Lessons from Sovereign Debt

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Sovereign debt

- Governments of less developed countries (LDCs)
- External debt mostly in foreign currency
- Limited collateral available to creditors
- No bankruptcy procedures

Sovereign debt

- LDCs borrow significant amounts externally
- They repay, but some times, default
- Creditor losses can be large
- Defaults more likely for previous defaulters
- Defaults tend to happen simultaneously

This talk

- Why do LDCs borrow?
- Why do they repay?
- Why do lenders lend?
- What can go wrong?
- Policies

Why do LDCs borrow?

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- Faced with high interest rates — why borrow?

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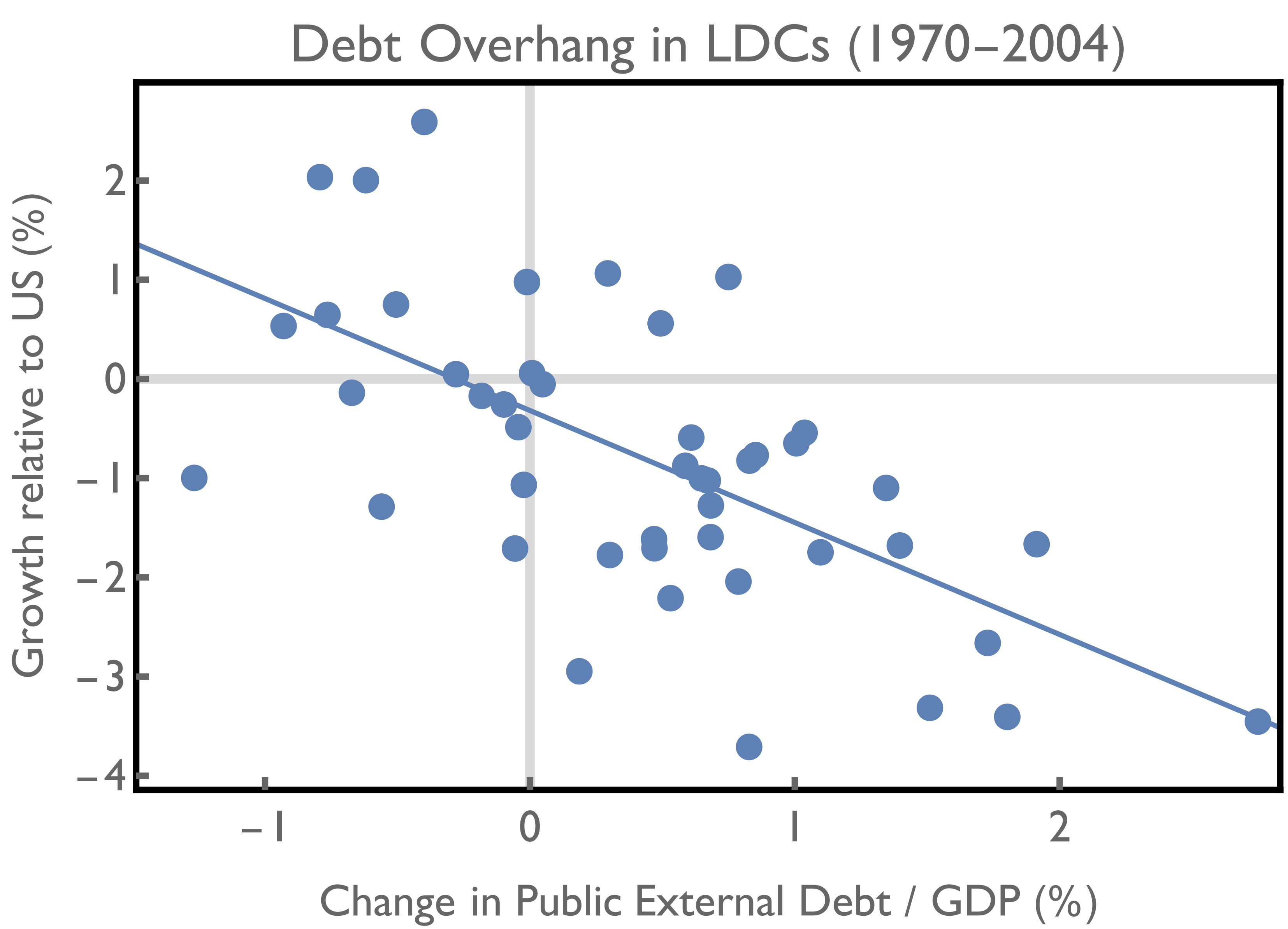

