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CONVERSION OF BULGARIAN BRADY BONDS: FIVE YEARS AFTER

In 2002 Bulgaria performed some operations with its government external debt. These operations were unique in its history in terms of their size. In spring, two types of global bonds were issued – for EUR 535.5 million and for USD 513 million. During the fall of the same year there followed another issue of global bonds for USD 759 million. Those global bonds were used to buy back and exchange the Brady bonds already in circulation. The managerial team acted trying to get a financial advantage of the operations carried out. Five years later one can draw up a complete balance of the outcomes. They are disastrous for Bulgaria. Not a single hypothesis of the managerial team has been confirmed. The projections were carried out unprofessionally and incompetently. On the other hand, however, the counterparts (investors) could not have lost. In the end, the country has paid about one billion EUR more to service its external debt.

JEL: H63; F34

The Bulgarian Brady Bonds

The Bulgarian economy encountered the 90s of the XXth century with an exceptionally hard indebtedness. At the end of the 80s of the XXth century the gross external debt (ED) of Bulgaria exceeded 160% of the GDP. A. Lukanov's government failed to find an acceptable settlement of the ED problem and in the early 1990s imposed unilaterally a complete moratorium on servicing the government ED.

Following this rash decision Bulgaria got into a four-year long period of painful negotiations with the London Club (LC) on restructuring its ED to more than 300 private lender-banks. Eventually they came to an agreement about the rescheduling of the Brady-type of indebtedness and in June 1994 the new ED obligations of Bulgaria came into force.

The agreed restructuring with the LC covered an ED of USD 8273 million. Four options were chosen:[1]

- A buyback of some of the ED at market prices;
- Bond issue to cover part of the ED with reduced interest payments;
- Bond issue to cover part of the ED with reduced principal but servicing it under market interest rates;
- Bond issue to cover all unserviced interest payments (with the exception of those connected with the ED buyback).

The buyback of ED at the amount of USD 1027 million at the market price of $25\frac{3}{16}$ cents/USD[2] was agreed on. The remaining part of the ED to be restructured

[1] *Houben, A*. Commercial Bank Debt Restructuring: The Experience of Bulgaria. IMF PPAA/95/6, April 1995; *Александров, Ст*. Българските брейди облигации (*Alexandrov, St.* Bulgarian Brady Bonds). - Банков преглед, БНБ, N 1, 1995.

[2] A number of information sources and specialist publications quote the buyback price at 25 cents.

was negotiated to be covered by newly issued long-term government securities (Brady bonds - BB).

For a principal of USD 1658 million, bonds with reduced interest payments were issued (FLIRB - *Front Loaded Interest Reduction Bonds*). This option did not envisage any reduction of the principal but the interest payments were fixed at a considerably lower level than the market one (for the first seven years), i.e. their servicing was made easier. The bonds had a collateral of one-year interest payments (in the form of UST bonds) but only for the first seven years. The collateral covered the one-year interest payments at a growing interest rate (of 2.6% to 3%).

FLIRB were issued in two tranches – **A** and **B**. Tranche **B** amounted to USD 196 million, covered 30% of the short-term ED and its yield was half a percent higher.

An ED of USD 3730 million was covered by long-term collateralised bonds with a discount (DISC – *Collateralised DISCount Bonds*). This option envisaged a 50% reduction in the principal by keeping the market interest rate.

The DISC issue was covered best – both the principal and the interest payments. The principal was collateralised by 30-year-long zero coupon UST bonds. Bulgaria bought this type of bonds at the amount of USD 222 million, which for 30 years and an annual interest rate of 7.35% grew to the starting price of the issue of USD 1865 million.

The DISCs were issued in two tranches too – **A** and **B**. Tranche **B** was for USD 165 million, covered 30% of the short-term ED and its yield was half a percent higher.

A particular feature of the DISC was the *Value Recovery Clause* (VRC). It envisaged an increase in the interests rates paid on DISC, given that the GDP level of 1993 was reached and/or exceeded by a quarter. Provided that the GDP went on growing, especially after it had hit 125% of the 1993 level, then the interests paid on the DISC rose by half a percent for every percent GDP growth.[3]

VRC made servicing the DISC more difficult in case of economic expansion. It provided a conditional form of indexing the bonds in accordance with the GDP growth (*GDP-indexed bond*). This type of indexing in international dealings is applied to alleviate interest payments under relatively poor economic performance of the issuing country (in this case given a GDP level below 125% of the 1993 one).[4]

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[3] Details in connection with VRC, are discussed in *Минасян, Г.* Външен дълг: Теория, практика, управление , второ издание *(Minassian, G.* External Debt: Theory, practice, management. 2nd edition). Sofia: СИЕЛА, 2007, т. 4.1.

[4] An example of indexing is a type of ED issued by Mexico, whose yield is pegged to the level of oil output and its revenues (*Hawkins, J., P. Turner.* Managing Foreign Debt and Liquidity Risks in Emerging Economies: An Overview. - In: Managing Foreign Debt and Liquidity Risks, BIS Policy Papers N 8, September 2000, p. 21).

Introducing such clauses is not a new thing for the international financial operations. Bulgaria, for instance, had such clauses in the past, too. There was a *safeguard clause* in the contract for the so called Refugee Loan given by the UN in 1926. This loan, as a matter of fact turned into a Stabilization loan for Bulgaria. In accordance with it, if the financial situation in Bulgaria got better or worse significantly, both sides had the right to revise the conditions of the agreement (120 години БНБ, 1879-1999. Под общата редакция на Р. Аврамов (120 Years BNB, 1879-1999, ed. R. Avramov). Sofia: БНБ, 1999, p. 120-121).

A special option in the agreements with the LC was meant to settle the servicing of calculated but unsettled interests - IAB (*Interest Arrears Bonds*). These covered the principal of USD 1858 million, which was compiled from accumulated and unpaid off interest for the period of the moratorium (under lower conditional interests since the month of September 1992 onwards). No collateral was to be provided for them.

The yearly interests on all bonds were floating and pegged to the six-month LIBOR for USD interbank deposits (with the exception of the first seven years for FLIRB). It was agreed with the LC that the minimum fixed risk premium would be at $\frac{13}{16}$ percent, which was rather symbolic and did not reflect the reality at that time. Two dates were set for the interest payments during the year - the15th of January and the 15th of July.

The agreements with the LC contained a *call option,*[5] which envisaged a probable future buyback of the BB. There were two possibilities:

First, a buyback of the face value at each date of interest payment. This option required the debtors to inform the LC about the government's intentions not earlier than a month and not later than two months of the date set for the operation and the buyback announced became irreversible. If a partial buyback was declared, then that had to be on a proportional basis (no privileged bondholding was allowed to happen).

This type of buyback was advantageous provided the bonds' quotations exceeded 100%. This was especially so for the DISCs, since there was a collateral released in this case and the latter joined the gross international reserves of the country. The higher quotations meant also an increased creditworthiness of the issuer and higher confidence of investors in the country (lower credit and political risk). Then the country was able to issue new bonds under more favourable conditions.

The buyback at face value was also beneficial when servicing the bonds was expected to become more expensive (increase in the interest rates) either because of a general rise in the global interest rates (expressed by a positive upward LIBOR growth), or because of activating the VRC for DISC's. In principle higher market rates than the par value were only possible if the yield fell, which implied real opportunities for the issuer to issue new ED instruments at more favourable parameters.

