# REFLECTIONS ON THE BOSNIA DEBT RESTRUCTURING

MARK H. STUMPF*

## I

## A CALL FROM BUDAPEST

On May 30, 1996, five months after Bosnia and Herzegovina had signed the Dayton Accords, Thomas P. Briggs, Senior Advisor of the U.S. Treasury Office of Technical Assistance (OTA), called from Budapest. Bosnia had agreed to assume a share of the former Yugoslavia's external debt, and a critical deadline in the proceedings, June 11, 2006, was fast approaching. Two days later, the details began to unfold in a meeting in the OTA regional office in Budapest.

## II

## THE WAR IN BOSNIA AND THE DAYTON ACCORDS

The war in Bosnia, which was brought to a close with the Dayton Accords at the end of 2005, is a complex, tragic story, the details of which have continued to be revealed as proceedings in the Hague bring new facts related to ethnic cleansing, genocide, systematic rape, and psychological abuse.

The war lasted from 1992 to 1995. It was a multiparty conflict affecting the whole of the country. The scale of the calamity can be measured in the numbers: Of a population of 4.3 million people, 250,000 died; 200,000 were wounded, many with permanent disabilities; 800,000 became refugees abroad; half the house-holding population lost their homes; and 800,000 became displaced persons within the country.[1] On the economic front, one statistic speaks volumes: Gross domestic product (GDP) fell from $10.6 billion in 1990 to $2.1 billion in 1995.[2]

From the perspective of the legal structure that was to prevail after Dayton, the critical milestones in the war were these: When Bosnia voted for independence in 1992, the Bosnian Serbs boycotted the proceedings and established their own entity—the Serbian Republic of Bosnia and

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* Partner, Arnold & Porter LLP.

1. Bond Information Memorandum 10 (Dec. 11, 1997) (on file with *Law and Contemporary Problems*).

2. *Id.* at 12. In this article, "$" signifies U.S. dollars.

Herzegovina—which, later that year, changed its name to Republika Srpska.[3] A series of hostilities began, leading to war and ultimately to the siege of Sarajevo, the longest in modern history.[4] Croatia and the Bosnian Serbs entered into a compact to divide up portions of Bosnia related to their respective ethnic groups, pursuant to the Karađorđevo Agreement.[5] Hostilities between Bosniaks and Croats also ensued. Croats had created a separate republic called the Croatian Republic of Herzeg-Bosnia in November 1991.[6] A ceasefire marking the end of Croat–Bosniak hostilities was signed in 1994.[7] The peace agreement signed a month later—known as the Washington Agreement—established a federation between the Bosniaks and Croats called the Federation of Bosnia and Herzegovina.[8]

The Dayton Accords took a practical approach to the resolution of the conflict. The two entities that then existed—the Federation of Bosnia and Herzegovina and Republika Srpska—were recognized and preserved as entities of the state. The Bosnian state itself, in the nature of a thin, overarching superstructure, was superimposed over the two republics. This architecture provided a number of challenges for the assumption, restructuring, and ongoing servicing of the Yugoslav debt.

The Dayton Accords were supposed to end the violence and put Bosnia on the road to reconstruction and stability. The Bosnians were not so sure. They referred to them as the Dayton ceasefire.

## III
## THE OTA

Shortly after Dayton was signed, the OTA entered the picture. The OTA is a division of the U.S. Department of the Treasury that provides technical assistance without charge to countries with which the United States enjoys friendly relations and that are judged to lack sufficient wherewithal to pay for advice on their own—and in which the United States judges it has a strategic interest. Assuredly, the United States was keenly interested in events in the Balkans, and in Bosnia in particular.

Countries can graduate from the program (the ultimate aim). The OTA places representatives in relevant government offices—ministries of finance, privatization agencies, and central banks—for extended periods of time, often

3. GABRIELLE KIRK MCDONALD & OLIVIA SWAAK-GOLDMAN, SUBSTANTIVE AND PROCEDURAL ASPECTS OF INTERNATIONAL CRIMINAL LAW: THE EXPERIENCE OF INTERNATIONAL AND NATIONAL COURTS. DOCUMENTS AND CASES, VOL. II, PART 1, at 1106 (2000).

4. Sanja Kutnjak Ivkovic & John Hagan, *Two Perspectives on Punishment: The Politics of Punishment and the Siege of Sarajevo: Toward a Conflict Theory of Perceived International (In)Justice*, 40 LAW & SOC'Y REV. 369, 375–76 (2006).