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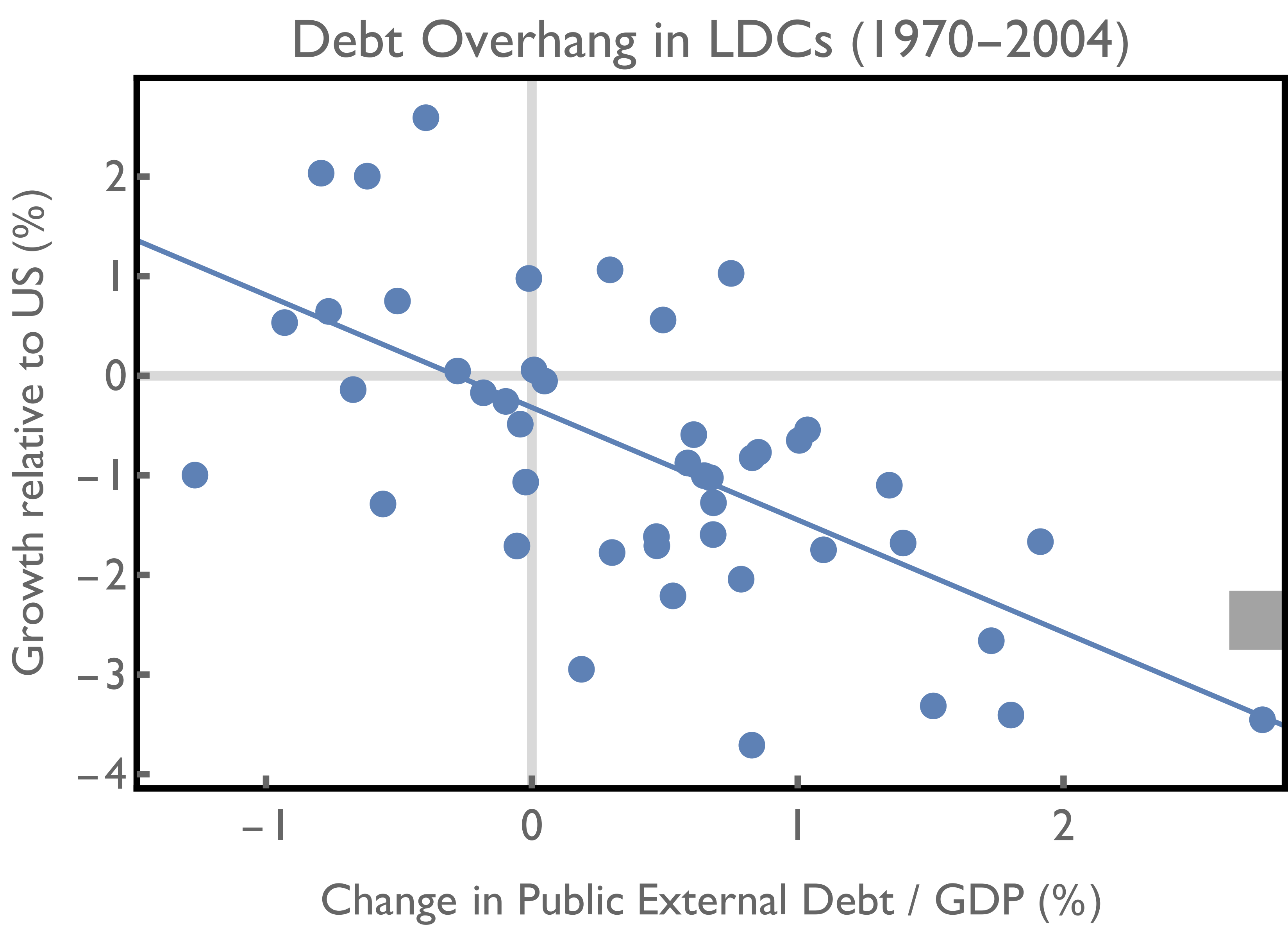

LDCs that borrowed did not grow

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    - Borrow more in good times
    - No asset accumulation (until recently)

