

The Menu Approach*

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The Brady Plan's proposals represent an important advance in the conception of how to manage the problems of the highly indebted countries (HICs). The positive aspects of the proposal can be best appreciated by first examining the scope and limitations of the Brady Plan's predecessor, the Baker Plan, and more specifically, the second stage of that Plan, the so-called Market Menu Approach.

The Market Menu Approach emerged in 1987 on account of the shortcomings of the Baker Plan's original formula for restoring growth in the highly indebted developing countries, which involved intensification of economic reforms in the debtor countries, coupled with a redoubled effort to mobilise concerted loans for them from commercial banks and official lenders.¹ As it became evident that the commercial banks were unwilling to support the Baker Plan's lending commitments, the official focus shifted to the so-called Menu Approach as a way to overcome the problem of developing countries' growing financing constraint.²

The Menu concept essentially supplemented new concerted lending packages by the banks with other

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¹ The Baker Plan was announced in September 1985 and 'promised' to mobilise US\$29 bn over three years for 15 heavily indebted developing countries (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia). Later Jamaica and Costa Rica were added to the list. US\$20 bn was to come from commercial banks and US\$9 bn from official lenders. However, programmed bank financing — which represented a modest 2½ per cent annual expansion of exposure — proved difficult to mobilise, in part because by 1986 commercial banks had substantially reduced their vulnerability to default and therefore had less incentive to lend in concerted fashion to problem borrowers. Indeed, World Bank data suggest that net lending by banks totalled only US\$6 bn over 1986-88, in contrast to US\$15 bn for official lenders. Source: World Bank, *Quarterly Review*, Washington DC, March 1989, p. 3.

² For a more completed analysis of the evolution of the official debt management strategy and the emergence of the Market Menu Approach, see CEPAL, *La Evolución del Problema de la Deuda Externa en América Latina y el Caribe*, Estudios e Informes de la CEPAL No. 72, Santiago, Chile, 1988 and Robert Devlin, *Debt and Crisis in Latin America: The Supply Side of the Story* (Princeton: Princeton University Press, Chapters 5 and 6).

financing options. On the one hand, the Menu proposed the use of alternative new money instruments such as trade and project loans, international bond placements and limited capitalisation of interest payments. On the other, it introduced for the first time in the management of the debt problem the possibility of financing the debtor countries through debt reduction techniques such as debt-equity swaps, debt-bond exchanges, and buybacks. In the official scheme, the items on the Menu had to emerge voluntarily from the market on a case-by-case basis in negotiations between the debtor country and its creditor banks. Moreover, the creditor governments made it emphatically clear that their support of the Menu could *not* involve costs for their taxpayers, i.e., public guarantees and the like to enhance financing packages were explicitly excluded from the official management strategy.

Although appearing in 1987, the Menu did not gain concrete form until 1988 when an array of its market-based options actually emerged from the negotiations between debtors and creditors. Moreover, financing schemes tended to stress debt reduction techniques, in part because net lending by the banks had become practically impossible to mobilise. Indeed, according to World Bank estimates net bank financing to the highly indebted countries, after adjustment for the net movement of arrears, was only US\$500 mn in 1988, compared to an already low figure of US\$7 bn in 1987.³

Events in Latin America, where the bulk of the highly indebted countries are located, were indicative of the general situation in 1988. Indeed, new money operations were a rare event. Brazil secured a US\$5.2 bn loan in June as part of a package that rescheduled US\$62 bn of outstanding debt. The terms were a 12-year maturity and an interest rate of 0.81 per cent over LIBOR. Venezuela also secured some new money, but by exploiting a non-conventional option in the menu: bond placements. During the year the country emitted four bonds worth approximately US\$350 mn. The notes typically had a maturity of five years and interest rates ranging from 11.13 per cent fixed, to 1.13-1.88 per cent over LIBOR.⁴ Finally, in early 1989 Colombia — the only HIC to avoid a rescheduling — secured a new money commitment

³ World Bank, *op.cit.*, p. 3.

involving a US\$1.5 bn loan from its bank creditors with a 12½ year maturity and a 0.88 per cent spread over LIBOR, coupled with a US\$0.2 bn bond placement carrying an eight year maturity and a spread of 1.5 per cent over LIBOR.

