

## ECONOMICS OF SOVEREIGN DEBT

### Lecturer:

Prof. Silvia Marchesi, PhD

Office: Bicocca, DEMS, #3073

Email: [silvia.marchesi@unimib.it](mailto:silvia.marchesi@unimib.it)

### **Contents**

Public debt in advanced economies is at levels not seen since the Second World War, while emerging market public debt is at levels last seen during the 1980s debt crisis. Low-income countries have seen sharp increases in their debt burdens over the past five years. In this context, the Covid-19 crisis is going to increase even more the need of public finance and hence to make debt sustainability a much more serious concern, especially for emerging countries, which are facing a financial crisis as well as a public-health emergency. The course will deal with the incentives that a sovereign country could have in repaying its debt, with the distortions created by the inadequacy (or lack) of these incentives and finally with the remedies that have been proposed and implemented to solve sovereign debt crises.

### **II. Date and Time**

tba

### **III. Note**

The readings consist of a series of papers, published in international journals. Each student is expected (a) to choose and present two papers among those listed in the Syllabus; (b) to prepare a discussion of one of the papers presented by the others.

Teaching will be in English.

### **IV. Grading**

- 2 Presentations (50%)
- 1-2 page discussion (25%)
- Active participation (25%)

### **V. Requirements**

- Students are expected to do all required readings and to participate in all the sessions.
- Presentation: each student will be responsible for a 30 minutes' presentation, which will be followed by a discussion and Q&A (about 20 minutes). Please relate your paper to the literature discussed in the initial lectures.
- Discussion: each student is expected to prepare a (1/2 page) discussion on one of paper presented by the others, which will help to make the presentations more lively. The discussion should not simply summarize the paper. Instead, it should highlight strengths and weaknesses of the paper and provide suggestions for extensions and potential future research.
- Given the nature of the topics of this course, students are encouraged to relate both presentation and discussion to the most recent news and economic events.

### **VI. Preliminary Lecture Plan**

#### *Part 1 Incentives*

Introduction. Sanctions and reputation, costs of default

#### *Part 2 Distortions*

Debt overhang. Debt structure: maturity and foreign currency composition

#### *Part 3 Remedies*

New lending, Debt Restructuring and Debt Relief

## VII. Reading list

### INTRODUCTION

Aguiar M. and M. Amador. 2013. Sovereign Debt: A Review. in E. Helpman, K. Rogoff and G. Gopinath (eds) Handbook of International Economics Volume 4, Elsevier, 647-687

Ali Abbas S., Alex Pienkowski and Kenneth Rogoff. 2019. Sovereign Debt: A Guide for Economists and Practitioners. Oxford University Press

Blanchard Olivier. Public Debt and Low Interest Rates. 2019. *American Economic Review* 2019, 109(4): 1197–1229

Boone Peter and Simon Johnson (2014) Forty Years of Leverage: What Have We Learned About Sovereign Debt? *American Economic Review: Papers & Proceedings*, 104(5): 266–271

Cameron Ballard-Rosa, Layna Mosley and Rachel L Wellhausen. 2020. Contingent Advantage? Sovereign Borrowing, Democratic Institutions and Global Capital Cycles. *British Journal of Political Science*

Chian Koh Wee, M. Ayhan Kose, Peter Nagle, Franziska Ohnsorge and Naotaka Sugawara. 2020. Debt and Financial Crises CEPR Discussion Paper 14442

Eaton J.R. and R. Fernandez (1995) “Sovereign debt,” in G. Grossman and K. Rogoff (eds.) Handbook of International Economics Volume 3, Elsevier, 2031-77.