Second, a buyback at any time at market prices, but under the following conditions:

- The buyback should be at a public offer or operations on the open market;
- All bonds should have been regularly and successfully serviced meanwhile.

Reduction of the Brady Bonds Strategy

Bulgaria started a series of long-term operations on settling all Brady liabilities of the country in the fall of 2001.

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[5] *Call option* – a contract enabling the beneficiary to buy bonds at a given price within a given period. The option may or may not be exercised since there is no obligation for a deal under it. The option's holder might decide to avail themselves of a favourable development of the quotations (*Alexandrov, St.,* Op. cit., p. 2-3).

Formally, the need, motivation and advantage of carrying out such an operation were based on the following considerations:

1. Improving the international debt image of the country.

The BB had the print of external insolvency of the country and it was thought that this predetermined the restrained and negative investors' assessments of the country , i.e. the poor foreign investors' interest in it. The most prominent expression of the lack of confidence on behalf of investors were the low values of the country's credit rating, which did not reach acceptable levels because of keeping and sustaining large volumes of BB too. Moody's attributed the unenviable credit rating of **B**2 for bonds and long-term securities to Bulgaria at the end of 1997 and it took four years to have it raised by an interim step to **B**1).

2. Decrease in the nominal indebtedness.

Due to the lower market prices of the Bulgarian BB than their face value all operations for their buyback and conversion were connected with savings, i.e. with savings based on the nominal value of the Bulgarian ED. There was a parallel development of improved assessment criteria connected with the ED (the ratio of the gross ED and GDP, as well as others), which gave rise also to a more benevolent attitude of the international investors' circles towards the country and its current economic state.

Since the beginning of the XXIth century the government started repaying the principals of IAB (mid-2001) and of FLIRB (mid-2002). These payments increased the updated ED's value (the repayments were in the short and mid-term) and were viewed negatively given the current state of the economy. For the global bonds the principal repayment was a lump sum payment on the maturity date (in the long-term, in 10-12 years). This shifted the large repayments in time and decreased the updated value of the ED.

3. Reduction of the risks connected with the ED servicing.

The interests on the BB were floating (pegged to LIBOR), which contained the risk of making them more expensive to service (interest risk).The latter was further intensified by the VRC in force, too. It made difficult to predict future repayments and their planning in the government budget. The fixed interest rates provided predictability and made timely planning easier.

In view of the currency board arrangement (CBA) in the country, which national currency was pegged to the EUR and in view of minimising the currency risk, it was preferable and advantageous to reduce the non-EUR currency component in the ED. The BB were denominated in USD and reducing their share either through buyback and/or conversion for EUR-denominated global bonds (*debt-bond swap*) brought the currency risk to a minimum. The latter also contributed to the driving for a gradual liquidation of the BB.

4. Release of collateral.

Converting DISC released collateral which would build up into the *fiscal reserve* of the government.[6] The collateral released came along both from the principal and

[6] The government's fund called conditionally "*fiscal reserve*", was made up in accordance with the agreements with the IMF in 1997and in connection with the introduction of the CBA.The fiscal reserve was

the interest repayments and improved the characteristics of the ED (increased duration and reduced the updated value).

The advantages from converting the BB speak in favour of such operations on a global scale. For two years (2000-2002) the total volume of BB in the world declined by USD 31.2 billion (due to their due date including), and the debt instruments issued at the world financial markets from the same countries grew by USD 30.7 billion (Table 1). All BB withdrawn from circulation were replaced by other international debt instruments.

Table 1

Debt instruments in circulation (billion USD)

Country	Brady bonds		Other debt instruments issued at the international markets	
	2000	2002	2000	2002
Brazil	25.3	18.2	54.1	61.3
Mexico	16.1	5.6	58.0	54.2
Argentina	10.8	6.8	75.6	86.8
Venezuela	9.6	7.9	6.6	7.9
Bulgaria	5.0	2.6	0.1	1.7
Poland	4.5	2.8	1.8	5.5
Peru	3.7	2.5	0.3	1.3
Ivory Coast	2.3	2.3		
Nigeria	2.1	0.0		
Panama	1.7	1.5	2.6	4.5
The Philippines	1.4	1.2	14.0	19.3
Jordan	0.6	0.5	0.2	0.1
Vietnam	0.6	0.6		0.5
Costa Rica	0.5	0.4	0.5	0.5
The Dominican Republic	0.5	0.5	0.9	1.3
Uruguay	0.5	0.5	0.2	0.8
Total	*85.1*	*53.9*	*214.8*	*245.5*

Source. BIS-Basle.

The modern forms of borrowing new foreign indebtedness increasingly gravitate to the issue of bonds on the world capital markets (euro- and global bonds). So the CEE countries actively adjusted to the global experience (see Table 2). For two years (2000-2002) the bonds issued on the world capital markets from these countries grew by more than 2.5 times. Specialists are definite that this type of issuing ED will be predominant. Despite the risks Bulgaria could not stand clear of this trend due to which it was necessary (at least) to gain some experience.

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meant to accumulate financial resources, to be used to regularly service the government ED. The predominant part of the fiscal reserve (for example 90% and more) was kept at the BNB.

Table 2

Eurobonds issued by Central and East European countries
(million USD)

Country	2000	2001	2002
Bulgaria		223	1303
Croatia	490	670	575
Czech Rep.		233	350
Estonia	196		295
Hungary	196	853	
Latvia		178	
Lithuania	319	222	380
Poland	1316	1387	3149
Rumania	147	1161	665
Russia		777	3350
Slovakia	1114		146
Slovenia	392	494	
Ukraine			400
Total	*4169*	*6196*	*10 613*

Source. UN. Economic Survey of Europe, 2003, N 1, p. 92. The incomplete correspondence with the official IMF data for Bulgaria is due to the use of different information sources as well as to approximations (for example in connection with the transition from EUR to USD).

The experience mentioned justifies the consideration how to withdraw the BB in circulation (through buyback or conversion), but the concrete operations always and necessarily had to be accompanied by committed projections and accounts. Responsibility is always specific.

On the other side of the negotiations table – the investors – were not less interested in carrying out such a kind of ED operations and actively participating in them. The following considerations may be pointed out to this end:

First, the BB are not an attractive ED instrument for investors. The bonds are not easily traded due to the disparity between the minimal (symbolic) risk premium and the value of the government risk of the issuer. Possessing these bonds could be estimated as an ill-suited investment option.

Second, they are long-term, which reduces the updated value of the investments. DISC are 30-year long (with a maturity in 2024), FLIRBs are due in 2012, IAB – in 2011. The issues of convertible euro- and global bonds are for example due in ten years, moreover they are regularly traded and normally a preferred ED instrument. All in all, the conversion is desired and sought by investors from the point of view of the duration of investments.

Third, the yield (both the coupon one and on the due date) of the newly-issued euro- and global bonds could not be worse than of the BB. The starting point and fixing the coupon yield of the euro- and global bonds issue is obtained on a normal competition basis and on market principles. The BB holders in this process are some of the many investors who are trying to achieve an efficient use of their capital. The economic and financial condition of the issuer are decisive in forming the issue's parameters. At that time Bulgaria carried much higher risk factors, so it was normal for the real risk premium to be much higher than that of the BB.

The BB holders had nothing to lose. The risk for them (as far as it existed) was symbolic rather than real. It would have been a different story if the stable economic development of Bulgaria had predetermined considerably higher interest payments, provided the VRC was put in motion. However, by 2002 this moment was still in the indefinite future. And as experience showed the VRC was only to be activated in 2007.

