2.1 Commercial Debt

In the three year period following the beginning of the debt crisis, the commercial banking community was ill equipped to address the problem. The main response was to attempt to protect the value of commercial loans in developing countries. To achieve this end, bank advisory committees would recommend the restructuring of debt on more favourable terms to the developing countries, and would provide new financing to protect the book value of the loans and ensure that they kept performing. Normally these restructurings followed the granting of the International Monetary Fund's (IMF) seal of approval in which countries agreed to programmes designed to help stabilize their economies by improving fiscal and current account deficits, ultimately leading to an expected improvement in their ability to service the external debt. New voluntary lending from the banks dried up, although involuntary lending as part of the bank packages was extended to enhance the quality of outstanding obligations. This approach was insufficient.

The first concerted international effort, the Baker Plan, was announced in Korea at the joint meetings of the World Bank and IMF in October 1985. The announcement was significant since it was the first official recognition by the U.S. government that indebted countries were suffering from solvency problems, not simply temporary liquidity shortfalls. The Baker Plan called for the World Bank to put up US $20 billion over three years, an amount that was to be matched by commercial creditors. Outstanding interest and principal payments were to be capitalized. The result, however, was little more than a bookkeeping entry and offered indebted countries little debt relief, despite the fact that the World Bank nearly doubled its exposure to the Severely Indebted Middle-Income Countries (SIMICs) from 1985 to 1987, although by only US $12.9 billion, well short of the US $20 billion originally envisaged.[3]

It was also during the period of the Baker Plan that debt-equity and other debt swaps became common, and a secondary market for developing country debt emerged. In addition, selected developing countries, such as Bolivia, Chile and Mexico, were allowed by commercial bank creditors to buy back some debt at a discount or to exchange debt at a discount for other instruments. In 1988, for example, Mexico exchanged public sector debt at a sizeable discount for new and collateralized 20-year Mexican bonds, resulting in a reduction in total external debt of US $1.1 billion.[4] Still, countries were not always in a better position after such

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[3]Culpeper (1993), p. 1240. See the Appendix for the definition and a list of SIMICs.

[4]Powell (1990), p.11.