Gourinchas Pierre-Olivier, Philippe Martin and Todd Messer. 2020. The Economics of Sovereign Debt, Bailouts and the Eurozone Crisis. CEPR Discussion Paper 14891

Horn Sebastian, Carmen M. Reinhart and Christoph Trebesch. 2020. China’s Overseas Lending. NBER Working Paper 26050

Horn Sebastian, Carmen M. Reinhart and C Trebesch. 2020. Coping with Disasters: two Centuries of International Official Lending. NBER Working Paper 27343

Kose M. Ayhan, Peter Nagle, Franziska Ohnsorge and Naotaka Sugawara. 2020. Global Waves of Debt. Causes and Consequences. World Bank Group editions.

Kose M. Ayhan, Peter Nagle, Franziska Ohnsorge and Naotaka Sugawara 2020. Can This Time Be Different? Policy Options in times of Rising Debt. CEPR Discussion Paper 14528

Kose M. Ayhan, Peter Nagle, Franziska Ohnsorge, and Naotaka Sugawara 2020. Understanding the Global Waves of Debt. CEPR Discussion Policy Series

Obstfeld M. and K. Rogoff (1996) “Foundations of International Macroeconomics” (chapter 6) MIT Press.

\* Panizza U., Sturzenegger F. and J. Zettelmeyer. 2009. The Economics and Law of Sovereign Debt and Default. *Journal of Economic Literature* 47(3), 1-47.

Tomz M. and M. L. J. Wright. 2013. Empirical Research on Sovereign Debt And Default. NBER Working Paper 18855

### INCENTIVES:

Asonuma T. and C. Trebesch. 2016. Sovereign Debt Restructurings: Pre-emptive or Post-Default. *Journal of the European Economic Association*. 14: 175-214.

Eaton and Gersovitz (1981), “Debt with potential Repudiation: Theoretical and empirical analysis”, *The Review of Economic Studies*, 48(2), 289-309;

\* Borensztein E. and U. Panizza (2009) The costs of sovereign default. IMF Staff Papers 56 (4), 683—741

Borensztein E., and U. Panizza (2010) Do Sovereign Defaults Hurt Exporters? *Open Economic Review* 21(3), 339-412.

Bulow, J., and K. Rogoff (1989) “Sovereign debt: Is to forgive to forget?” *American Economic Review*, 79, 43-50

Cheng, G., Diaz-Cassou, J. and A. Erce. 2017. From Debt Collection to Relief Provision: 60 Years of Official Debt Restructurings through the Paris Club. Inter-American Development Bank (IDB) Working Paper Series 753

- Cheng, G., Diaz-Cassou J. and A. Erce. 2018. The Macroeconomic effects of Official Debt Restructuring: Evidence from the Paris Club. *Oxford Economic Papers*, forthcoming.
- Cline, William, 1995. *International Debt Reexamined*. Washington, DC: Institute for International Economics
- Cole H.L., Dow J. and W.B. English. 1995. Default, Settlement and Signalling: Lending Resumption in a Reputational Model of Sovereign Debt. *International Economic Review*, 36, 365-384.
- \* Cruces J. J. and C. Trebesch. 2013. Sovereign Defaults: The Price of Haircuts. *American Economic Journal: Macroeconomics* 5, 85-117
- De Paoli B., Hoggarth G. and V. Saporta (2009) Output costs of sovereign crises: some empirical estimates. Bank of England Working Paper No. 362.
- Gennaioli, N., A. Martin, and S. Rossi. 2014. Banks, Government Bonds, and Default: What do the Data Say? IMF Working Paper 120
- Furceri F. and A. Zdzienicka. 2012. How costly are debt crises? *Journal of International Money and Finance* 31, 726—742
- Manasse P. and N. Roubini. 2009. “Rules of thumb” for sovereign debt crises. *Journal of International Economics* 78 (2009) 192–205
- Özler S. 1993. Have commercial banks ignored history? *American Economic Review*, 83, 608-620.
- Rose, A. 2005. One reason countries pay their debts: Renegotiation and international trade,” *Journal of Development Economics*, 77, 189-206.
- \* Levy Yeyati E. and U. Panizza (2011) The Elusive Costs of Sovereign Defaults. *Journal of Development Economics* 94, 95-105.
- Reinhart C. M. and K.S. Rogoff (2009) *This Time is Different: Eight Centuries of Financial Follies*. Princeton University Press.
- Reinhart Carmen M. and Kenneth S. Rogoff. 2011. From Financial Crash to Debt Crisis. *American Economic Review* 101: 1676–1706
- Reinhart Carmen M. and Kenneth S. Rogoff. 2013. Financial and Sovereign Debt Crises: Some Lessons Learned and Those Forgotten WP/13/266
- Reinhart Carmen M. & Kenneth S. Rogoff. 2014. This Time is Different: A Panoramic View of Eight Centuries of Financial Crises, *Annals of Economics and Finance*, Society for AEF, vol. 15(2), pages 1065-1188, November.
- Schumacher Julian, Christoph Trebesch and Henrik Enderlein. 2018. Sovereign Defaults in Court. CEPR Discussion Paper 12777
- Sturzenegger, F., and J. Zettelmeyer. 2007. *Debt Defaults and Lessons from a Decade of Crises*, MIT Press, first two chapters.
- Sturzenegger F. and J. Zettelmeyer. 2008. Haircuts: Estimating Investor Losses in Sovereign Debt Restructurings, 1998-2005. *Journal of International Money and Finance* 27, 780-805.
- Tomz M. and M. Wright. 2007. Do countries default in bad times? *Journal of the European Economic Association* 5 (2), 352--360.
- \* Trebesch C. and M. Zabel (2017). The Output Costs of Hard and Soft Sovereign Default. *European Economic Review*. 92: 416-432
- Schlegl Matthias, Christoph Trebesch and Mark L. J. Wright 2019 The Seniority Structure of Sovereign Debt, NBER Working Paper 25793