Financial Risks

Such a type of large-scale debt operations are burdened with a number of risks for the issuer. The most important ones being:

1. A provoked increase in market quotations.

The preliminary increase in the market quotations of the BB means that the issuer has to pay a higher price for the buyback and/or the conversion. Letting the intentions known leads to increased quotations, i.e. the operation becomes more expensive. What is best is for such operations to be carried out unexpectedly in order to avoid a counter action on behalf of the market. However, such large-scale operations are hard to remain secret. In the Bulgarian case things got more complicated both due to the clauses in the contract and the preliminary exploratory pilot first issue of eurobonds (November 2001), whose purpose did not remain concealed.

2. An unfavourable change in the interest rates.

The unfavourable change in the interest rates for the issuer leads to higher current interest expenses for the newly-issued euro- and global bonds. With interest coupons of the newly issued bonds at about 8%, the operation of converting the BB could be lucrative provided the current interest expenses had LIBOR values (for the six-month USD-deposits) at around 5.5-6.0%. If, however, the world interest rates were kept for a long period of time at much lower levels, then the expenses for servicing the newly issued bonds would exceed these for the BB, i.e. a net financial loss is being registered.

3. Unexpected change in the forex.

Under a relatively strong USD (high values of the EUR/USD), converting the BB in EUR-denominated global bonds needs spending much more leva resources. The latter is related to the *timing*. If the USD happened to weaken after the operation was completed (lower values of the rate EUR/USD), this could make servicing the ED more expensive, as far as the ED denominated in USD would necessitate smaller amounts of leva resources for servicing it.

4. Strain in government finances.

The newly issued euro- and global bonds for a buyback and/or conversion for the BB envisaged a single payment on the due date (2007, 2013 and 2015), which implied setting huge amounts of foreign currency (EUR or USD) aside in these respective years. The normal and usual expectations are that in the future the country will manage to get stable enough so that it could meet these shock payments without a problem. The risk of financial strain still exists though.

The operation of converting the BB for euro- and global bonds and the conversion of the USD-denominated ED in EUR-denominated one had both its advantages and disadvantages (risks). As far as it concerned state-owned money in very great amounts and under the strict restrictions imposed by the CBA, all similar activities should have been assessed very carefully and executed most of all with a view to diminishing the risks for incurring losses.

The Issue of Euro- and Global Bonds[7]

The operation began with an issue (for the first time in Bulgaria) of EUR 250 million long-term *eurobonds*. The issue was meant to accumulate money for a buyback of BB (DISC, about a third of the BB) and the release of collateral. Thus, the second option for the issuer for a buyback was activated, as envisaged in the agreements with the LC.

The first Bulgarian issue of eurobonds looked like this:

Date of issue -	November 2001;
Due date -	1st March, 2007;
Interest coupon -	7.25%;
Principal repayment -	A single payment on the due date;
Market price by 31.12.2002 -	1070 (for 1000 face value).

The yield of the issue was 3.76% higher (the risk premium) than the yield of the analogous German bonds.

Over the following 2002 Bulgaria went on with its large-scale debt operations with the issue of new *globa*l bonds, the buyback and conversion of the available BB with global bonds. In the early 2002 (8th of March) the Ministry of Finance (MF) regulated officially its intention to buy back and convert BB for global bonds. There were two new issues of global bonds:

- An EUR-denominated issue with a maturity date in 2013 and upper ceiling of the annual interest (interest coupon) of 8%;
- A USD-denominated issue with a due date in 2015 and upper ceiling of the annual interest (interest coupon) of 8.5%.

On 21.03.2002 the yield on the bonds offered was set at:

1. For the EUR issue: The yield of the German bonds with a due date in January 2012 (5.237% at this moment) plus a risk premium of 2.75% (275 bpp);

2. For the USD issue: The yield of the UST bonds with a due date in 2015 (5.4% at this moment) plus a risk premium of 3.7% (370 bpp).

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[7] The information about the issues and the results of the operation are in accordance with the official government sources: *Exchange* of Brady with eurobonds. MF, Sofia, March 2002 (Internet); *Exchange* of Brady bonds with new global bonds (Outcome of the operation). MF, 28 March 2002 (Internet); *Exchange* of Brady bonds. MF, September 2002 (Internet).

Bulgaria started collecting the investors offers. Here are the results:
1. The EUR issue of global bonds:

Date of issue - 22nd March, 2002;
Due date - 15th January, 2013;
Interest coupon - 7.5% ;
Schedule of interest payments - 15th January;
Value of the issue - EUR 835.5 million;
Starting price - 96.617.

2. The USD-issue of global bonds:

Date of issue - 22nd March, 2002;
Due date - 15th January, 2015;
Interest coupon - 8.25% ;
Schedule of interest payments - 15th January and 15th July;
Value of the issue - USD 513.0 million;
Starting price - 93.681.

Buyback and Conversion of Brady Bonds

The global bonds were used for the buyback and conversion of the available BB. The prices obtained are presented on Table 3.

The volume of the deal by individual elements is presented on Table 4. During the operation the Bulgarian ED transferred, issued in BB, was for a total nominal value of USD 1327.9 million.

Table 3

Brady bonds prices at the deal in March 2002

Brady bonds	Buyback	Conversion for global USD bonds	Conversion for global EUR bonds
DISC A	90.50	90.50	90.50
DISC B	90.50	92.50	90.50
IAB	88.25	88.50	88.50
FLIRB A	90.25	90.50	90.50
FLIRB B	90.25	92.50	91.45

Table 4

Approved offers (million USD)

Brady bonds	Buyback	Conversion for global USD bonds	Conversion for global EUR bonds	Total
DISC A	184.6	198.9	142.4	525.9
DISC B	3.6	71.9	1.3	76.8
IAB	85.0	168.8	94.9	348.7
FLIRB A	74.3	41.8	121.4	237.5
FLIRB B	1.6	54.0	83.4	139.0
Total	349.1	535.4	443.4	1327.9

By this moment investors in EUR had shown a restrained interest and so the BB converted for EUR bonds were for a smaller amount. The reservations to the EUR can be explained by two reasons:

1. Most of the Bulgarian BB holders were non-Europeans (Americans), who were used to dealing with the USD;

2. The common European currency EUR was new and not well established yet and concealed the risk of unpredictable fluctuations.

Expansion of the Global USD Bonds Issue

In fall 2002 there was a new operation on the conversion of Bulgarian BB for global ones. It was announced on 09.09.2002 and carried out on 26.09.2002 with a settlement on 09.10.2002. This operation consisted in expanding the global USD issue from the spring of 2002 with a maturity on 15.01.2015.

One can see on Table 5 the results from the expansion of the global USD bonds issue. Because of the great interest in the issue, as well as its high profitability, the bond price reached 1.0395 of the face value (given a price of 93.681 in March 2002). As a result a nominal of USD 866 million BB was exchanged for USD 759 million newly issued global bonds.