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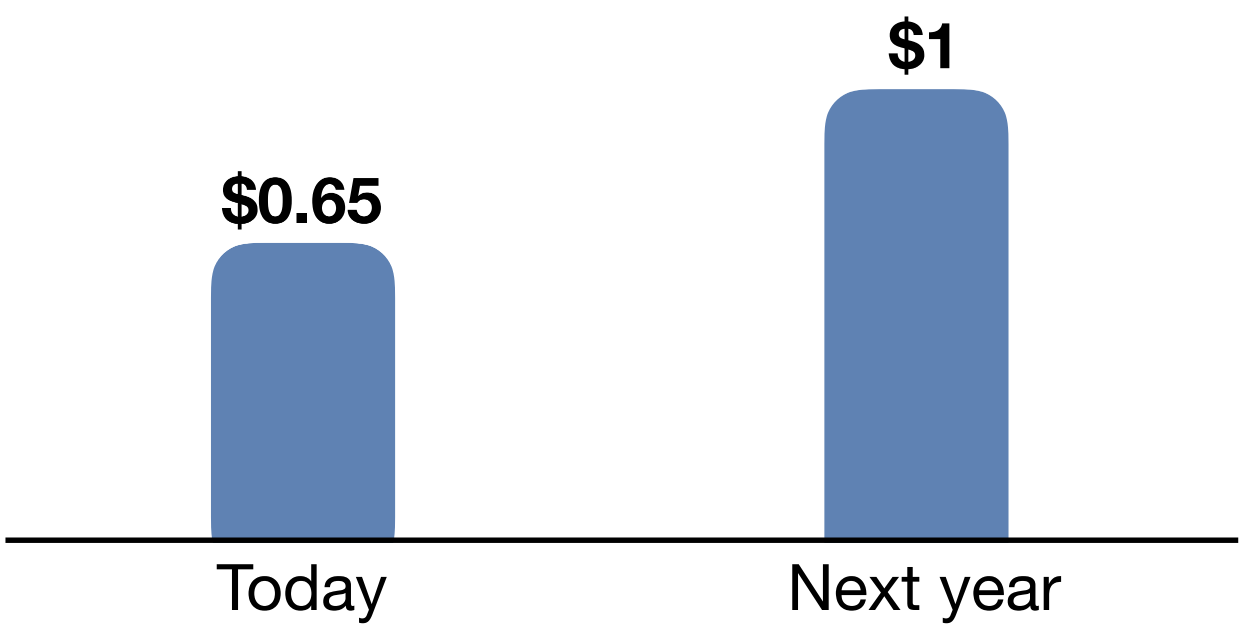

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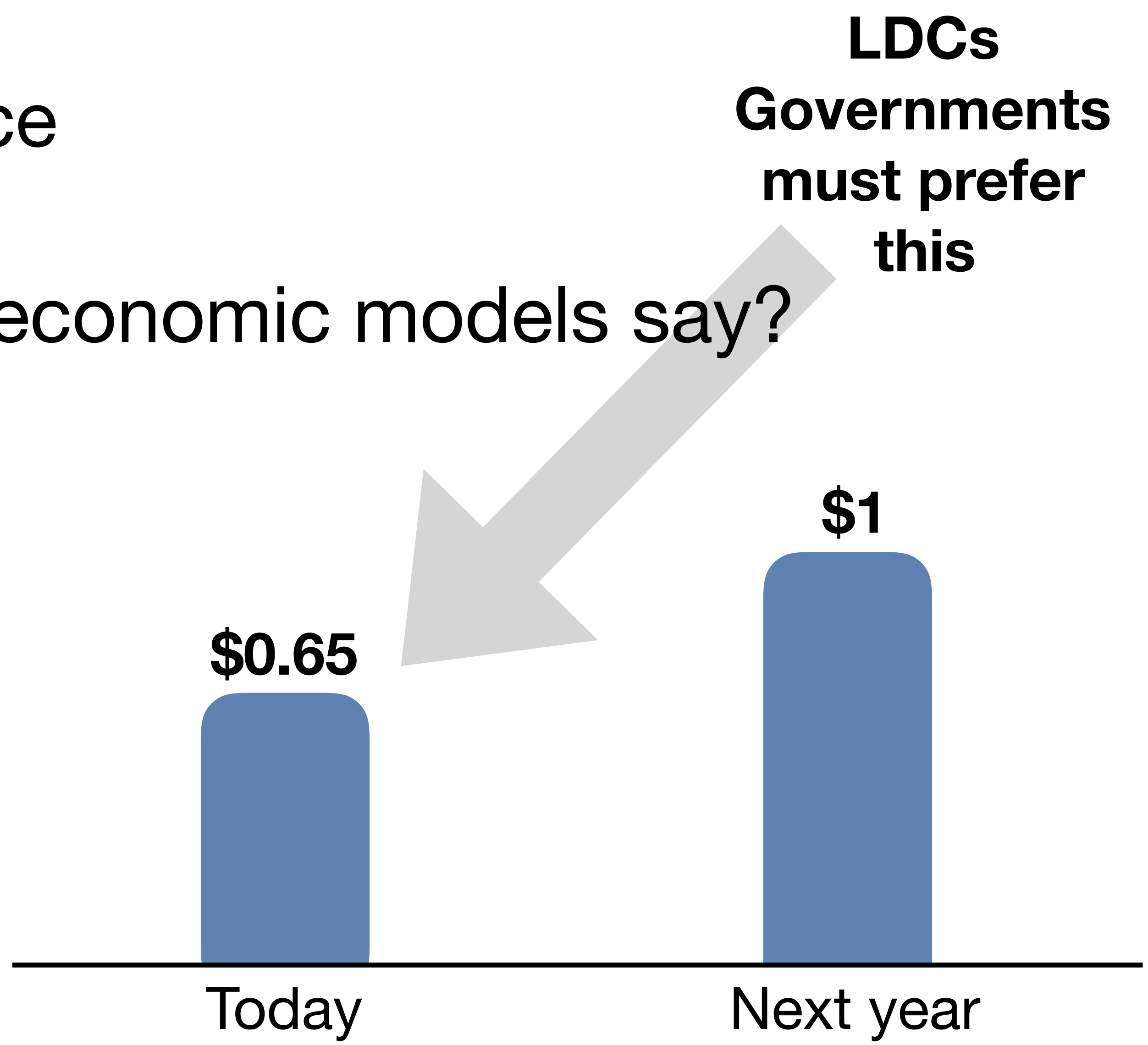