## DISTORTIONS

- Arellano Cristina, Xavier Mateos-Planas and José-Víctor Ríos-Rull. 2020. Partial Default. NBER Working Paper 26076
- Bordo Michael D., Christopher M. Meissner. Original Sin and the Great Depression NBER Working Paper 27067
- Broner, F., A. Martin, and J. Ventura 2010. Sovereign risk and secondary markets. *American Economic Review*
- Broner F. A., G. Lorenzoni and S. L. Schmukler. 2013. Why Do Emerging Economies Borrow Short Term?, *Journal of the European Economic Association*, Vol. 11, pages 67-100, 01.
- \* Claessens S., D. Klingebiel, S. Schmukler. 2007. Government Bonds in Domestic and Foreign Currency: The Role of Macroeconomic and Institutional Factors, *Review of International Economics*, 15(2), 370–413, 2007
- Cordella T., Ricci L.A., M. Ruiz-Arranz. 2005. Debt Overhang or Debt Irrelevance? IMF staff Papers 57: 1-24
- Debrun Xavier, Jonathan D. Ostry, Tim Willems and Charles Wyplosz. 2019. Public Debt Sustainability. CEPR Discussion Paper series DP14010
- Funke Manuel Moritz Schularick Christoph Trebesch. 2016. Going to Extremes: Politics after Financial Crisis, 1870-2014. *European Economic Review*, 88, 227-260
- \* Gelos, G., R. Sahay, and G. Sandleris, 2011. Sovereign borrowing by developing countries: What determines market access? *Journal of International Economics*, 82(2), 243-254.
- Gonzalez-Aguadoy Eugenia. 2019 Financial Development and Vulnerability to External Shocks: The Role of Sovereign Debt Composition. Mimeo
- \* Hausmann R. and U. Panizza. 2003. On the determinants of Original Sin: an empirical investigation. *Journal of International Money and Finance*, 22, pp. 957-990.
- Herrera Helios, Guillermo Ordoñez, and Christoph Trebesch. 2020. Political Booms, Financial Crises. *Journal of Political Economy*, forthcoming
- Jeanne, O., 2009. Debt Maturity and the International Financial Architecture. *American Economic Review*, 99, 2135-2148
- Koh Wee Chian, M. Ayhan Kose, Peter Nagle, Franziska Ohnsorge and Naotaka Sugawara. 2020. Debt and Financial Crises. CEPR Discussion Paper 14442
- \* Krugman P. 1988. Financing versus forgiving a debt overhang. *Journal of development economics*, 29(3): 253-68.
- \* Marchesi S. and A. Missale. 2013. Did high debts distort loans and grants allocation to IDA countries?, *World Development*, Volume 44, pp. 1-300
- Ottonello Pablo and Diego J. Perez. 2019. The Currency Composition of Sovereign Debt. *American Economic Journal: Macroeconomics*, 11(3): 174–208
- Presbitero Andrea and Ugo Panizza. 2014. Public Debt and Economic Growth: Is There a Causal Effect?, *Journal of Macroeconomics*, 41:21-41.
- \* Presbitero Andrea and Ugo Panizza, (2013), Public debt and economic growth in advanced economies: A survey", *Swiss Journal of Economics and Statistics*, 149(II): 175-204
- \* Reinhart, Carmen M., Kenneth S. Rogoff and Miguel A. Savastano. 2003. Debt intolerance. *Brookings Papers on Economic Activity*, Vol. 1: 1-62
- \* Reinhart, Carmen M and Kenneth S Rogoff. 2010. Growth in a Time of Debt. *American Economic Review*, May
- Reinhart, Carmen M, Vincent R Reinhart and Kenneth S Rogoff. 2012. Public debt overhangs: Advanced-economy episodes since 1800, *Journal of Economic Perspectives*, 26(3): 69-86.
- Herndon Thomas, Michael Ash and Robert Pollin (2013) Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff. Forthcoming in *Cambridge Journal of Economics*
- Ottonello Pablo, Diego Perez. 2019. The Currency Composition of Sovereign Debt. *American Journal Macro* forthcoming