Table 5

Expansion of the global USD bonds issue, September 2002

	Conversion price (cents)	Converted quantity (face value, million USD)	Market price (million USD)	Global bonds issue (million USD)
DISC A	92.000	302	278	267
DISC B	94.500	40	38	36
IAB	89.125	226	201	194
FLIRB A	91.375	293	268	258
FLIRB B	92.350	5	5	4
Total		*866*	*789*	*759*

Table 6

Bulgarian Brady bonds (million USD)

	2001	After the operation of March '02	After the operation of September '02
DISC A	1483	957	655
DISC B	142	65	25
IAB	1594	1245	1019
FLIRB A	1395	1121	828
FLIRB B	145	6	1
Total	*4759*	*3395*	*2529*

Table 6 shows the changes in the Bulgarian BB still in circulation following the operations in 2002. The efforts were aimed most of all towards reducing the number of DISCs in circulation – their buyback and conversion reached a maximum (58%). This effort was justified by the double benefit for the issuer:

- Release of collateral on the DISC's principal;
- Avoidance of higher interest repayments after a possible activating of the VRC.

The issues of tranche **B** have almost been cleaned.

Positive Results

The positive results achieved from the ED operations come along the line of improving the government ED parameters rather than registering any financial benefit.

Reduced Nominal Value of the Government ED

In the spring of 2002 the conversion of the BB was effected in accordance with the current exchange rate (1.137 EUR/USD by 22.03.2002). The issue of EUR 835.5 million was equivalent to USD 734.8 million, so the total available money for the financial operation amounted to USD 1247.8 million. The difference with the nominal value of USD 1327.9 million represents the reduction in the nominal value of the ED (USD 80 million).

With the expansion of the USD-denominated global bonds a new nominal reduction in the ED of USD 107 million was fixed, so that the total nominal reduction in the ED as a result of these operations in 2002 was estimated at USD 187 million.

The nominal reduction of the ED was the outcome of the combination of:

- Lower market price of the BB;
- Value of the exchange rate EUR/USD;
- The initially discounted market price of the global bonds issue.

The nominal reduction in the ED, however, does not by far mean a reciprocal reduction in the market price of the ED (Table 8). This is the contradictory nature of this parameter in the context of the *Bulow-Rogoff's* criticism.

Reduced Interest Rate Risk

The BB accumulate interest through floating interest rates, pegged to the LIBOR (for six-month USD-deposits). The global bonds carry fixed interest rates and their servicing is reliable and predictable, which facilitates planning the interest expenditure in the government budget. Having completely cleared all BB (July 2005) the ED with fixed interest rates now dominated in the composition of the ED. As a result of these operations with the ED the government debt share (external and domestic) with fixed interest rates reached 39% at the end of 2002 and about 60% in the mid 2005. The government's official document,[8] however, envisaged its increase

[8] The main criteria in managing the government debt are fully described in the Law on the Government Debt (LGD) and in the "*Strategy for Managing the Government Debt*". *The LGD* was passed by

to 45-50%. By settling all Brady obligations the goal officially set in terms of the interest structure of the government debt has been over fulfilled.

Reduced Forex Risk

The financial operations performed reduced the forex risk of managing the ED. The EUR-component of the ED grew (respectively the share of the USD-denominated ED shrank (Figure 1), which is viewed well in connection with the CBA. The "*Strategy …"* of 2005 envisaged the USD-share in the government ED to fall below 50% and later, aiming at 2009 to drop to about 30%. Actually, in the middle of 2005 (July, after the final buyback of the BB) the share in the government ED denominated in USD fell to 28.2%. Servicing the government ED has become less vulnerable to unfavourable forex adjustments.

Longer Duration

The 2002 operations prolonged the ED duration. The MF's estimates gave the following durations of the Bulgarian BB by the spring of 2002: FLIRB **A** – 4.1 years (maturity 2012); FLIRB **B** – 4.0 years; DISC **A** – 4.8 years (maturity 2024); DISC **B** – 4.9 years; IAB – 5.1 years (maturity 2011). The DISC's duration was shorter independently of the 30-year maturity, because there were no payments on the principal – it was paid off with the collateral in mid 1994. At the same time the duration of the new global bonds in EUR was 7.2 years (maturity 2013), and of those in USD – 7.7 years (maturity 2015). The longer duration is linked to the longer period of time left till the big payments are to be made and is debtor-friendly.

Released Collateral

The operations carried out released some of the collateral, which by 2002 was only on the DISC principal and the interest repayments. By early 2002 the value of the collateral on the DISC's principal, initially invested in 30-year-long zero coupon UST-bonds (USD 222 million), had reached USD 392 million. In March 2002 the DISC bonds bought back and converted amounted to USD 602.7 million, i.e. 32.3% of the initial issue of USD 1865 million. The respective part of the collateral was evaluated at USD 126.5 million. The collateral on the interest repayments released amounted to 7%. Given the total value of the reduced number of DISC bonds, the collateral released on the interest repayments reached USD 42.2 million. Thus, the total released collateral was USD 168.9 million.[9] After the expansion of the USD-denominated global bonds issue in the fall of 2002 the MF worked out the collateral released at USD 136 million (a total of USD 333 million according to the MF's estimates). The collateral released has further to be reevaluated from the point of view of forming new investment revenue.

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the National Assembly in the fall of 2002 and it regulated the principles in managing the government debt, involving both external and domestic liabilities. "*The Strategy …*" detailed some clauses in the LGD and was passed as an official document of the MF in 2003.

[9] The official statement of the MF determined the released collateral at USD 197 million.

Financial Reassessments

The results from the operations performed on restructuring the ED in 2002 were projected given a number of initial prerequisites. In case of a change or an unexpected turn in the initial prerequisites, the results from the operations might undergo substantial alterations.

Starting Point

In the autumn of 2001, when Bulgaria issued its eurobonds at the amount of EUR 250 million, the larger idea was launched to embark on a large-scale operation for converting the BB. All this had an impact on the market prices of the BB.

One can see on Table 7 the prices of the Bulgarian BB right before the first issue of eurobonds and by the date of issuing the global bonds. The disparity is amazing -within12-15%! The prices even went on going up (much more under their own momentum rather than due to some meaningful prerequisites) and for some time after the issue of the global bonds (Figure 2). The highest price growth was recorded with DISC, which were the most interesting for the issuer from the financial point of view. The investors were fully aware of the issuer's interest (as well as their own), so that they duly pushed the prices upward.

Figure 1

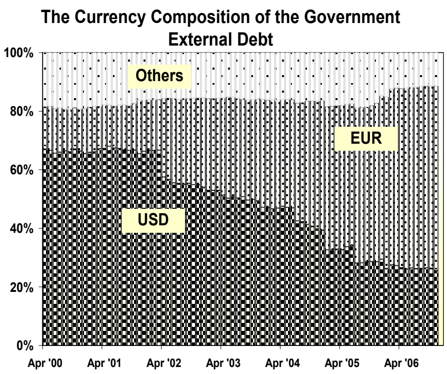


Figure 2

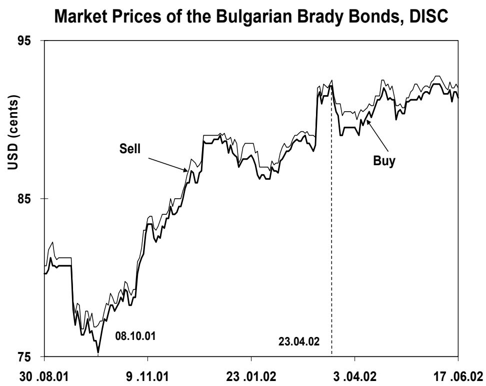


Table 7

Bulgarian Brady bonds prices (cents)

	DISC		FLIRB		IAB	
	Buy	Sell	Buy	Sell	Buy	Sell
8.10.2001	75.25	77.00	78.25	80.88	76.00	78.25
20.03.2002.	91.13	91.50	90.13	90.63	88.25	88.75

The BB prices increase during the time of the eurobonds issue (2001) and the global bonds issue (2002) is a fact with losing consequences for the issuer. In the spring issue of the global bonds BB of nominal value of USD 1327.9 million were converted and about USD 160 million (12% of the face value) were paid more because of the preliminary launch of the government's intentions. In the expansion of the USD-issue in the fall of 2002 another USD 866 million BB were converted and the potential loss from the increased market prices is evaluated at another USD 100 million. The total higher expenditure for the country from the higher quotations of the BB, most of all as a result of the declared intentions for the buyback and/or conversion amounted at USD 260 million.