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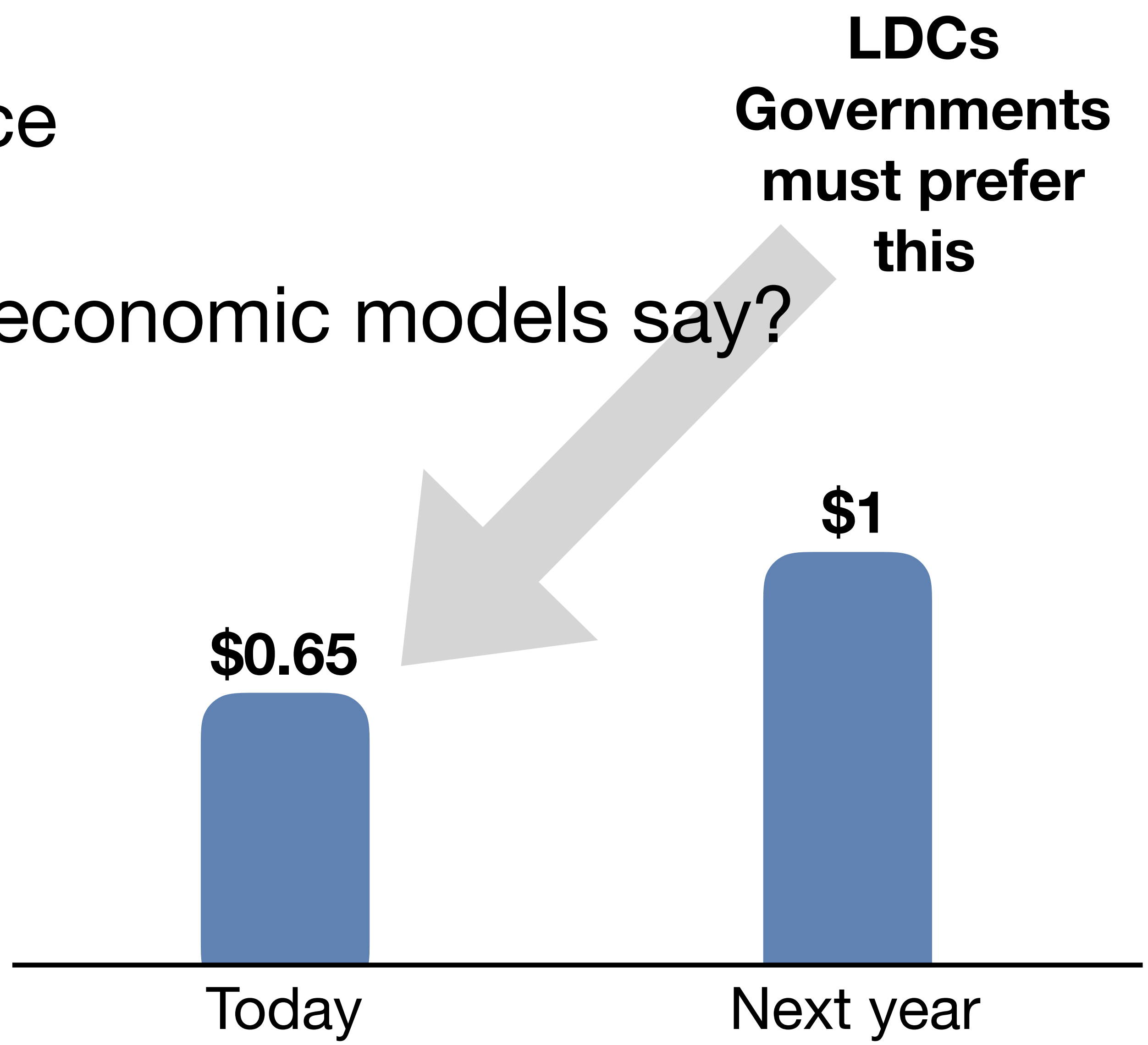

