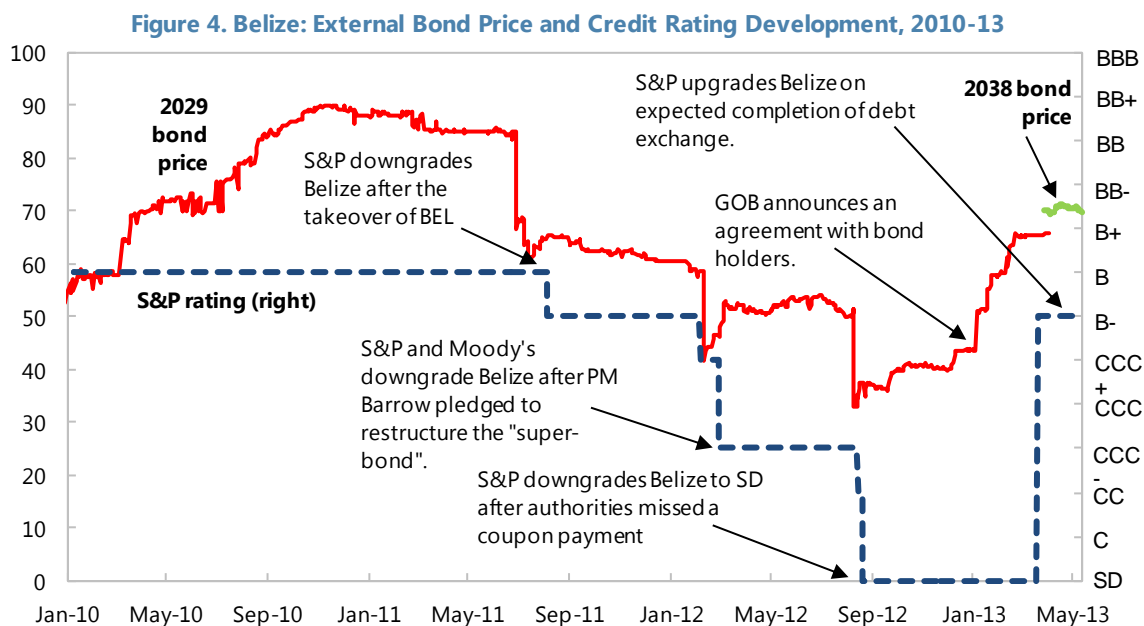
⁴⁴ <http://www.reporter.bz/front-page/no-idb-guarantee-but-negotiations-will-go-on/>.

Figure 3. Belize Debt Restructuring, 2012-13: Debt Service of Old Instruments and Exchanged Bond 1/
(In millions of U.S. dollars)



The credit ratings were upgraded immediately after the debt restructuring, with a significant drop in EMBI spread. S&P upgraded Belize to non-default rating (B-) on March 20 given expected completion of the debt exchange, followed by an upgrade by Moody's from Ca to Caa2 on April 15, reflecting an improvement in the government's liquidity position.⁴⁵ Further, the bond price recovered from 60 to 65 percent of the face value (Figure 4).

⁴⁵ Standard and Poor's (2013) explains that credit ratings on Belize are constrained by its weak political institutions, weak medium-term growth prospects which are weaker than those of peers rated in the B category, limited financing options reflecting shallow domestic capital market, and potential risk of contingent liabilities to the government's ability to service its newly issued debt.



Despite the cash-flow relief, concerns over public debt sustainability and external stability remain mostly due to liquidity needs over the long term, necessitating strong fiscal policy efforts. Our calculations suggest that the debt exchange would reduce the debt-to-GDP ratio by around 8 percent in 2018. Although the debt path would be *ceteris paribus* more favorable after the restructuring, there still remains uncertainty about the size, modality, and timing of the possible compensation payments to the former owners of the two nationalized companies. The compensation payments could increase the debt level by 17 percent of GDP at end-2015 and push up the financing needs to above 6½ percent of GDP in 2016, and to more than 7 percent of GDP after 2018.⁴⁶ Unless the authorities adhere to an active fiscal adjustment policy that will help contain growing financing needs and achieve a faster downward debt trajectory, the debt level will remain elevated.⁴⁷

The government of Belize is committed to revamp the public debt management framework, and the reform is underway. The current administration announced its intention to “modernize” the debt management framework after the debt restructuring.⁴⁸ Robust debt management scheme with solid medium-term debt management strategy will help the authorities monitor various risks that are inherent in the public debt portfolio.

⁴⁶ Due to high uncertainty surrounding the nationalization compensation, the calculations are based on the assumptions, and are for illustration purpose. For further details, see IMF (2013b).

⁴⁷ IMF (2013b) suggests that raising gradually the primary surplus to 3 percent of GDP over the medium term—1 percent of GDP above the average over the last 10 years—would help reduce the debt-to-GDP ratio to less than 60 percent of GDP a decade from now and to below the long-term value of 50 percent of GDP by mid-2020s.

⁴⁸ Belize, Ministry of Finance, “Achieving debt sustainability, Stimulating economic expansion”, Budget Presentation for Fiscal Year 2013/2014.

IV. CONCLUSION

The underlying motivation for the sovereign debt restructurings of 2006–07 and 2012–13 was different. The former was driven by external liquidity concerns while the latter was motivated by a substantial increase in the coupon rates and future fiscal solvency concerns. Some market participants had a different take, particularly with respect to the second restructuring. They recognized that the 2006–07 debt exchange was largely motivated by liquidity concern, but they viewed the 2012–13 debt exchange as driven by a lack of “willingness” to pay. A difference in understanding of the underlying motivation of the second restructuring negatively affected the smoothness of the negotiation process, at least at its initial stage.