Aside from the small number of HICs which were able to secure new bank credit, the volume of loans for those privileged few countries was disappointing also. In the Brazilian operation, nearly two-thirds of the loan was earmarked to liquidate interest arrears accumulated a year earlier. Meanwhile, the two-year financing package for Colombia, in addition to being extremely difficult to organise, fell short of the cost of upcoming amortisation. That means that the creditor banks actually will reduce their exposure in a country that by most any standard is quite creditworthy. Finally, the Venezuelan issues were both small and extremely expensive. Moreover, much of the money was reportedly subscribed by Venezuelan residents, making the bonds more of a vehicle for repatriating capital flight than an international bond placement as such.

As for the debt reduction items in the Menu, 1988 began with an interesting operation in Mexico in which the government proposed to trade up to US\$20 bn of restructured public debt for US\$10 bn of bonds with a single maturity of 20 years and an annual interest rate of 1.63 per cent over LIBOR (compared to 0.81 per cent over LIBOR for the restructured debt). To enhance the new government bond, Mexico indicated a willingness to guarantee its principal by using the country's foreign exchange reserves to make a parallel purchase of a specially issued US Treasury zero-coupon bond with a face value and a maturity identical to that of the Mexican instrument.⁵

The proposed scheme at the time was hailed in some circles as the solution to the problem of the HICs.⁶ However, the launching of the operation ran into a number of unexpected difficulties. Gaining the necessary waivers from the banks to initiate the conversion operation was not as difficult as it might have been because protracted negotiations over a March 1987 rescheduling agreement had already exempted public debt from the sharing clause, which

⁴ Venezuela undertook four operations in 1988: (i) a US\$100 mn note in February which carried a five-year maturity and a fixed rate of 11⅞ per cent; (ii) another US\$100 mn issue in August carrying a five-year maturity and a spread over LIBOR of 1⅞ per cent; (iii) a DM\$100 mn issue in November carrying a five year maturity and a 8¼ per cent fixed interest rate and finally; (iv) a US\$500 mn issue in December, of which only US\$100 mn was in cash, the rest being composed of restructured private sector debt. This latter operation carried maturities of six, ten and 15 years and an interest rate of 1⅞ per cent over LIBOR.

⁵ For more detail on the Mexican proposal, see Ruben Lamdany, June 1988, 'Voluntary Debt Reduction Operations: Bolivia, Mexico and Beyond . . .', Washington DC, World Bank.

⁶ Mexico's New Bond Scheme Points to Long Term Solution to Region's Debt Crisis', 11 January 1988, *Business Latin America*, p. 9.

required approval of 100 per cent of the banks. The remaining obstacle was the negative pledge clause which had to be waived to collateralise the new bonds. Since this waiver required the consent of only 51 per cent of the banks, it was secured within two months. The major problems arose on other fronts.

First, Mexico's collateral was for principal only, which represented just 18 per cent of the discounted/present value of the 20 year Mexican bond. In other words, the banks perceived that 80 per cent of the income stream on the bond was unsecured Mexican risk. The Mexican authorities tried to overcome this problem by asserting that the new bond would be senior to existing loans, but most banks were apparently unconvinced about seniority being created by fiat. Second, the attractiveness of the offer was reduced by a ruling of the United States Securities and Exchange Commission which stated that US banks would have to write down all loans tendered for the exchange, even if ultimately they were not accepted by the Mexican government. Third, the announcement of an offer to exchange up to US\$20 bn of debt for US\$10 bn of bonds implied a discount of 50 per cent on outstanding bank loans: yet many institutions in the US had loan loss reserves sufficient to cover discounts of only 25-30 per cent,⁷ while the Japanese banks were formally even less covered for loan losses.⁸ Fourth, national tax codes were such that for many European banks there was little or no advantage to recognising the lower value of their assets in an exchange. Fifth, the placement confronted inherent free rider problems since certain banks would be tempted to withhold their participation in anticipation of having the value of their loans rise as the absolute amount of Mexican debt fell. Finally, the exchange offer was a very novel twist in the official debt management strategy: it is well known that the market reacts cautiously to new instruments and therefore conversions of this type might normally be expected to start quite small even under the best of circumstances.⁹