## REMEDIES

Arellano Cristina, Yan Bai and Gabriel P. Mihalache. 2020 Deadly Debt Crises: Covid-19 in Emerging Markets. BER Working Paper 27275

\* Arslanalp Serkan and Peter Blair Henry (2006) “Policy Watch Debt Relief” *Journal of Economic Perspectives*, 20(1), 207–220.

\* Arslanalp S., P.B. Henry (2005) “Is debt relief efficient?” *Journal of Finance*, 62: 2, pp. 1017-051.

Daseking, Christina and Robert Powell, 1999. From Toronto Terms to the HIPIC Initiative: A Brief History of Debt Relief for Low-Income Countries, IMF Working Paper 99/142.

Easterly, W., 2002. How did highly indebted poor countries become highly indebted? Reviewing two decades of debt relief. *World Development* 30, 1677—1696.

Fang Chuck, Julian Schumacher and Christoph Trebesch. 2019. Restructuring Sovereign Bonds: Holdouts, Haircuts and the Effectiveness of CACS. Mimeo

Jayachandran, Seema and Michael Kremer. 2006. Odious Debt. *The American Economic Review* Vol. 96 No. 1

Marchesi S and T Masi. 2020a. “Life after Default. Private and Official Deals”. CefES Working Paper 431.

Marchesi S. and T. Masi. 2020b. Sovereign Rating after Private and Official Restructuring. *Economics Letters*, 192:1-7.

\* Marchesi, S., J.P. Thomas 1999. IMF conditionality as a screening device *The Economic Journal*, 1999, 109, 111-125

\* Marchesi, S. 2003. Adoption of an IMF programme and debt rescheduling. An empirical analysis. *Journal of Development Economics*, 70(2), 403–423.

\* Reinhart, C. M. and C. Trebesch. 2016. Sovereign Debt Relief and its Aftermath. *Journal of the European Economic Association*, 14(1): 215-251

Tirole, J. 2002. Financial Crises, Liquidity, and the International Monetary System, Princeton University Press.

**\* papers explained during the lectures**

**\*\* papers to be selected for presentation and referee report**