The provoked growth in the market price of the Bulgarian ED casts a blight on the economic advisability of carrying out such deals. The literature contains the so called *Bulow-Rogoff* criticism regarding the benefit from the unilateral act of buyback of the ED.[10]

Table 8

The Spring deal of 2002

	Before the deal million USD)	After the deal (million USD)	Buy on 8.10.2001	Sell on 23.04.2002	Market price (million USD)	
					Before the deal	After the deal
DISC	1625.2	1022.5	75.25	91.13	1222.9	931.8
FLIRB	1539.9	1127.4	78.25	90.13	1205.0	1016.1
IAB	1594.0	1261.3	76.00	88.25	1223.6	931.8
Face value	4759.1	3411.2				
Market value					3651.5	3061.0

What one could see from Table 8, is that with the spring 2002 operation the face value of the BB fell by USD 1363.9 million, whereas its market price went down by USD 590.5 million. To obtain this result Bulgaria had issued global bonds of EUR 835.5 million and USD 513.0 million. By this time the *"buy"* price for the EUR-denominated global bonds was 95.5, and for the USD-denominated ones – 92.3. Under the exchange rate in operation the market price of the newly issued global bonds was calculated at USD 1170 million. The recapitulation showed an increase in the market price of the Bulgarian ED by USD 580 million. With time the estimates have changed since the market quotations changed as well.

[10] *Bulow, J., K. Rogoff* . Cleaning up Third World Debt Without Getting Taken to the Cleaners. - Journal of Economic Perspectives, Winter 1990, Vol. 4, N 1, p. 33; *Възможни* ползи и рискове от операцията по замяната на българския външен дълг (оценки от Интелинюз) (*Possible* benefits and risks of the operation for exchanging the Bulgarian external debt (Intellinews estimates). - Банки, Инвестиции, Пари, 2002, N 2, p. 9.

Bulow&Rogoff give the example of the Latin American experience. In 1988 Bolivia bought back almost half of its ED of USD 670 million. Right before the deal the Bolivian debt was quoted for 6 cents with a total market value of USD 40.2 million. Using USD 34 million Bolivia bought back USD 308 million of its ED and the market price of the remaining USD 362 million rose by 11 cents for a total market value of USD 39.8 million (see too *Sachs, J., J. Morales.* Bolivia: 1952-1986. International Center for Economic Growth. Country Studies N 6, 1988, p. 38).

The calculations made revealed that the essence of the *Bulow& Rogoff* criticism was valid for the case of Bulgaria in 2002, too.

Interest Repayments

The main starting premises for the 2002 ED operations were linked most of all with the expectations for relatively high values of the world interest rates, the LIBOR in particular. Servicing the BB depended on the LIBOR values (plus $\frac{13}{16}$%), due to which a higher LIBOR meant higher interest repayments on the BB.

The time series for the LIBOR values for the six-month USD-deposits are given on Figure 3. By the spring of 2002 the values of the respective LIBOR were at record low levels (at about 2%). Figure 3 illustrates that LIBOR had never been so low for the previous 10-15 years. In the past the LIBOR values fluctuated around 6 % and the expectations were for a return to these average values.

Reality, however, came out differently. The subjective expectations for the LIBOR's return to around 6% were based much more on mechanic grounds rather than on meaningful economic prerequisites. The fall in the world interest rates began in the middle of the year 2000, when in the following 15 months LIBOR lost half of its value (from 7.0% to 3.5%) as a result of the driving of the leading central banks in the world (FED, ECB) to push economic growth. The terrorist acts of 11.09.2001 just intensified the fears for a pending economic recession, due to which the world interest rates went on following the downward trend. In 2001only, for instance, the FED lowered 11 times its interest rates – from 6% (03.01.2001) to 1.75% (11.12.2001). It should be pointed out that the last four reductions followed the terrorist acts of 11.09.2001 (from 3% to 1.75%). ECB also reduced its interest rate – from 3.25% before the terrorist acts to 2.25% at the end of 2001.

Figure 3

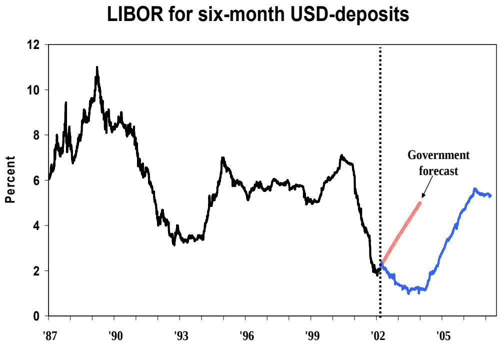
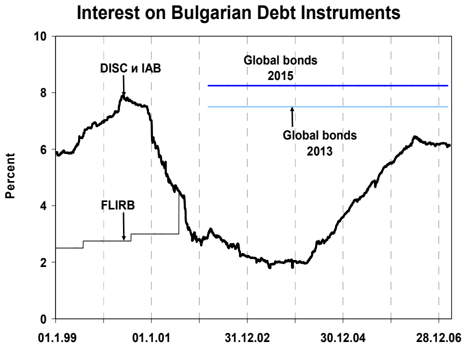


Figure 4



The macroeconomic elite had not logically understood and thought out well in detail the reasons for this development in the interest rates. On 10.09.2001 the six-month USD LIBOR was 3.5%, two months later its was 2%. In the spring of 2002 there was a short-term policy of increase up to 2.3% and here a more responsible and committed assessment of the possible short-term and mid-term behaviour of the world interest rates was required as a prerequisite for undertaking those exceptionally large-scale and long-term financial operations. The consequences from the terrorist acts on a global plan were underestimated as well as the economic counter-measures of the leading developed countries. It was only by the summer of 2004 that there emerged some justified grounds and expectations for a rise in the interest rates in the world.

The adequate assessment of the interest rates levels concerned the projections for the exchange rates and most of all the possible weakening of the USD.

The interest rates on the world capital markets led to losses for Bulgaria from the servicing of the restructured ED in 2002 (Figure 4). For LIBOR of about 1.0-1.5% Bulgaria paid interest on the BB of about 2.0-2.5%, while servicing the global bonds was with interest of about 8%. In 2003 for instance Bulgaria paid off BGN 108 million interest on the BB and BGN 327 million interest on the euro- and global bonds. Moreover, the principal of the BB possessed by Bulgaria on the one hand, and that of the euro- and global bonds on the other were almost equal (about USD 2.1 billion). Only from the spread in the interest rates and only for 2003 the operations of 2001-2002 led to about BGN 220 million (EUR 112 million) loss. As a total until the end of 2006 the accumulated over-expenditure on interest repayments connected with the operations performed is estimated to stand at EUR 550 million.