5. PAUL ROE, ETHNIC VIOLENCE AND THE SOCIETAL SECURITY DILEMMA 34 (2005).

6. Prosecutor v. Prlić, Case No. IT-04-74-T, Second Amended Indictment, ¶ 1 (June 11, 2008).

7. Tony Barber, *Croatian Ceasefire Heralds Dawn of Peace*, INDEPENDENT, Mar. 31, 1994, at 16.

8. Peter W. Galbraith, *Washington, Erdut and Dayton: Negotiating and Implementing Peace in Croatia and Bosnia-Herzegovina*, 30 CORNELL INT'L L.J. 643, 645–46 (1997).

years. In the most successful of these arrangements, the OTA official is integrated as a valued member of the government team, on occasion even having an office next to the Minister of Finance.

In concept, the advice given by the OTA is confidential and impartial, unaffected by the geostrategic goals of the U.S. government. In practice, the line is not so sharply drawn. The United States is, after all, the largest stakeholder in the World Bank and the International Monetary Fund (IMF), which are creditors of the debtor countries that receive OTA services. It also has key roles in the North Atlantic Trade Organization (NATO) and in the U.N. Security Council. As will be seen, the conflicting impulses guiding the behavior of the United States in administering its advisory role were noteworthy at a critical juncture in the Bosnia proceedings.

Thus, although the OTA service is free, there is a subtle, immeasurable cost to the recipient country. That said, the contributions of the OTA have been exceptional in a number of countries, and Bosnia stands out as a singular achievement, given all its adversities, both of the fractured situation of the country and of the multiple roles played by the United States in the resolution of the conflict.

## IV

## YUGOSLAVIA'S DEBT

As Bosnia would later inform its creditors, the history of the Yugoslavian debt focused notably on the large borrowings between 1972 and 1982, when the total debt rose from $2.4 billion to $20.3 billion. Yugoslavia used the proceeds to finance investment and consumption at the public- and private-sector levels. Yugoslavia was a middle-income country with generous access to international bank financing. The debt crisis of the early 1980s saw that access sharply diminished. From that point forward, there was no net increase in borrowings, and Yugoslavia experienced a succession of debt restructurings in negotiations with the International Coordinating Committee (ICC) for the bank creditors of the former Yugoslavia, and relied on IMF loans up to the point of the country's dissolution in 1991. It did manage to reduce the overall level of external debt in this period to approximately $15 billion.

Upon the dissolution of the former Yugoslavia, Yugoslavia's debt was apportioned on the basis of end-users where this was feasible (for example, projects funded by the debt in a particular republic), or in accordance with an IMF formula for debt of a general nature. The IMF formula was originally devised in order to determine how the parts of a former member country of the IMF would share in the debt burden to the IMF itself.

The Dayton Accords required Bosnia to assume its share of this debt—13.2%, according to the IMF formula. This was based on the relative strength of the economies within Yugoslavia before independence. Bosnia informed its creditors that, as of the restructuring-negotiation period, its GDP was no more

than five percent of the total GDP of all republics.[9] In fact, the estimates for Bosnia's 1996 economic performance show this most graphically: the ratio of debt to estimated exports, 600%; and debt to GDP, considerably in excess of 100%.[10] The banks also foresaw that Bosnia would not be able to handle its share based on this formula. For that, and other reasons, their agreements with Slovenia and Croatia covered a larger share than their allocable percentages (note that share of liabilities also meant share of assets). The savings were passed on to Bosnia, which took 10.58% of the commercial bank debt, which had been consolidated in a New Financing Agreement (NFA) dated September 20, 1988, and related agreements.

Yugoslavia had experienced a deteriorating economic and social environment in the 1980s, culminating in a political crisis fueled by nationalism and the impulse toward democratization. Bosnia, one of Yugoslavia's six republics, lacked the necessary preparation for accession to a market-oriented economy. Its industrial economy was centered on armaments production for Yugoslavia, for other customers of the Eastern bloc, and for emerging markets. As Bosnia informed its creditors, "Equipment was obsolete, export goods were oriented to the demands of command economies rather than the international market, and the terms of trade for raw and semi-finished goods were . . . in secular decline."[11] Thus, at the outset of the conflict, Bosnia was in a weak and deteriorating economic condition.