The reaction of the market to the Mexican offer indeed fell far short of initial expectations. In the auction Mexico received 320 bids from about a quarter of the country's nearly 500 creditor banks for a total value of US\$6.7 bn. The government accepted just 95 of those bids valued at US\$3.7 bn and traded them for US\$2.6 bn of Mexican bonds. Thus the average discount on the operation was 30 per cent and bank debt was reduced by US\$1.1 bn. The government had to expend about US\$490 mn of foreign exchange

⁷ See CEPAL, 28 February 1989, 'Estudio Económico de los Estados Unidos 1987', Santiago, Chile, LC/G.1477, table 32.

⁸ Bouchet, M. and Hay, J., 'The Rise of the Market-Based Menu Approach and Its Limitations', Washington DC, World Bank, 1989, p. 19.

⁹ Kenneth Telljohann, June 1987, 'Analytical Framework', *Prospects for Securitization of Less Developed Country Loans*, New York, Salomon Brothers, p. 11.

reserves to collateralise the new bonds, plus, in order to avoid discrimination, at least another US\$100 mn had to be drawn upon to collateralise the country's outstanding bonds already in circulation.

The results of the Mexican exchange offer clearly disappointed creditors and debtors alike. Nevertheless, even the most optimistic scenario of a US\$10 bn debt reduction would not have produced dramatic relief for Mexico's harried balance of payments. This is because the principal on the debt was not being paid and there was little prospect of it being paid in the foreseeable future. (Hence the 50 per cent discount on Mexican debt trading in secondary markets in early 1988.) In these circumstances, and with an interest rate on rescheduled debt of LIBOR +0.81 per cent, every dollar of debt reduction brought with it at that time only 8.8 cents of cash flow relief in the form of lower interest payments.¹⁰ However, this interest savings was partially offset by the fact that Mexico attempted to enhance the new bond with a higher spread over LIBOR than found on the old debt and also had to disburse upfront liquid interest-earning foreign exchange reserve to purchase collateral that would not yield a cash flow for 20 years. Indeed, in these circumstances a US\$10 bn exchange would have produced only slightly more than US\$650 thousand annually in net interest savings, compared to an annual interest bill on the debt of nearly US\$9 bn. Moreover, in view of the need to disburse for collateral, the net cash balance on that hypothetical operation would have been negative for Mexico for the first three years. With Mexico's actual voluntary conversion being realised at a relatively low discount and low volume, net annual interest savings will be tiny and the net cash flow balance of the transaction will be negative for Mexico for most of the 20 year life of the agreement.¹¹

Another important debt reduction operation was launched in March 1988 by Bolivia. Because of economic and political problems, this nation

¹⁰ At that time LIBOR was about 8 per cent.

¹¹ Since LIBOR at that time was 8 per cent, the hypothetical reduction of US\$10 bn of restructured debt would have reduced annual interest payments by US\$880 mn. On the other hand, the new US\$10 bn Mexican bond would have carried an interest rate that was 0.82 per cent higher than the rate on restructured debt, generating additional interest costs of US\$82 mn per annum for the country. Liquid foreign exchange reserves of US\$2 bn would have had to be used to purchase collateral that would have no cash return for 20 years; hence, if those deposited reserves were earning a very conservatively estimated 7 per annum, cash interest income of US\$140 mn per annum would have had to be foregone. Thus net interest savings from the exchange would have been US\$658 thousand annually. But since US\$2 bn would have to be disbursed for collateral, the cumulative net cash flow would have been negative for Mexico for the first three years. The interest savings and cash flow benefits, of course, fall as the exchange ratio worsens for the debtor. Using the same assumptions about interest rates, Mexico's actual exchange at a 30 per cent discount generated at that time net annual interest savings of about US\$35 mn and an overall negative cash flow balance that would not be rectified for 17 years.