The reason for their record high quotations is the considerably higher interest coupon on the Bulgarian global bonds compared to the global interest rates (Figure 5). The highly yielding USD-denominated Bulgarian global bonds (8.25% interest coupon), as well as of the EUR-denominated ones reached and exceeded the quotations of 125 %! The explanation lies in the significantly higher yield in terms of interest. The yield till maturity of the Bulgarian EUR-denominated global bonds (with a maturity in 2013) fell below 3.5% by the mid 2005, i.e. by that time, the mid 2005, Bulgaria could have issued long-tem global bonds with an interest coupon of at least for example four percentage points (400 bpp) lower than that in the spring of 2002.

Figure 5

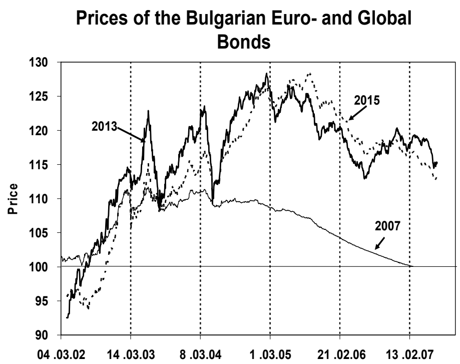
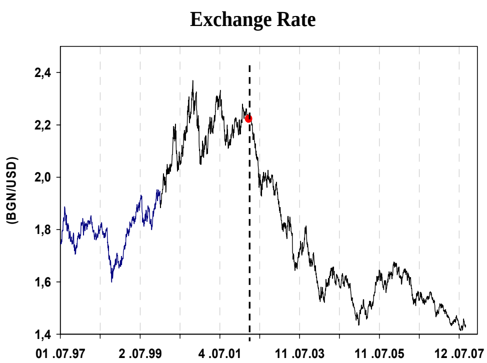


Figure 6



Together with the efforts for getting rid of the liabilities on the BB the government of S. Sax-Coburg-Gotta (2001-2005) undertook some operations on reformatting the government debt, especially to provide currency revenue from the issue of government securities on the domestic capital market.

On 18.02.2003 and 10.03.2003 the MF made two openings on the first auction for the sale of government securities denominated in EUR and registered on the domestic market. The papers were for 2646 days (seven years and three months) and with an annual interest coupon of 5.75 %. The quantity offered for sale on both openings was EUR 50 million and EUR 25 million respectively, where the orders received were for a total of EUR 216.5 million (approved EUR 50 million on the first opening and EUR 55 million on the second opening). It is interesting that the first opening brought an average yield of the offers approved of 5.58 %, and the second – of 5.65%.

In 2003-2005 the MF carried out four openings of new issues of government securities on the domestic market denominated in EUR. Their due date was 5447 days (14 years and 11 months). There were offered EUR 100 million for the issue while the demand was for EUR350.9 million. The interest coupon was fixed at 6%, the yield achieved - 6.55% on the first opening and then it fell to 4.99% on the fourth opening.

The above two issues of government securities on the domestic capital market, the first one a year after the issue of the global bonds and the second – 20 months later, as well as their parameters show that the MF could have attracted foreign financial resources at even a lower price. It has to be noted, however, that the participation of foreign investors in both issues was insignificant (Table 9).

Table 9

Government securities issued in forex on the domestic capital market

Issue Number	Currency	Initial Issue	Maturity	Principal (th.)	Interest	Government securities, owned by non-residents (th., July 2005)
Government securities issue for the structural reform						
BG 20 097 94228	USD	01.01.1994	01.01.2019	138 472	LIBOR	119
BG 20 400 99223	EUR	01.07.1999	01.01.2019	116 943	EURIBOR	2 045
Government securities issued to finance the budget deficit						
BG 20 402 03213	EUR	24.02.2003	24.05.2010	105 000	5.75	15 673
BG 20 404 03219	EUR	11.20.2003	11.10.2018	100 000	6.00	

Source. Government debt, July 2005. MF.

Varying the issues of government securities of this type can be assessed positively. This is a step in the right direction as far as the established international experience goes. The processes have to be monitored carefully though with a view to making an adequate analytical assessment of the real condition of the domestic capital market. Given all the possible existing conditionality the interest of the foreign investors in the domestic issues of government securities should be treated as a step towards the integration into the European and world financial structures.

The curves of Figure 5 represent a good illustration of the investors' behaviour towards the debt instruments of various maturity. The quotations of the short-term eurobonds are much steadier than those of the long-term ones. The market price of the short-term government securities (due date 01.03.2007) cannot fluctuate too much because of the closer maturity date when the issuer will repay the nominal to the eurobond owners. At the same time the long-term global bonds are much more influenced by the specificities of the given moment and their quotations are highly sensitive to the investors' moods.

Exchange Rate

On Figure 6 one can trace the change in the exchange rate BGN/USD (respectively EUR/USD) in the period right after the introduction of the CBA in Bulgaria. The figure shows also the moment of issuing the global bonds and the conversion of the BB (March 2002). For a period of about a year and a half till the conversion the exchange rate remained on average at the level of 2.20 BGN/USD. At the moment of the issue the government expected and forecasted that the exchange rate would still keep at this level.

Actually what happened was quite different. It was connected to a great extent to the descending trend of interests of the FED. Anyway this dependence remained unnoticed and underestimated. On the 01.04.2002 the exchange rate was still 2.24 BGN/USD, but since May 2002 there started a trend of the USD depreciation. It went on three stages and by the end of 2004 it reached the level of 1.45 BGN/USD. Such a dynamic of the exchange rate caused conditional and real financial losses to Bulgaria, related to the conversion of the BB.

The conditional losses resulted from the wrong timing for the conversion. If the latter had not been effected in March 2002 but in May 2003 (14 months later and after that too) the conversion of the USD-denominated BB for EUR-denominated global bonds would have been performed not at the exchange rate of 1.15 EUR/USD, but at the exchange rate of 0.85 EUR/USD. In March 2002 Bulgaria paid for the conversion of the BB for EUR-denominated global bonds 35% more than it would have done in a conversion taking place in May 2003. The conditional loss from the unfortunate timing for the conversion cost the country about EUR 290 million.

Bulgaria suffered some real losses from the unpredicted weakening of the USD. In accordance with the official data of the MF in March 2002 a nominal of BB of USD 443.4 were converted for EUR 468.4 million global bonds. The interest on the BB, which was paid in USD, was replaced by interest on the EUR-denominated global bonds paid in EUR. The money which the government accumulates as a reserve to service the government ED is transferred above all from the government budget, i.e. in BGN (respectively in EUR). For 2003 for instance, for the exchanged USD 468.4 million BB it should pay about USD 10 million interest. Instead, the government paid 7.5% interest on the exchanged EUR 468.4 million global bonds, i.e. EUR 35 million. The real servicing of this part of the government ED amounted to BGN 69 million whereas the unchanged option of the ED would have required about BGN 17 million. The difference of more than BGN 50 million covers the effect of the higher interest rates and the weakening of the USD.

The conditional and real losses for the country would grow up if the hypothetical timing of the assessment was brought much more forward in time.