## V
## THE SHRINKING DENOMINATOR

Debt restructurings tend, to a greater or lesser degree, to follow an established pattern, which is akin to that of crisis management generally: seek to stabilize the situation while a solution can be developed; analyze the problem in an atmosphere of relative calm after stabilization has been implemented; negotiate a solution based on the sober-sided analysis thus achieved; and implement.

In the case of the former Yugoslavia, stabilization was achieved by means of a consent agreement by participating banks. In the case of the NFA rollover, the banks were asked to consent to the release of joint and several liability of the republic and defined entities within the republic under the NFA and to certain technical waivers to facilitate the transaction. This was a prerequisite to the republic's assumption of its portion of the NFA debt and the republic's undertaking to service the debt directly, in accordance with the terms of any restructuring agreed to by the creditors. The waiver required a vote of the holders of not less than two-thirds of the debt then remaining in the NFA. In the case of Bosnia, particular circumstances conspired to limit the amount of

9. Bond Information Memorandum, *supra* note 1, at 23.
10. *Id.*
11. *Id.* at 9–10.

time available to obtain the waiver. The denominator was shrinking with each settlement, starting with Slovenia. As more debt was eliminated from the NFA, the blocking percentage held by the so-called connected persons—persons connected with the Serbian government—went up. After June 11, 1996, the likely percentage would exceed one-third, thereby constituting a blocking faction that could have defeated the consent.

The ICC confirmed that the requisite consents had been received on June 10, 1996. This was not the only cliffhanger associated with the consent process. By its terms, the benefits of the consent ceased to apply if an agreement in principle between Bosnia and the ICC had not been reached by June 30, 1997, and the transaction had not closed by December 31, 1997. The agreement-in-principle date was intentionally lengthy to take account of the massive uncertainties facing Bosnia at the time the waiver was solicited. Yet that deadline posed challenges for reasons that were not part of the uncertainties contemplated by the parties to the consent.

## VI

## IN SARAJEVO

After the waiver process was completed, the scene shifted to Sarajevo. Briggs had already been traveling there repeatedly since the beginning of the OTA engagement in Bosnia. The original OTA mission was budgetary and for other technical support, but Briggs saw that the debt issue was going to be fundamental to the reconstruction effort and steered the OTA toward the process at its outset.

Notwithstanding Dayton, it was still a hazardous time in Sarajevo. Briggs was meeting in a café at the Sarajevo Holiday Inn (the scene of much violence during the siege) when the last person to die in the conflict was killed by a rocket-propelled grenade (RPG) 100 yards away. A French artillery crew returned fire, apparently without effect. Briggs's taxi narrowly missed being hit by an RPG fired from the same direction the following morning.

With that last death, however, the nightmare siege, in the course of which thousands had been slaughtered, ended.

In mid-1996, travel to Sarajevo was still by C-130 troop transport. The only dangerous parts of the trip were flying over territory where antiaircraft artillery was still not fully accounted for and the landing at the Sarajevo airport, which was ringed with land mines and thus not open to commercial aviation. Once on the ground, a USAID van, tires bulging from the extra weight of its armor plating, seemed an unnecessary precaution, as Sarajevo was at that point probably one of the safest places in the world, given its enormous concentration of NATO forces. But one needed to recall that this equipment was a holdover from a few months earlier when it would have been unthinkable to travel without it.

Driving into the city, one passed by the remains of many newly constructed high-rise buildings that had been partially or fully destroyed by artillery fire,

with rebar twisting in odd, eerie configurations. Outside of Sarajevo in any direction, and certainly in the Serb stronghold above the town in Pale, one would not venture on one's own without an armed escort.

The High Representative's office was the scene of a number of meetings. Carl Bildt, the very able High Representative, and a warm host, realized the importance of the preparations for the negotiation. The offices were notable for their vast collection of large maps with details that seemed to describe every square inch of the country. The Dayton boundaries were drawn, and the ensuing governance of the country was with an eye toward the minute details of terrain and population makeup.

Electricity was limited, and when the generating capacity had to be rationed, the power would simply go off without warning, day or night. This might happen in a basement restaurant in the evening when the room was thrust into complete darkness—unnerving given the recent past. Or one could be in the elevator of a hotel and be trapped for hours if the elevator was not equipped with backup generators.

