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Latin American Debt in the 1990s:  
A New Scenario for Creditors and Debtors

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When the elephants dance, warns the old adage, the dandelions should watch out. Private sector borrowers in countries that experience a foreign exchange liquidity shortage will strongly sympathize with the dandelions. A private sector entity, particularly one that has its own reliable source of foreign currency earnings, may be perfectly creditworthy when viewed in isolation. The company's predicament results entirely from its location in a country whose aggregate foreign exchange inflows are insufficient to pay for the country's necessary imports and external (that is, foreign currency-denominated) debt service. It is the common practice of governments when facing such difficulties to enact foreign exchange control regimes that require all (or most) of the foreign currency earned by public and private sector enterprises in the country to be sold up to the central bank in return for local currency. This centralized pool of foreign exchange is then doled

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out by the government for such purposes, and in such priorities, as the
government sees fit.

As a consequence, even the most solvent private sector company
may find itself irresistibly drawn into its government’s external debt
difficulties. But the fate of a private sector borrower that earns for-
eign exchange in these circumstances is much more preferable to one
that sells its goods or services domestically for local currency. The
former at least enjoys, by virtue of its foreign currency income, a natu-
ral hedge against currency devaluation. The latter can only watch
with concern as the government’s debt problems result in a currency
devaluation, a slowdown in the local economy and a tightening of
credit in the domestic capital markets. Even when it is permitted to
purchase foreign exchange for the purpose of servicing its external
obligations, a borrower in this position may find the cost of that for-
eign exchange (in devalued local currency) prohibitively high.

The rating agencies have long recognized that even the most
creditworthy private sector borrower cannot resist its government’s
call for a centralization of foreign exchange nor can it avoid being
swept up in its government’s debt problems. “Sovereign ceiling” is
the rating agencies’ shorthand expression for the proposition that no
private sector borrower in a developing country can achieve an exter-
nal debt rating higher than that of its own sovereign unless the trans-
action is structured so as to intercept an off-shore stream of foreign
currency revenue for the benefit of the debtholders, or other special
circumstances exist.1

Unlike the predominantly syndicated bank lending of the late
1970s (which was directed mostly to sovereigns and state owned or
guaranteed enterprises), private sector borrowers have been the prin-
cipal beneficiaries of private capital flows in this decade.2 Inevitably,
therefore, the external debt position of private sector borrowers will
be a centerpiece of concern should liquidity problems recur in one or
more of these countries. The possibility of private sector defaults can-
not be ignored. Both private sector borrowers and their creditors may
therefore be forced to confront issues such as how and where debt
renegotiations will take place, the pros and cons of a bankruptcy alter-
native to renegotiation, and the availability to the creditors — both at

1 Taylor, “Securitizations Can Overcome ‘Sovereign Ceiling’,” in Duff & Phelps Credit Rat-
ing Co., Perspectives on Emerging Markets, Jan. 1995, at 5; Apasco Outdoes The Sovereign,

the theoretical and at the practical levels — of legal remedies such as attachment of assets, set-off and litigation.

Oddly enough, private sector borrowers during the global debt crisis of the 1980s did not have much occasion to worry about these issues. In many of the countries undergoing a generalized external debt restructuring during the 1980s, formal programs were established pursuant to which the host government agreed to assume the outstanding indebtedness of private sector borrowers in return for payment of the local currency equivalent of the amount due to the central bank or other monetary authority. These programs often conveyed a measure of foreign exchange risk protection to the original private sector borrowers. Over time, these programs operated to transform most private sector debt into sovereign debt of the host country.

If liquidity problems again afflict one or more developing countries, the fate of private sector borrowers is not clear. Not only is the stock of private sector debt far larger today (both in nominal terms and as a percentage of overall credit exposure in most countries) than it was in 1982, the special circumstances that induced the governments of the debtor countries to assume or guarantee private sector debt in the 1980s may not be replicated in the future. In addition, the lenders of the 1990s (principally bondholders) will almost certainly respond differently to the financial problems of their LDC borrowers than did the lenders of the 1970s (principally commercial banks). They may, for example, show far less reluctance to pursue their legal remedies. The precarious position of private sector borrowers in the current environment was highlighted by the Mexican devaluation crisis of December 1994. Although the risk of widespread default by Mexican private sector borrowers was averted, this risk seemed disturbingly imminent to many observers.

The pressing nature of these concerns led Northwestern University School of Law to organize and host a colloquium in the spring of

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3 The Mexican program involved the establishment of a trust, Fideicomiso para la Cobertura de Riesgos Cambiarios (FICORCA). See El Koury, Mexico's Foreign Exchange Programme for Private Sector Companies, INT’L FIN. L. REV., July 1983 at 18. The principal author of the FICORCA program was a promising young economist by the name of Ernesto Zedillo; a man who was later to advance in life. The Philippine program was called Circular 1076. See Lee Buchheit, Details of the Philippine Debt Repayment Programme, INT’L FIN. L. REV., Dec. 1985, at 15.


5 Planning of the conference was the joint responsibility of Prof. Ralph Reisner, Dean David Van Zandt and William Elwin, Associate Dean. They were assisted by an Advisory Committee which included Lee Buchheit, Esq. of Cleary, Gottlieb, Steen & Hamilton; Ambassador
1995 which brought together noted legal and financial experts from throughout the hemisphere. The agenda for that conference is outlined in Appendix A. The articles appearing in this symposium are an outgrowth of the conference. For the most part, these articles focus on the unique issues arising from foreign currency debt exposure of the private sector.


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