The Contradictory Economic Nature of the Collateral Released

The striving for the release of collateral as an end in itself cannot be appraised unambiguously. The prevailing part of the collateral was in the form of 30-year long-term UST-bonds with a yield high enough (7.35%). The released collateral would fill the gross international reserves of the country and its investment begin to follow strict conservative rules for managing it with a view to restricting to minimum any possible concomitant risks. These rules bring to a minimum the possibilities for investing in long-term government securities due to the requirement for reducing both the market (interest), and the credit risk. This is why the average yield of the invested international reserves of the country is at a considerably lower level (for example about 2-3%). The difference between the yield of the 30-year UST-bonds and the average yield of international reserves, on the other hand, represents a loss for the issuer.

The MF reported released collateral in the form of bought ED securities at the amount of USD 333 million (USD 197 million in spring and USD 136 million in the fall of 2002). About two thirds of the collateral released (USD 220 million) was in the form of long-term UST-bonds. If this amount had remained in its initial form in the course of four and a half years (till the end of 2006), it would have grown to USD 300 million, while the conservative management of the international reserves increased the same amount to USD 250 million. The difference of USD 50 million is also at the expense of the issuer.

*

It would not be exaggerated probably to say that the debt problems of Bulgaria have been chronic (or were chronic).[11] They had accompanied the country's development almost since the Liberation till the early XXIst century. And these have

[11] For details see *Аврамов, Р.* Стопанският XX век на България (*Avramov R.* The Economic XXth Century of Bulgaria). Sofia.: ЦЛС, 2001; *Иванов, М.* Политическите игри с външния дълг (български сюжети на стопански кризи и възход 1929-1934) (*Ivanov, M.* The Political Games with the External Debt (Bulgarian plots of economic crisis and boom 1929-1934). Sofia: "Златю Бояджиев", 2001; *Minassian,G.* Op. cit.

always been the outcome of mismanagement or failure to manage the domestic economic processes rather than the outcome of extremely increased financial liabilities. Quite often these difficulties resulted from poor political assessments and the political behaviour of the managerial elite.

The moratorium of 1990 brought a lot of damage on the international image of the country and now this takes a lot of time to clean and fade, and necessitates a lot of staunchness and consistent efforts. These impediments have been left behind but their lessons, however, should not be forgotten. The most important one is a confirmation of the eternal cybernetic principle – the difficult problems require difficult solutions. Moreover, poor management, especially and above all at a national level is being paid for sooner or later and the payer is always the population, always and unfailingly this is each one of us, each citizen.

Table 10

Comparative cross-country analysis of restructuring
the ED after the brady plan

Country	Year	Restructured ED	Restructured ED p.c	The Price of restructuring	Reduction	The equivalent buyback price	The ED price on the secondary market
		m USD	m USD	m USD	%	cents	cents
The Philippines	1990-2	5.8	94	1.8	64	49	50
Venezuela	1990	19.7	1010	2.6	32	40	46
Costa Rica	1990	1.6	535	0.2	71	19	19
Mexico	1990	51.9	624	7.7	45	34	44
Nigeria	1991	5.8	66	1.7	76	38	40
Uruguay	1991	1.6	511	0.5	55	50	54
Argentina	1993	28.1	830	3.0	35	29	39
Brazil	1993	47.2	311	3.9	25	38	35
Jordan	1993	0.7	133	0.1	43	35	39
Bulgaria	**1994**	**8.3**	**983**	**0.7**	**46**	**19**	**27**
The Dominican Republic	1994	1.1	142	0.1	45	36	36
Poland	1994	14.4	374	1.9	49	27	39
Total		*186.2*	*369*	*24.3*	*39*	*34*	*40*

Source: Houben, A. Op. cit., p. 11; IMF Survey, July 17, 1995, p. 232; The author's calculations.

The four-year long efforts of the managerial teams for concluding an acceptable agreement with the LC for restructuring the Bulgarian ED can definitely be assessed as positive. This assessment is based on the comparative cross-country analysis (see

Table 10). However conditional, the data in Table 10 demonstrate parameters which no doubt speak of the success of the negotiating teams and Bulgaria in general, in these hard and prolonged negotiations. From there on, we had to face a difficult and steady process of reaffirming our abilities for an efficient management of the ED.

A successful operation, connected with the cancellation of USD 948 million, was performed through the buyback of ED against liabilities to the International Investment Bank and the International Bank for Economic Cooperation bought by Bulgaria on the secondary market.[12] This operation was planned and carried out in 1999 when Russia was experiencing a deep financial crisis which led to a significant plunge of the market prices of debt securities coming from Russia. The average price achieved by Bulgaria of the buyback in this debt operation was 16.7 cents, i.e. about USD 790 million of nominal ED was reduced. The criticism of *Bulow&Rogoff* does not apply to this case since the operation was conceived and carried out as a single act which settled all liabilities.

As a matter of fact, it is for the first time in the beginning of the XXI century since the Liberation onwards that Bulgaria has got a real chance to bring its relationships with the outside financial world to normal on the ground of equal market treatment. The outside financial world now tends to consider Bulgaria as a normal and solvent counterpart, without any disparaging and discriminating marginal attitude to it. So, this situation further more obliges the macroeconomic elite to keep and go on improving the positive results achieved, to prevent any other collapse once financial stability has been reached.

The last decade has recorded a remarkable progress in the ED relationships of Bulgaria. It was made possible by the steady economic growth achieved and the financial stability staunchly defended. Endorsing unflinchingly the market principles of management gave the expected positive results.

Now the operations with the ED of 2001-2002 can be given a clear and definite assessment. In 2005 Bulgaria surpassed 125% of the GDP level of 1993 (in real terms), in the following year 2006 recorded a positive growth rate of the GDP of 6.1% and in accordance with the VRC of 2007 the interest on DISC had to be about four percentage points higher than the six-month LIBOR for interbank deposits in USD. In the current international interest situation this meant that interest on the DISC in 2007 were to reach 10%, i.e. the conversion and buyback of the BB was a must till the early 2007.

The initial hypotheses of the ED operations of 2001-2002, regarding the growth of the interest rates and the exchange rate remained unconfirmed. It is quite

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[12] By 1998 Bulgaria had got liabilities (overdue payments on principal and interest) of USD 719 million to the International Investment Bank and USD 229 million to the International Bank for Economic Cooperation. Both banks are based in Moscow and the liabilities represent leftovers from the time prior to 1990. Bulgaria suspended servicing its debt to these banks in 1990, when it declared a moratorium on any repayment of its foreign indebtedness. By the spring of 1990 Bulgaria's liabilities to both banks amounted to USD 540 million, but nine years later they swelled with new interest payments of USD 408 million. This information is published on the website of the MF, as well as in Annual Review of the Government Debt 1999, MF, p. 40.

perplexing that despite the definitely unfavourable change in the world financial situation the MF doggedly persisted with the issue of the global bonds in USD in the fall of 2002. In March 2002 the benchmark LIBOR was at about 2.2-2.3%, but in September it fell down to 1.8% (despite the official forecast of the MF of the spring of 2002. According to it, the latter was supposed to remain at a level of 3.2-3.3%). Moreover, the issue continued with a value quite impressive for Bulgaria – of USD 759 million - in spite of the interest coupon of 8.25% absolutely fabulous for this time. And what is more, Bulgaria will go on paying generously in the future (in the coming 6-8 years) the exorbitantly high interest on its global bonds. If the issue of USD-global bonds of September 2002 were discontinued, this would have saved to Bulgaria about a third of the real and conditional financial losses recorded.