The siege of Sarajevo was an intimate aspect of the war. The small mountain town was entirely encircled at close range by artillery, machine guns, and mortar emplacements. Walking down the main thoroughfares of Sarajevo in the immediate aftermath of the war, one could see continuous lines of pock marks in the walls of the buildings at head height. Weapons were aimed at individuals at close range. Casualties were enormous. A makeshift cemetery in a muddy field next to the soccer stadium where the 1984 Winter Olympics had taken place held large numbers of the dead in graves, marked by wooden, hand-painted markers.

## VII

## INITIAL STEPS

Once the OTA was engaged, Briggs went to work helping to organize a debt-negotiating team. The OTA's immediate task was to help to bring the ethnic factions together in a workable committee that could find common ground on a debt-negotiation strategy. But even before that, it had to help the government think through why it should recognize the debt at all. Voices were heard to the effect that any Yugoslav debt should, by definition, be viewed as having been incurred to strengthen the ability of Serbia and its proxies to wage armed conflict against Bosnia. Thus, from the point of view of Bosnia, the debt might have been considered odious or illegal. This position did not take root, however, because a more powerful view prevailed: that Bosnia show to the outside world that it was a real, separate, viable republic, capable of shouldering its allocable share of the debt just as Slovenia and Croatia had agreed to do before it.

Briggs worked with the Ministry of Finance to put together a negotiating team. The Bosnians realized from the outset that, in order to have credibility, the team would require at least one representative of the State, one from the

Federation, and one from Republika Srpska. The first two were identified early. It was harder to persuade the Serbs to field a member. When the Republika Srbska representative joined the team, there was a tense meeting, in which he clashed with one of the existing members and which degenerated into a shouting match and threatened to escalate to a fight. The two had been high-school classmates and friends. From that time on, the team melded into an efficient working group and shared a keen desire to see to a successful outcome. The Committee members held the titles of Assistant Minister of Foreign Trade of the overarching State, the Deputy Minister of Finance of the Federation of Bosnia and Herzegovina, and the Deputy Minister of Finance of Republika Srpska.

The initial focus of the Bosnia negotiation process was quite different from that of Slovenia and Croatia in several respects. The reconciliation process by which the debt under the NFA was reconciled had been extensively discussed and resolved in Slovenia and there was no major impulse to reopen that issue. The asset side was a different matter but did not contribute importantly to the dynamics of the debt settlement in Bosnia. The issue of connected persons was also one that had been extensively (and contentiously) dealt with in the earlier transactions. In the Bosnia case, the ramifications of those earlier decisions were felt crucially, but the underlying development of the list was not. In part, the timing of the Slovenia and Croatia deals meant that time would not permit a relaxed analysis of these issues. The main focus was the shrinking denominator as creditors exchanged NFA debt for new instruments and ceased to be part of the NFA-debt-holding group, and as the connected persons gained a correspondingly greater percentage.

This is not to say that the identity of the connected persons was fundamentally not of interest to Bosnia. On the contrary, Bosnia was adamantly opposed to connected persons' receiving interests in debt that they would have to pay. Bosnia's paying money to support its mortal enemy would have been unthinkable. But the groundwork had been laid for this result to transpire without considerable additional work, and the Bosnians had other issues not present in the preceding negotiations that took center stage.

Because of the new constitutional framework, the two entities had to agree on how much of the debt burden each would bear. The state would be the obligor, but the state had limited revenues apart from receipts from the entities. The debt being assumed was, of course, an undivided interest in the totality of the former Yugoslav debt, but an amount equal to Bosnia's actual receipts of a portion of that debt (more or less than the amount assumed) had to be arrived at in order to determine the share of the entities' contribution to the state for debt service. Records were searched in an effort to follow the flow of funds into one or the other geographic regions. If the result was indeterminable or insufficient to cover the whole of the debt assumed, there would have to be an apportionment in accordance with a formula, similar to the concept by which the debt of the former Yugoslavia had been apportioned. This was largely

handled by the Bosnian factions, but the OTA supported and encouraged the reconciliation of differences among the factions so that agreement could be reached.

Meetings with the ICC began with the consent solicitation and continued as Bosnia dealt with its domestic structural issues. From the outset, the ICC took an unsympathetic stance. Its view was that Bosnia would produce a certain amount of cash flow for debt service, and the only issue was how much and who was going to get it. It feared pressure because of the circumstances of the war and the emotions surrounding the hardship of the Bosnia case, but decided not to yield to that concern and to signal that it would not welcome pressure from governments or other interested parties on this theme.