- Impatience ~ Government myopia ~ Political Economy

Why do LDCs repay?

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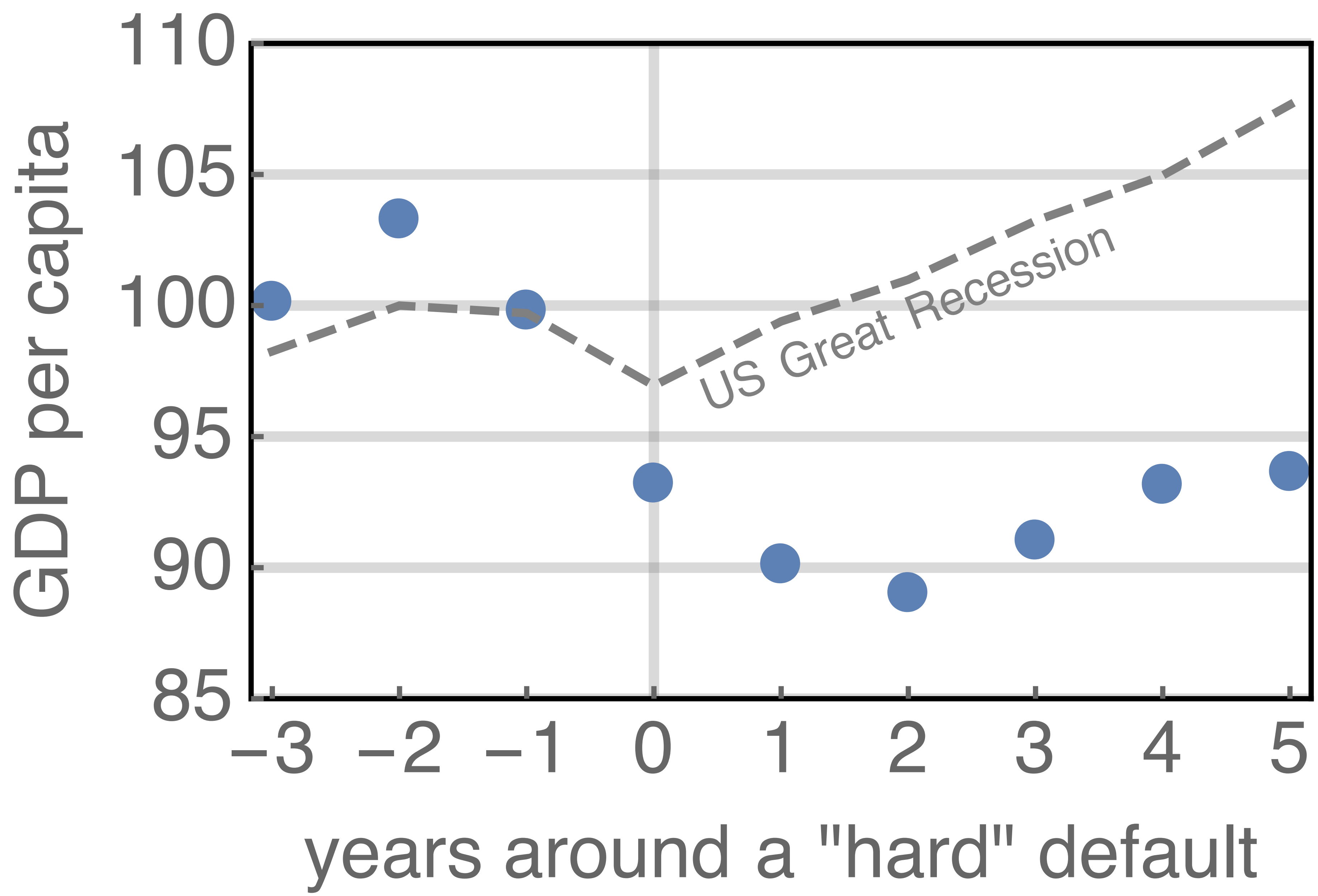
- Reputation
  - Higher interest rates after a default
- Real economy goes wrong
  - Default associated with output and investment collapses, bank crises, high unemployment