unilaterally suspended its debt service in mid-1984. After rescheduling its Paris Club debt in July 1986, Bolivia began to actively negotiate a buyback of its bank debt, worth about US\$670 mn (excluding interest on arrears), or 15 per cent of the country's total public foreign debt. The country's bank debt had been circulating in secondary markets at about 6 cents on the dollar, but with news of a potential buyback, secondary market prices quickly rose to 11-12 cents.

A year after initial contacts, in July 1987, Bolivia won waivers of the already mentioned restrictive clauses which were contained in a 1981 rescheduling agreement. Among the conditions established for the buyback were that the resources for the purchase had to come from third party donors; the contributions had to be placed in an IMF Trust Fund, and an identical price would have to be offered to all the country's bank creditors. The banks also won the option to accept, in lieu of cash, 25-year collateralised peso denominated zero-coupon bonds, which were indexed to the US dollar and eligible for conversion into local equity at a 50 per cent premium over their face value.¹²

The buyback was formally announced in January 1988 with an offer price of 11 cents on the dollar. In March Bolivia announced that 53 of its 131 creditor banks had made bids; nearly US\$270 mn of debt was exchanged for cash and US\$64 mn for notes. The outstanding debt was reduced by nearly half.

The buyback clearly illustrated how assistance from the international public sector can accelerate a reduction of outstanding bank debt. Indeed, the entire operation would not have been feasible without the resources provided by government donors and the IMF's good offices. Nevertheless, the operation was far from an unqualified success and revealed shortcomings of the Market Menu Approach as then conceived.

It is rather striking that facing an unquestionable state of insolvency in Bolivia; an offer price that nearly doubled that prevailing in the secondary market before the announcement of a buyback, and the availability of third party to finance a full scale repurchase, only 40 per cent of the country's creditor banks 'volunteered' to participate in the operation. The reasons for this sluggish response are varied. Some banks clearly preferred to free ride, evaluating that with a reduced debt Bolivia might eventually be willing to settle the remaining outstanding obligations on terms more favourable to them. Other banks which were fully reserved against Bolivian portfolio risk estimated little immediate tax or accounting benefits from a formal recognition of a loss; indeed, by sitting tight a bank might achieve a windfall benefit from an unexpected sharp rise in the country's terms of trade.

¹² For a more detailed summary of the Bolivian operation see Lamdany, *op.cit.*

Other banks, with inadequate reserves against their LDC exposure, would have wanted to avoid the losses implied by participation in a buyback and thereby keep their loans at book value. Finally, some institutions undoubtedly preferred to avoid the precedent of debt forgiveness.

Another problem was the rise in the secondary market price itself. At 6 cents on the dollar the secondary market had been valuing the country's US\$670 mn debt at US\$40 mn. However, anticipating the buyback the market price rose to roughly 11 cents, meaning that the remaining unpurchased debt of US\$336 mn gained a market value of US\$37 mn. Thus slightly less than US\$37 mn of cash and Bolivian notes bought only a US\$3 mn reduction in the market value of outstanding obligations; in other words Bolivia paid 11 cents on the dollar for a debt with a marginal value of less than one cent.¹³

Buying back a debt with a low marginal value is not unequivocally the best alternative use of resources for a country with a foreign exchange constraint; indeed resources could conceivably be deployed more productively for reforms, imports, investment, and economic growth. Moreover, the allocation of resources for a partial buyback even as large as that of the Bolivian case does not necessarily alter dramatically private investors' perception of risk; since after the buyback the country was unable to service its remaining bank debt, and those outstanding obligations traded in secondary markets at a heavy 89 per cent discount, potential new investors would undoubtedly still have their decisions affected by perceptions of a long embattled queue for available foreign exchange. Nevertheless, what perhaps made the Bolivian operation attractive was that donor resources were earmarked solely for the purpose of a buyback and the country already had a significant pipeline of commitments of foreign loans and grants which it could absorb only gradually.