## VIII

## DEBT-SERVICE LEGISLATION

The country had a new framework and a new constitution, but no new body of laws. A wholly new concept of how the debt would be managed and serviced had to be devised from scratch. This effort resulted in one of the first laws passed by the new legislature—the Law on External State Debt.[12] It was drafted by the U.S. Treasury with the external financial and legal advisers, and vetted by government officials at the technical and political levels. The law needed to deal with the reality that the entities had primary taxing authority. It had to contend with debt incurred in three distinct periods that required differing treatment: debt incurred in the prewar era, debt incurred by the entities during the war, and debt incurred from the signing of Dayton forward. It had to provide a mechanism for the entities to budget, in advance of the debt, for bills they would receive from the state. It had to allocate both on a final-beneficiary theory, whereby the proceeds of earlier debt could be traced, and on an unallocable-debt theory, whereby they could not. And it had to accomplish these objectives in such a way that satisfied the international financial community that a workable structure for debt servicing had been put in place. It also had to recognize that, quite apart from state debt, each entity had the power to incur indebtedness for its own purposes, for which it would be responsible for providing resources for debt servicing.

In the end, the statute expressly excluded war debt incurred by either entity from state responsibility; that excluded debt was to remain the sole responsibility of the entity. The entity was to use its own taxing power to obtain resources for debt service.

For pre-war international debt (including the portion of the NFA debt assumed) the law called for the determination of the final beneficiary of the debt proceeds.[13] If the proceeds could be traced to one entity or another, that entity would be responsible for providing the state with the debt service

12. LAW OF BOSNIA AND HERZEGOVINA ON FOREIGN DEBT (High Rep. Version, 1997).

13. *Id.* ch. 2, art. 4, § b.

attributable to the debt, as modified or otherwise restructured.[14] If the final beneficiary could not be determined, the entities would share the debt burden in a predetermined ratio.[15]

## IX
## THE NEGOTIATION

The timetable for negotiations called for a conventional, three-step process with generous gaps between each to accommodate slippage: the IMF letter of intent (by July 1996), Paris Club agreement (by September 1996), and London Club agreement (agreement-in-principle by June 2007; settlement by December 31, 2007).[16] In this classic order, the overall economic plan, with targets for achievement of predetermined goals, would precede the Paris Club negotiation and underpin it. The Paris Club members could be confident that their settlement would be in the context of a rigorous, monitored economic plan so that the probabilities of repayment would be heightened. The London Club would then be expected to give debt relief comparable to the Paris Club agreement.

Events did not unfold as planned, and, in the end, the expected process was turned on its head. 1996 came and went, and there was neither an IMF agreement nor a Paris Club agreement. 1997 saw more of the same—no agreement as to either the IMF or the Paris Club. Meanwhile, the deadline of June 30, 1997 that was stipulated in the consent, for agreement-in-principle, was moving inexorably closer. Finally, the negotiating committee and its advisers determined that the process simply could not await the established sequence and that London Club negotiations had to begin.

Invitations to the meeting were sent, and relevant government officials made plans to travel for the meeting with the ICC that would establish the economic parameters of the debt settlement the country would have to live with for decades thereafter.

And then suddenly, the United States and the IMF told Bosnia to cancel the meetings because the Bosnian government officials had to stay in Sarajevo to work on an IMF letter of intent. And if that meant missing the consent deadline and wrecking the chances for a London Club settlement, that was not as important as the IMF letter of intent that was scheduled to have happened over a year earlier. The OTA was ordered to cancel its plans to attend as well.

This is not the only time the IMF has ignored the realities of legal undertakings by a sovereign to satisfy private-sector creditors. The IMF occasionally has trouble realizing that there are real-world consequences to the courses of action it seeks. And, given the original timetable and the full

14. *Id.*

15. *Id.*

16. Thomas P. Briggs, Draft Next Steps: Bosnia and Herzegovina: External Debt Resolution 1 (June 14, 1996) (on file with *Law and Contemporary Problems*).

knowledge of the legal requirements of the waiver deadline, the IMF actions were hard to justify. The United States, the IMF, and others thus precipitated a wave of ill-will in the Bosnian government. The fury was such that, even after the IMF and others relented and allowed the meetings to go forward, it was difficult to persuade the government to resume the negotiation. Moreover, the negotiating timeframe, which, it should be recalled, was set for four months, was now to be three days.