Default costs



From Trebesch and Zabelb (2017)

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    - Just as junk bonds

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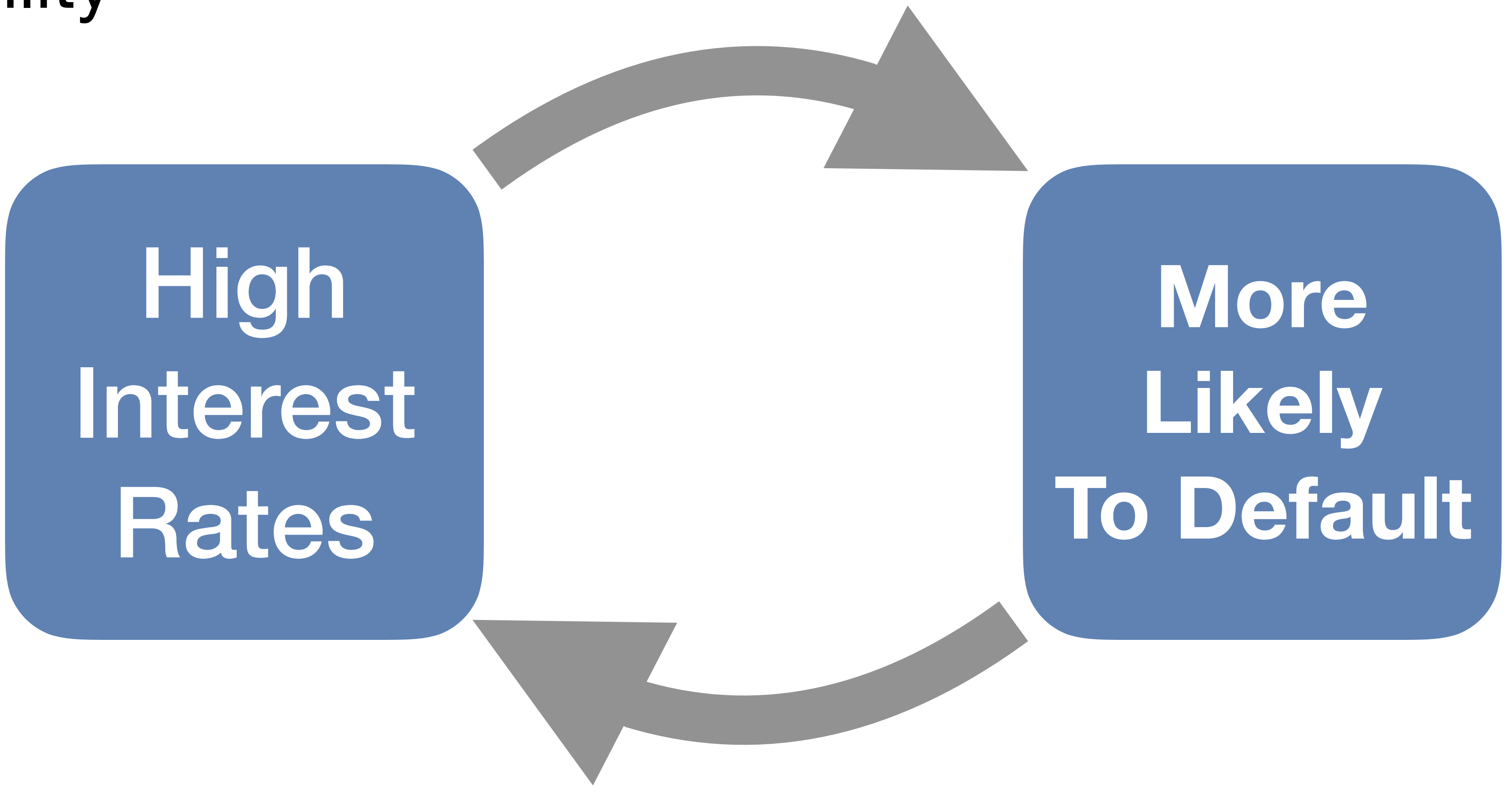