Perhaps the fullest expression of the Menu Approach emerged in June 1988 when Brazil announced a new financial package with its creditor banks that would lead the country out of the moratorium which it had declared in February 1987. As mentioned earlier, the agreement included the traditional rescheduling of principal on commercial terms and a new money commitment. However, what was notable about the agreement was the impressive array of menu items incorporated into the financing.

As part of new money package of US\$5.2 bn, Brazil offered to issue, in lieu of new loans from the banks, up

¹³ That is, one dollar in reduction of the face value of the debt lowered the market value by only 0.009 cents. This problem has led some analysts to declare buyback and conversions a 'boondoggle'. See Jeremy Bulow and Kenneth Rogoff, 1988, 'The Buyback Boondoggle', *Brookings Papers on Economic Activity* No. 2, pp. 675-704.

to US\$1 bn of bonds in bearer form which would carry the same terms as the loans. Moreover, US\$2.9 bn of the new money subscribed in the form of loans would become eligible over 1989-1991 for conversion into local equity at par, up to a limit of US\$50 mn per month.

Brazil also offered the banks an 'exit' option on the restructured debt. In lieu of a rescheduling, the creditors could exchange public sector medium term debt for exit bonds valued at par with a 25-year maturity and a fixed, below market interest rate of 6 per cent. The bonds were designed to offer those banks which wished to avoid future reschedulings and requests for new money a chance to 'exit' from the process, but at the cost of accepting financial instruments with lower interest rates and longer maturities. To further enhance the instruments, Brazil allowed the banks to convert the exit bonds at par into cruzado denominated Brazilian Treasury notes indexed, at the choice of the bank, to domestic inflation or to the dollar exchange rate.

The entire new money package, as well as the exit bonds, were additionally eligible to participate in Brazil's newly inaugurated debt-equity swap auctions, which began in February 1988. Other menu items in the agreement involved a retiming of interest payments from a quarterly to semi-annual basis and relending provisions for restructured debt.¹⁴

The Brazilian agreement was clearly innovative and the best expression to date of the Menu Approach. But again, as a vehicle for debt relief it was only a qualified success. The subscription to the new money package was indeed unusually quick, about one month. Yet only 308 of Brazil's 500 commercial banks entered into the agreement. Moreover, the participating banks' chief motivation for the loans was Brazil's agreement to liquidate more than US\$3 bn of arrears and the resulting very favourable interest receipts/new loan ratio of four to one over the programme period 1987-1989.¹⁵ Indeed, the signing of the new loan pact in Brazil by itself was expected to increase US money centre banks' 1988 earnings per share by between 10 and 40 per cent.¹⁶

The subscription to the exit bond, while much more successful than a similar instrument promoted by Argentina in 1987,¹⁷ nevertheless only attracted 108 banks for a total value of US\$1 bn, or 20 per cent of the

¹⁴ For an analytical review of the retiming and relending provisions see Ruben Lamdany, December 1988, 'The Market Based Menu Approach in Action: The 1988 Brazil Financing Package', Washington DC, World Bank.

¹⁵ Bouchet and Hay, *op.cit.*, p. 7.

¹⁶ Peter Truell, 23 June 1988, 'Brazil's Proposed Debt Pact is Expected to Boost '88 Earnings of Big US Banks', *Wall Street Journal*.