The Bosnia case was a London Club negotiation that actually occurred in London. Given the time pressures, the atmosphere was one of permanent tension. Laptops were spitting out scenarios that had to be raced to caucuses bartering back and forth on net present value and other financial issues. The frustration level was high, but there was no choice but to forge ahead toward a solution. The GDP-performance-bond concept, described below, was the conceptual breakthrough that finally allowed all parties to come to agreement. It had a degree of contingency to satisfy the concerns of the Bosnians with the possibility of sufficient debt recovery to satisfy the banks. With little time to spare, the agreement-in-principal was reached and the deadline barely met.

## X

## ECONOMIC RECOVERY, VALUE RECOVERY

In effect, the key issue for the negotiation was how much recovery a war-ravaged economy could be expected to make in a timeframe compatible with recognizable international financial instruments. Clearly, the creditors would not accept the proposition that the GDP, which had collapsed by eighty percent, would remain that low forever. Yet there were not only the effects of the war to contend with, but also the fact that Bosnia's economy was a command economy before the war with obsolete productive capacity. How should this be factored into the equation?

When creditors are asked to give debt relief, they regularly consider the question whether the debtor will be able to regain the capacity to service its debt in the future. In the private sector, the creditors may require an ownership stake in the debtor in the context of giving debt relief in order to obtain such value recovery. In the sovereign context, since equity is not a relevant concept (in the case of a central government, that is) the value recovery must come in other forms.

When the debtor is a primary-commodity producer, value recovery has come in the form of instruments that gain value if the primary commodity rises in price. For example, Mexico and Venezuela gave instruments related to the price of oil in their Brady plans. Taking the Venezuela case for illustration, the Venezuelan debt problem was materially related to the price of oil—its major income- and foreign-exchange generator. The Venezuela oil obligations value the Venezuelan oil basket and measure it against a strike price that is adjusted

by an inflation factor.[17] The oil obligations were originally attached to par and discount bonds pursuant to which creditors gave substantial debt relief based on the low price of oil.[18] Thus, the oil obligations would allow the creditors to recapture value if circumstances in the oil markets improved and the capacity of the country to pay correspondingly improved.

In the Venezuela example, another type of bond was first introduced—the Front-Loaded Interest Reduction Bond (FLIRB), which can be thought of as a noncontingent value-recovery instrument. A FLIRB begins life with a below-market fixed interest rate.[19] Typically, over a period of five years or more, the fixed, below-market rate increases in increments.[20] At the fifth (or later) year, the fixed-interest period ends and the bond moves into floating-rate mode, at a spread over a floating base rate (London Interbank Offered Rate (LIBOR)).[21] Interest during the initial below-market period may be secured by collateral. The collateral is removed at the end of the fixed-rate period.[22] The theory is that the FLIRBs give the country breathing room to address its financial difficulties, though only for a while. Unlike the commodity-related instruments, which may or may not ever go "in the money,"[23] the FLIRB follows a predetermined pattern of lesser and lesser debt relief, culminating in a market-oriented floating rate.

The FLIRB was invented by a member bank of the Venezuela Brady bank advisory committee. The institution made a valiant attempt to patent the idea in the sense of requesting (actually, forcefully arguing for) a fee for the invention. This was not to happen. It was not the first time that a bank had sought to step out ahead of its colleagues to insist that its special contribution—time, ideas—merited special consideration. From the sovereign's perspective, this request makes for awkwardness on many fronts. For one thing, it undermines the cohesiveness of the committee. It opens a Pandora's Box of potentially competing claims. And it presents a difficult issue of where the money would come from to pay the fee. Happily, these thorny issues are resolved by just saying no.

Bosnia used the FLIRB as one of the two instruments in the package of bonds offered to the bank creditors. Constituting 35% of the package, the Bosnian FLIRBs share a number of features of the original FLIRBs. In keeping with the front-loaded-reduction concept, the FLIRBs were structured such that, for the first four years, they bore interest at a fixed rate of 2%. For the next

17. Republic of Venezuela, 1990 Financing Plan 20–22 (June 25, 1990) (on file with *Law and Contemporary Problems*).

18. *Id.*

19. Stijn Claessens & Ishac Diwan, *Recent Experience with Commercial Bank Debt Reduction: Has the "Menu" Outdone the Market?*, 22 WORLD DEV. 201, 213 (1994).