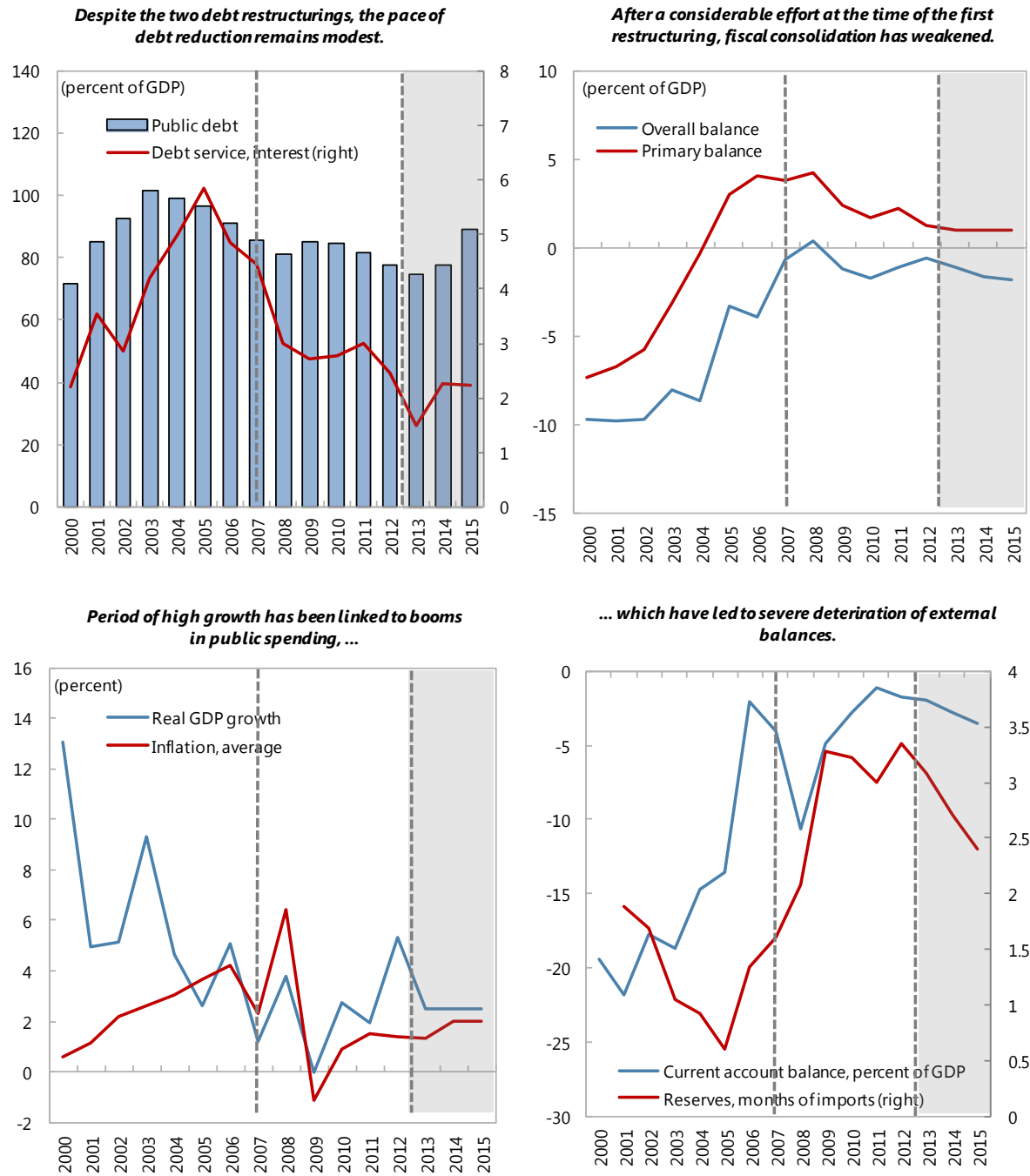
Both debt restructurings were undertaken in a preemptive and broadly transparent manner despite explicit discrimination between residents and non-residents.

A successful collaboration between the government and creditors in the first restructuring paved the way for the second restructuring through shared experience of renegotiation. Further, the representation of the creditor committee was also high in particular in the second debt restructuring—62 percent of the US\$547 million of bonds outstanding—which helped contain potential holdouts.

Belize introduced a number of new legal provisions to facilitate engagement with creditors. Examining the implications of the new legal provisions for future sovereign restructurings goes beyond this paper. In the 2006–07 restructuring, the exercise of CAC smoothed negotiations to yield high participation of creditors. In the 2012–13 restructuring, a more extensive bondholders’ committee engagement provision was included to augment contract enforceability in the future. Other new terms included a contingency account for trustee indemnification, principal reinstatement in the event of a future default, and a most favored creditor provision.

However, debt sustainability has not been effectively restored following the two restructurings, thus calling for more robust macroeconomic policy adjustments. Smooth debt renegotiation *process* did not necessarily guarantee successful *outcomes*. Even after the repeated debt exchanges, Belize still remains vulnerable both to external shocks (including weather) and domestic shocks, with debt sustainability overshadowed by the looming additional fiscal contingent liabilities. Ongoing plans to revamp the public debt management framework are a positive signal. However, further fiscal consolidation is warranted to achieve debt sustainability and reduce future financing needs.

Annex Figure. Belize: Selected Economic Indicators, 2000-15 1/



Sources: Belizean authorities; and Fund staff estimates and projections (IMF Country Report 13/227).
 1/ Dotted vertical lines represent debt restructurings in 2007 and 2013. Shaded area represents projection years.

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