Sovereign Debt and Default

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*The views expressed in this presentation are those of the presenter and do not necessarily represent those of the IMF or IMF policy.
- Paper 1: The Financial Returns on China’s Belt and Road
- Paper 2: Sovereign Defaults at Home and Abroad
- Paper 3: Why do some countries default more often than others? The role of institutions
Haircuts

Paper systematically estimates “haircuts” for Chinese banks. Finds haircuts to be small on average.

Bargaining over haircuts is often constrained:

- In broader official restructurings, coordinating mechanisms and comparability of treatment provisions limit scope for an individual creditor to negotiate its own haircut.
- Restructuring targets required to restore sustainability (e.g. under an IMF-supported program).
- In the case of HIPC, clear rules for treatment of each loan.

HIPC discount rates/LIC DSF discount rate should be the appropriate discount rate for official creditors (yardstick used for comparability of treatment).

Small realized real rate of return (1.7 percent) despite low haircuts. How does it compare with other official creditors?
Larger haircuts under HIPC, when China’s exposure was still small

Note: The circle size reflects the amount of debt restructured in real US$.
- Paper 1: The Financial Returns on China’s Belt and Road
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- Paper 3: Why do some countries default more often than others? The role of institutions
Increasing role for domestic debt

Paper provides systematic comparison of external vs domestic defaults

- Important since domestic debt becoming relatively more important
- This time dimension covered explored in the paper, but could be explored in even greater detail

Domestic restructurings may be “easier” from a legal perspective. But bring financial stability risks

- However unpleasant a debt crisis is, adding a financial crisis will make it much worse
Relative creditor losses

Paper finds larger losses for domestic debt than external debt, which is a surprising result:

- Financial stability concerns should limit losses imposed on domestic creditors
- Lighter treatment of domestic debt in recent cases
- No expectation of comparability of treatment between external and domestic creditors (including cases where domestic debt not restructured at all)
Relative creditor losses

The paper could elaborate on how the NPV losses are computed (it relies on NPV reported by source)

- Choice of appropriate discount rate for restructured domestic debt may be particularly difficult in a high inflation environment
- Maybe complement with analysis of market haircuts for a few selected cases?
  - For example, compare market value of restructured claim to original claim in cases where data more easily available?
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Strong channel for overborrowing

Model with two separate groups making spending, borrowing and default decisions independently (which then affect both groups)
- Motivated by role of sub-national borrowers (states/provinces)

Alternative way to get over borrowing relative to more standard political economy channels involving high discounting/short horizons

The channel highlighted is quite strong, as shown by the calibrated model
- Explaining more than half of cross-country variation in default frequency

So strong, that there has been a lot of progress addressing this particular type of institutional shortfall
- The anecdotal evidence dates back from the 80s

But there are still cases where some borrowers may not internalize aggregate impact
- E.g. borrowing by SOEs outside the control of Ministry of Finance