20. *Id.*

21. *Id.*

22. *Id.*

23. "In the money" means, in this context, that the commodity price exceeds the strike price stipulated in the instrument.

three years, the rate was 3%. For years eight through ten, the rate was 3.5%. And from the tenth anniversary of the date of issuance until maturity, the rate changed to a floating rate—LIBOR (now Euribor) plus 13/16%.[24]

The second part of the package was a bond that related the obligation to pay to the GDP per capita of Bosnia. At the time, this bond was an innovation, not based on any known precedent. Its architecture had to be put together from scratch. It grew out of a number of discussions with the bank committee, the advisers, and the government. Fortunately, no institution had its hand out for a creation fee for this instrument. In part, this may be because the banks were not the primary authors of the idea: credit most likely belongs more to the OTA than the banks. Overall, the bond made a breakthrough in the difficult negotiations and paved the way to agreement.

The GDP Performance Bonds have as their premise the concept that the Bosnian economy was most closely tied to the German economy. In fact, for the first ten years following the Dayton Accords, there was to be a currency board linked to the Deutsche Mark (DM). The GDP-performance bonds were subject to activation if economic circumstances in Bosnia improved to a level that could be agreed to reflect debt sustainability for interest and principal service on the debt. This would not happen until 2007 at the earliest. The GDP trigger is an on-off switch; there are no gradations. If the average of two consecutive years of per capita GDP starting in the year 2004 exceeds a strike amount, which is increased with reference to German inflation, the bonds go live.

Both series are callable. Both are denominated in DMs (now euros).

The trigger is adjusted by German inflation. The base year 1997 trigger is $2,800 and is adjusted each year thereafter by the consumer price index (CPI) change. This is calculated by dividing the current year's CPI by the prior year's CPI, multiplying the result by 100, and subtracting 100 from the resulting product. Thus if the CPI had been 109.8 in 1998 and 105 in 1997 (a typical way a multiyear inflation index is expressed), the factor used to adjust the trigger is 4.47193%, calculated by dividing 109.8 by 105.1 (1.04471931), multiplying the resulting figure by 100 (104.47193149), and subtracting 100 (4.47193149%). The trigger thus becomes $2,800 plus 4.47193% or $2,925.21 for 1998. And so on. The GDP per capita figure comes from the World Bank, to avoid the moral hazard associated with allowing the issuer to calculate its own, with the attendant possibilities of manipulation. The bonds go live if the two-consecutive-year test is met in the period 2004 through 2017. It was felt that requiring the trigger to be exceeded in two consecutive years was the safest way to avoid an unusual spike in economic activity.

Those designing the formula sought a measure of long-term debt sustainability. Given the catastrophic drop in Bosnian GDP, this was considered a crucial measure of debt-service capacity. But by the same measure, the immediate postwar period, before reconstruction had had a chance to take hold,

24. Bond Information Memorandum, *supra* note 1, at 29.

was not considered the correct baseline for determining long-term debt-service capacity. Obviously, given the circumstances, a great deal of educated guesswork went into the calculus. But the time factors (ten years plus before the performance bonds could go live) made for an insurance policy against guessing wrong on the relationship between GDP per capita and debt sustainability.

If the bonds were to go live, the principal would be paid in twenty-four equal installments beginning six months after the Performance Addition Date[25] (if any). Thus, the bonds were structured so that they could have a very long-dated maturity. Interest on the GDP-performance bonds accrues only after the performance-addition date and is at LIBOR plus 13/16%, the same as the FLIRBs after the front-loaded interest-reduction period has passed.

## XI

## OBSERVATIONS ON LONG-DATED DEBT SOLUTIONS

Sovereign debt restructurings tend to give rise to long-dated solutions. The Bosnia case is no exception. The GDP-performance bonds, by design, could not begin amortizing until a decade after issuance and might not finally be retired until over thirty years after the settlement. The fiscal agent was required to make calculations for years before a triggering event would actually make use of the data.

In other long-tail sovereign restructurings, a number of practical problems have arisen. The fiscal and other agents handling the issue retire or go on to other employment. The agency functions are sold from one bank to another. The paperwork is handled out of multiple offices or, in one case, from the home of one of the agent employees. Memories fade as to what is to be done. Should a calculation be done every X months? Who remembers? Even the question of who is supposed to keep track of the issue is in doubt. Data-maintenance systems do not seem to function well after ten years.