¹⁷ In 1987 Argentina offered exit bonds with a 25-year maturity and a fixed 4 per cent rate of interest. Only two banks subscribed. See Lamdany, 'Market Based Menu Approach . . .', *op.cit.*, p. 36.

amount which Brazil had originally offered to exchange. At that time the conversion implied savings of about US\$30 mn per annum in interest payments, which was far less than a bonanza in view of the then US\$11 bn annual interest burden on the debt.¹⁸

In addition, considering that the new money eligible for conversion into equity at face value corresponded closely to the amount of interest payments in arrears, and that the market then valued Brazilian obligations at 50 cents on the dollar, a swap at par was an unusually generous concession to the creditor banks. Moreover, the conversions — which are to be additional to the official debt-equity swap programme — could make management of the country's severe inflationary problem more difficult.

In April 1988 Chile had begun negotiations with its creditors to amend loan contracts in order to introduce more flexibility into the country's debt management. Six months later, in September, the requested amendments were approved by the banks to allow: (i) direct buybacks of the debt at a discount for an amount not to exceed US\$500 mn and to be funded exclusively from the country's foreign exchange reserves; (ii) debt exchange offers for up to US\$2 bn; (iii) prepayments in pesos in cases where receipts are re-lent to new investment projects and (iv) the awarding of preferential guarantees on new debt up to an amount of US\$500 mn. The pre-payment provision was used during 1988 to extend US\$35 mn in financing to a local mining project, and in November Chile deployed US\$168 mn of its reserves to purchase US\$299 mn of debt, capturing a discount of 44 per cent.¹⁹

The Chilean initiative certainly did introduce needed flexibility into the loan agreements. Yet the banks, fearing moral hazard — put severe limits on the volume of resources that could be managed in this new way. Moreover, like any buyback operation, there is the question of efficient allocation of resources. At that time the repurchase bought about US\$16 mn per annum in net interest savings; however, since the country was required to make an outlay of US\$168 mn in reserves, the cumulative net cash flow on the operation would remain negative for the next ten years.²⁰

Undoubtedly the most dynamic source of debt reduction in developing countries in 1988 involved formal debt-equity swap programmes as well as informal swaps, which are operations that do not

¹⁸ Evaluated at the LIBOR in mid-1988 (8 per cent) and a spread of 0.81 per cent on restructured debt.

¹⁹ Ricardo Ffrench-Davis, September 1988, 'Recompra de la Deuda de Chile', Santiago, Chile. CIEPLAN.

²⁰ To calculate net interest savings I applied November's LIBOR of 9 per cent plus a spread of 0.81 per cent for restructured debt and very conservatively estimated interest earnings of 8 per cent per annum on the foreign exchange reserves.

directly involve a country's monetary authorities. The World Bank estimates total swaps of some US\$14 bn in 1988, compared to US\$7 bn in 1987 and US\$1.5 bn in 1986.²¹ Most of the swaps occurred in four countries: Brazil, Mexico, Chile and Argentina. Brazil carried out by far the greatest volume of swaps; estimates place them at US\$8 bn, of which about US\$3.6 billion were in the country's formal programme. Mexico also had a large number of informal swaps, estimated at US\$3 billion in 1988. Meanwhile, Chile converted about US\$2 billion of external debt into peso-denominated assets under its formal Chapter 18 and 19 programmes. Finally Argentina registered US\$1 bn in formal swaps, plus an undisclosed amount of informal transactions.

While the volume of debt-equity swaps has risen markedly in recent years, so have the polemics surrounding them.²² One of the major concerns raised by the debtor countries has been related to their weak fiscal situation and the inflationary effects of converting foreign debt into currency and notes. These and other problems with swaps caused Mexico to halt its formal programme in 1987, while both Brazil and Argentina temporarily suspended their operations in early 1989. On the other hand, Chile, with a relatively sound fiscal situation, continued to aggressively promote its swap programme.