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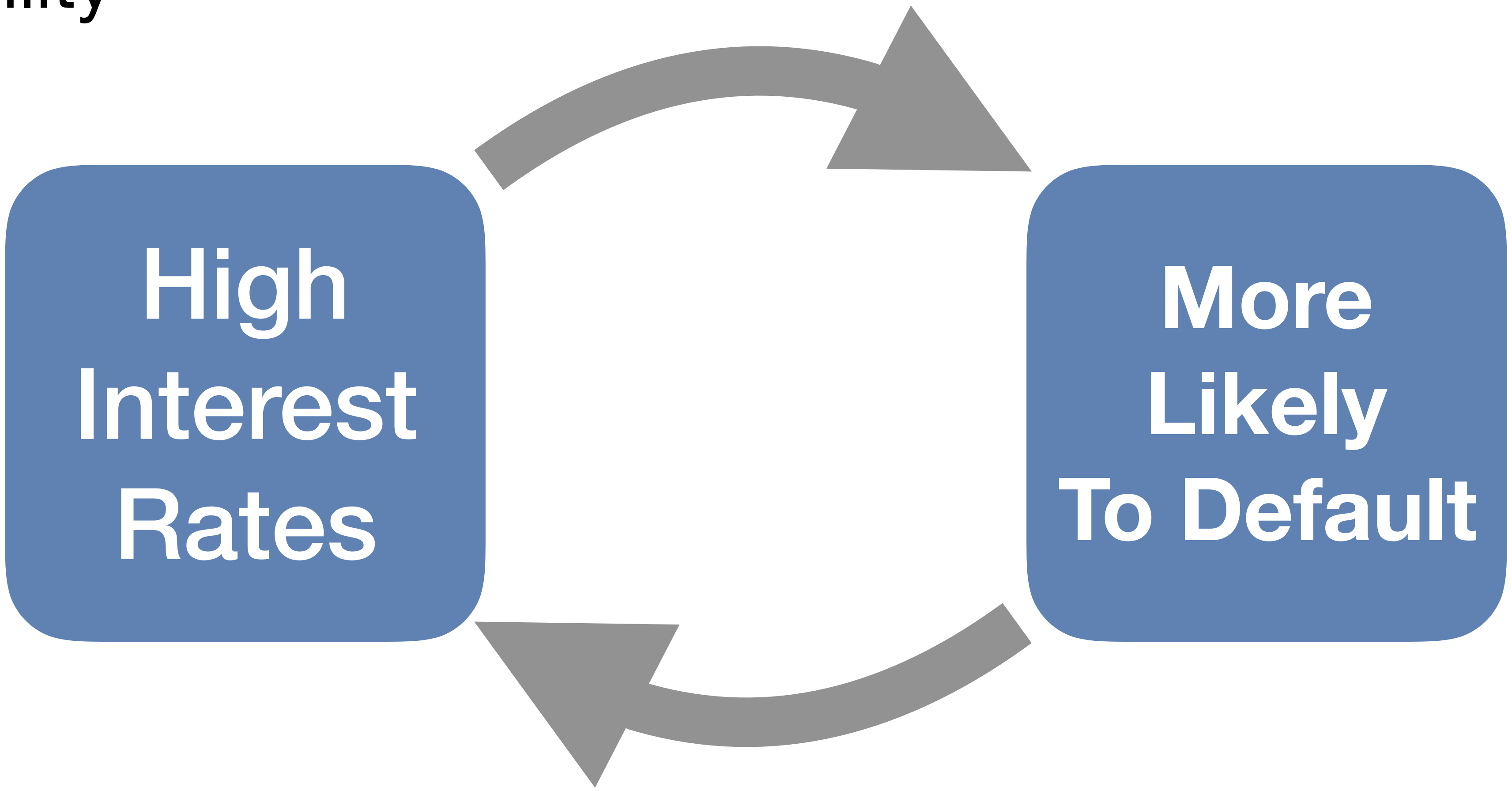

- Confidence crisis / Amplification

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- In crisis: time matters — **debt accumulates**

Lessons learned?