Till 2006 the overall total losses of the operations performed amounted at least to one billion EUR. On a comparative basis the average annual losses equalled about 3.5% of the average annual expenditure of the consolidated government budget for 2003-2006. For comparison's sake the total transfers from the Republican budget to the state-owned universities, the Bulgarian Academy of Sciences, the Bulgarian National Radio and the Bulgarian National Television for 2005 were BGN 420 million, i.e. they were by 15% lower than the average annual losses for the period 2003-2006 as a result of the operations performed with the ED. The gold reserves of Bulgaria available (40 tones) would have hardly covered 60% of the loss accumulated. The exhausting four-year long negotiations, led by various teams with the LC were finalized with a reduction in Bulgaria's ED of USD 3.8 billion and a third of this success was cancelled eight years later by rashly issuing the global bonds.

These colossal losses for Bulgaria could have been avoided if there had been an attempt at a more committed preliminary look into the future. The strategies and policies of the leading central banks in the world (FED and ECB) had not been studied thoroughly enough nor the events of 11.09.2001 sufficiently well appraised as inducing respective macroeconomic consequences with an impact on the world.

The reasons for the negative consequences have to be no doubt sought in the rash policies of the managerial team. These could be the result of:

(1) Lack of preparation and professionalism;

(2) Deliberately sought development of the financial processes.

In both cases the lessons should never be forgotten.

With a hindsight Bulgaria's history after the Liberation had quite a few periods of difficult and tough negotiations with foreign lenders to the country. Traditionally, in each case, the country has managed to be thrifty. The national negotiating teams have tried (more or less successfully to save each foreign financial resource to the country, by even trying to be definitely close-fisted to any payments in foreign currency. In its recent history Bulgaria has constantly felt the ED burden crippling its freedom. And it has tried to do the utmost to alleviate this ED burden.

The operations with the ED of 2001-2002 will probably remain unique in the Bulgarian modern history. They represent a textbook example of extravagant and irresponsible behaviour in operating with colossal for the country foreign currency resources for an extremely short period of time with a long-term negative impact. During the second half of the 80s the ED of Bulgaria swelled by more than three times but the borrowing was materialized, although the material resources were not efficiently put to use. In the early XXIst century there was no materialization of the financial resources – they were dissipated as a dead loss. In both cases it is the government management to bear the blame -in the 80s the system of management was not able to absorb the imported technology and in 2002, the existing and maintained institutional chaos enabled the abuse of power of large-scale economic dimensions[13]. In both cases the guilty ones (whoever they were) were not requited.[14]

For the operations of 2001-2002 one can speak about a pure leakage of foreign currency resources. The decisions were made by a highly restricted circle of people (the minister of finance M. Velchev and his deputy K. Katev), without making any comprehensive forecast and assessment. It is amazing that the prime minister S. Sax-Coburg-Gotta, who is known for his legendary mistrustfulness and sluggishness in making decisions at a national level, hastily and on the sly agreed twice to carry out these disputable financial operations of inestimable unfavourable consequences for the country. Finally, no matter who is at the root of such operations, these weigh and will weigh most of all on the concrete government and the concrete prime minister[15].

It is hard to understand and much more to acquit the hastiness in initiating the operations. According to the agreements all BB operations were to the letter under the control of the Bulgarian government. The VRC was going to be only activated four years later, and the Bulgarian economy had yet to prove steady and acceptable economic growth rates and assert itself. The global bonds issue could have waited for three-four years. The buyback prices of the BB could not exceed the face value, and the interest expenses could have been much lower. The release of collateral would not have suffered, it was even more advantageous to keep it in the form of long-term UST-bonds than pour it into the country's gross international reserves where the investment restrictions bring the yield to much lower levels. Thanks to the

[13] It is a telling fact that the institutional mess has been maintained (deliberately or not), since the expansion of the global bond issue was announced on the 9th of September 2002, while the LGD was passed by the National Assembly *ex post* on the 17th of September 2002.

[14] The unsuccessful attempts at outsmarting the market with large sums of money by self-confident brokers is not fresh news. The most recent banking history tells about the collapse of one of the oldest and most stable English commercial banks - the Barings Bank (founded in 1762) In 1995, due to his reckless investments the Singapore-based broker N. Leeson caused losses of USD 1.3 billion (comparable to the losses incurred by the operations with the Bulgarian ED in 2002) to the bank. The latter went bankrupt (the Dutch bank - ING bought it for a pound), and the guilty broker was sentenced to six and a half years of prison in a Singaporean jail for criminals (*Heffernan, S.* Modern Banking in Theory and Practice. J. Wiley &Sons Ltd., 1998, p. 282-288; *Cannon, T.* The Guinness Book of Business Records. Guinness Publishing, 1996, p. 166). In the case of the operations with the Bulgarian ED of 2001-2002 there is no bankruptcy, nor retribution.

[15] A curious fact is that as a member of the government the minister of finance M. Velchev managed to receive in good time two distinctions at a national level: He was made honorary doctor of the University for National and World Economy and given the award "*Economist of the Year*". Both examples illustrate the prevailing behaviour of anticipating servility in Bulgarian society.

accumulated international reserves in 2006 Bulgaria would not have felt the need to issue global bonds in such a large size – the gross international reserves of the country now cover more than five months imports of goods and services, or that a part of them could have been used for the buyback or exchange of the BB (as it happened in 2004-2005) and to economize the exorbitant high interest repayments on the global bonds. If Bulgaria decided now to buyback part of its global bonds in circulation to avoid the interest payments, it would have to pay at least a fifth higher price than their face value.

Moreover, in addition to the deviation from the initial prerequisites and hypotheses set, one should add the reassessment of the operation in line with the *Bulow&Rogoff* criticism. It is still disputable how much it is worth to issue a new "*expensive*" debt to redeem an old "*cheap*" one, the more so, if this market process makes the Bulgarian government debt more expensive.

The attempt at restructuring the ED in 2001-2002 has shown how difficult the discretionary operation with large-scale financial flows at the national economic level is. As a rule there are plenty of temptations to "*run*" and "*play with*" various variants and capital. History however teaches that outsmarting the market is not at all easy or harmless. And especially, because it is a question of other people's money (money belonging to the people of the country) one should be twice more careful and cautious[16].

Settling the country's Brady liabilities does not remove the debt strain. The maturity of the first issue of global bonds (EUR 835 million) is in 2013. Two years later the country has to face a big ED challenge - the maturity of the second issue of global bonds (USD 1.3 billion). These payments only make up liabilities of the government for about BGN four billion in the coming years. In fact the real payments for the period (repaying the principals and interest) will very likely be about a half higher. World interest rates will come back to their usual higher levels which will impede balancing the budget structures.

4.IV.2007

[16] An outstanding and consistent critic of the operations with the ED in 2001-2002 is *Pl. Oresharski* (2002; "*Banker newspaper*", N 26, 3.07-9.07, 2004, p. 9). His criticism is "*in principle*" and *ex ante*, i.e. for the doomed operations with the ED in 2002 because of the failed initial hypotheses. Along with the grounds for a criticism in principle however, the operations in questions would have met most of the initial positive expectations set, provided a given development of the world processes. The initial hypotheses remained unfulfilled but this was due more to the poor professionalism and analytical skills of the management team. A similar *ex post* assessment is given by *S.Tzonev* too ("*Capital newspaper*", 25.06.2005). All this outlines the pitfalls and the high responsibility required in carrying out such a type of large scale operations of national importance.