Sovereign Debt: A Guide for Economists and Practitioners

Sovereign Default

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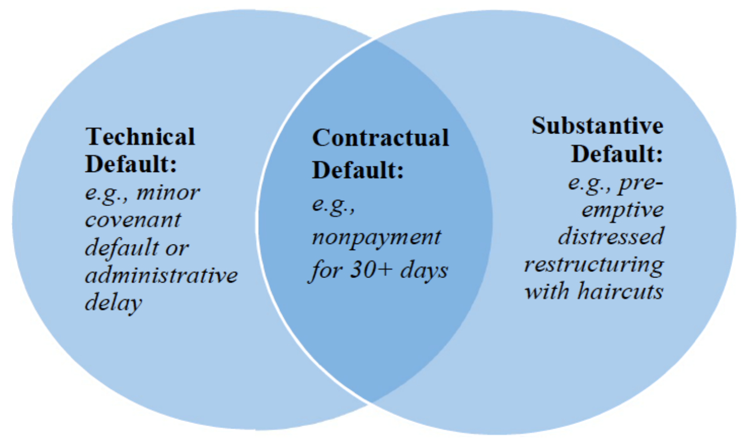
Chapter 7 contributions

- Glossary and nomenclature for defaults/restructurings
- Survey of causes, costs of defaults/restructurings
- Supporting evidence on “too little, too late” problem
- Role of IMF in reducing incidence/cost of defaults

Problems with nomenclature

- Too broad definition of "default" = any debt work out
- Odd choice: restructuring is the cure for an unsustainable debt of which defaults are one of many possible symptoms
- Undesirable side-effect: puts voluntary debt workouts under a bad light (as defaults get a bad rap)
- Alternative nomenclature: DSM, Debt Sustainability Management measures

Figure 7.1.1: Defining Default



Debt Sustainability Management

- Conventional measures
  - Asset and liability management (F, S)
  - Growth inducing (F, S)
  - Fiscal adjustment (F)
  - Official bail outs (F)
- Unconventional measures
  - Debt monetization—seigniorage, inflation surprise (F, S)
  - Financial repression—real interest rate compression (F)
  - Pre-emptive debt workout—no contractual default (S)
    - Reprofiling, debt rollovers—small NPV cut (F, S)
    - Restructuring—big NPV cut (S)
  - Post-contractual default debt workout—big NPV cut (S)

F= flow measure; S= stock (including denominator reducing) measure

IMF role in borderline sustainable cases

- IMF lending from its GRA has inherent constraints
  - Safeguard reserve quality of members' exposure to IMF to ensure low cost financing
  - Preserve preferred creditor status (ensure catalytic role of Fund financing via credible programs) to enable below market lending
- Reform toolkit to support borderline sustainable sovereigns
  - Entrust IMF to manage member-sponsored SPV with flexible financing mandate: ability to borrow in markets; ability to lend against collateral, intervene in secondary debt market, issue guarantees, e.g., to sweeten debt reprofiling; charge market rates
  - SPV is pari passu with private creditors (no seniority), upside and downside shared by participants into SPV
  - Benefits: no contamination of GRA lending, Fund catalytic role, and PCS; more skin in the game in borderline sustainable cases