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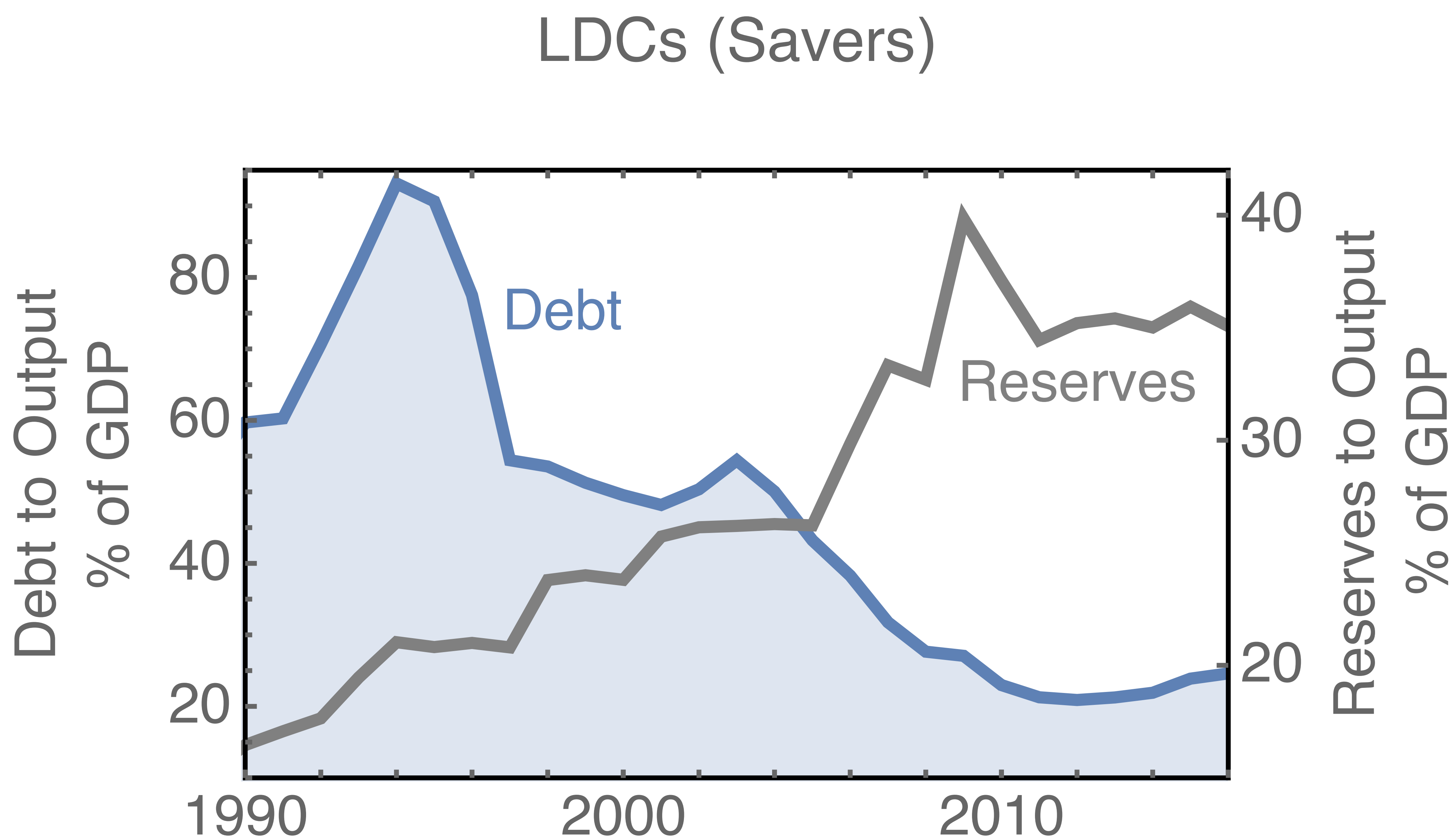

Conclusion

- Focus on Less Developed Countries
- Developed countries are different
    - European debt crises