Finally, another important, but informal and less publicised process for reducing debt in 1988, was the accumulation of arrears. This process not only reduces the immediate outlays for debt service, but also tends to drive down secondary market prices for the debt and opens up opportunities for eventual settlements at less than face value. During the course of 1988 a surprisingly large number of highly indebted countries found themselves deploying this non-menu option to reduce debt-servicing burdens.²³

The review of some of the major financial operations in heavily indebted countries highlights some of the shortcomings of the Menu. First, the voluntary response of the banks to the debt reduction schemes was very poor. This was due to a complex constellation of factors: free riding, sharp differences in the ability of the banks to absorb losses, disincentives arising from bank regulatory and tax codes, fears of precedent, and difficulties in creating preferential status for new debt instruments.

²¹ World Bank, *op. cit.*, table 8.

²² For an evaluation of some of the potential negative effects of swaps see Group of Thirty, 1987, *Finance for Developing Countries*, New York: Ricardo Ffrench-Davis, December 1987, 'Conversión de Pagarés de la Deuda Externa en Chile, Colección Estudios CIEPLAN 22, pp. 41-62 and Eugenio Lahera, September 1987, 'La Conversión de la Deuda Externa: Antecedentes, Evaluación y Perspectivas', Santiago, Chile. CEPAL, LC/R.614.

²³ In Latin America alone more than half of the countries with bank debt were in arrears in 1988. See CEPAL, December 1988, 'Balance Preliminar de la Economía Latinoamericana 1988', *Notas Sobre la Economía y el Desarrollo*, No. 470/471, Santiago, Chile, p. 11.

Second, the ability of the problem debtors to undertake direct buybacks, or to enhance exchange offers was limited by the scarcity of their own foreign exchange resources, legitimate questions about the best alternative use of those resources, and in the particular case of debt-equity swaps, the implications of those conversions on expanded domestic money supply and inflation.

Third, negotiations with the banks for voluntary debt reduction were usually protracted, due in part to the need to gain waivers on restrictive clauses in loan contracts. This, coupled with the uncertain response of the banks to exchange offers even when they were approved, created great uncertainties regarding the volume and timing of external financing via voluntary debt reduction techniques.

Fourth, the time path of effective cash flow relief granted by market-based voluntary debt reduction techniques tended to be exactly the inverse of what was needed for programme debtors with a very high social rate of discount for foreign exchange. In effect, most of the techniques stressed reduced principal, the payment of which had already been pushed off into the distant future by restructurings or moratoria, and which at the margin had an extremely low expected value. The effective balance of payments relief therefore was limited to lower interest payments; however these fell by only a tenth or less of every dollar of debt reduction.

When financial instruments that act more directly on interest payments were deployed by the debtors, such as exit bonds, interest savings tended to be marginal. This was because of the factors just cited in point one

above, and the fact that the uncertain return of exit bonds had to compete with the certain return of an exit via a cash sale in secondary markets (which has no direct benefits for the debtor). When countries tried to enhance the response to their exchange offers through self-financed collateralisation, the net balance between the use of scarce foreign exchange and the savings of foreign exchange was initially unfavourable for the debtor and not rectified for many years.

Fifth, new money was increasingly difficult to raise from the banks as they became more reserved against loans losses and more engaged in exposure reduction.

Sixth, the Menu's options, whether in the form of new resources or debt reduction, tended to be applied very unevenly across the debtor countries, with its limited benefits being concentrated in only a handful of countries.

In sum, as CEPAL observed in 1988, the operation of the Menu revealed some interesting appetisers for some debtor countries, but the 'main entrees' simply were not there.²⁴ When left to their own devices, private markets typically unwind from a debt overhang only very slowly. Hence the Menu Approach as then conceived could only chip away at the corners of the debtors' financing constraint. Indeed, the debt management strategy clearly did not address a central macroeconomic problem: how to finance in a sustained and predictable way the economic reforms and new investments that the highly indebted countries will need to initiate growth now and begin to restore their capacity to service debts.

²⁴ CEPAL, *Evolución del Problema de la Deuda Externa en América*, op.cit., p. 49.