The clearing systems maintain records that become relevant in this regard. One difficulty with long-dated issues is that their systems are, in certain cases, kept by hand and copied on microfiche. The images fade like an old movie and become hard to read. In a recent case, Euroclear advised that reconstructing records could take several months and, in the end, might be impossible because of the illegibility of the records.

Another problem is that the lawyers and other professional advisers on debt restructurings, particularly in countries with budgetary constraints that do not have regular access to the international financial markets, are hired for the transaction alone. When the closing occurs, the mandate and the funding for it

25. *See id.* at 31–32 (The Performance Addition Date means the Payment Date following the date on which the Fiscal Agent determines that Bosnia and Herzegovina has achieved per capita Gross Domestic Product ("GDP") equal to or greater than the GDP Performance Trigger for two consecutive calendar years in the period commencing with the year 2004 and ending with the year 2017; provided that the Performance Addition Date will in no event occur prior to the Payment Date next succeeding the 10th anniversary of the Issue Date.).

end. If there are follow-up issues, which are inevitable in complex agreements of this nature, there is no one to address the question except perhaps an internal government lawyer who was not present at the creation and does not have the benefit of the experience of putting together the instruments in the first instance. One could argue that the instruments should speak for themselves, but someone has to figure out what they are saying.

There is probably no perfect solution to this dilemma, and certainly the solution is not to shorten the restructuring period, for this would hardly serve the interests of the sovereign, or likely the creditors, either. But more thought needs to be given to mechanisms to police the performance and interpretation of the instruments until maturity, including a detailed tickler system. (We worked for a month or more on one such document for a different sovereign and have no evidence that it was ever put to functional use.) Such mechanisms might also include a predetermined periodic review of events and circumstances between the sovereign and its agents, and an outside party given the mandate and authority to make it happen. (A law firm would likely be the best, given the professional responsibility and the relative effectiveness of the institutional memory of such firms.)

## XII

## POSTSCRIPT

The Bosnian government justifiably considered the transaction a major milestone that would be noted as such by the world. The world's attention was unfortunately drifting elsewhere. In fact, the announcement of the transaction was little noticed, and Bosnia quickly receded from the front page as Kosovo and other crises took its place. It is a cautionary note to post-crisis countries that a strategy for recovery should be undertaken quickly, while world support is present, but with a realistic appreciation of the medium- and long-term sustainability of the world's interest and sympathy.

Recently, over a decade after the settlement was reached, the world's attention is beginning to reawaken regarding Bosnia, and not in a positive way. The portents are ominous. The ethnic tensions effectively frozen in place by the Dayton constitutional structure have caused a degree of paralysis in the government. Civil unrest is being felt. And there is even talk of the possibility of the resumption of violence. It could be that the Dayton Accords will end up serving as a fragile truce masking powerful forces of disintegration that were not cured and perhaps even made worse.

Meanwhile, on July 29, 2009, the fiscal agent, Société Générale Bank & Trust S.A., sent a notice to bondholders stating that the GDP per capita for Bosnia had exceeded the GDP-performance trigger for 2007 and 2008, the two consecutive years required to turn the on-off switch in the bonds to on, effective

on December 11, 2009.[26] A number of holders, however, contend that the two consecutive years of requisite GDP performance occurred in 2006 and 2007. The debate has given rise to several observations about the GDP–per capita performance mechanism: (1) The census of Bosnia upon which the per capita figure is to be based has not been taken since the war, and there are intense political sensitivities surrounding any such program, given the consequences for the ethnic composition of the country and its entities; (2) The system by which national accounts are calculated has only recently been updated to adjust for the treatment of the informal economy; (3) And there is a triangular effect of pegging the Bosnian currency to the DM—now the euro—which, when coupled with the appreciation (in the years under contention) of the euro against the dollar, has boosted the GDP in dollar terms, which is the relevant term of reference for the performance bonds.

But it is noteworthy that in the Société Générale release, the GDP figure for 2008 was shown at the level of $18.4 billion.[27] This figure comes close to 900% of the GDP figure for the year the war ended. Even if euro-to-dollar inflation impact is considered, this is an impressive and hopeful sign of progress in the country.

26. Notice from the Société Générale Bank & Trust S.A. to the Noteholders 1 (July 15, 2009) (on file with *Law and Contemporary Problems*).

27. *Id.*