

Dodging Default: Is it Good Policy?

Comments by Susan Schadler
CIGI and Atlantic Council

Europe 2010: Exploring the Future of European Integration
CASE International Conference
November 18-19, 2011

Sovereign Debt restructuring: three questions

- Is restructuring used too little, too late?
 - Are costs higher in a currency union?
 - Reducing the bias against restructuring?
-

I Is restructuring used too little, too late? When do countries restructure?

- Textbook advice: illiquidity vs insolvency
 - In practice: when all else fails
-

Why is restructuring the last resort?

- ❑ “Not-on-my watch” syndrome
 - ❑ No legal mechanisms/set procedures
 - ❑ Worth gambling to avoid costs
-

What are the Costs?

- ❑ Losses for creditors
 - ❑ Losses for borrowers
 - Loss of market access
 - Chaotic process
 - ❑ Systemic costs
 - Smaller/more costly debt market
 - Moral hazard for borrowers
-

But delay also has costs?

- Uncertainty in gamble for redemption
 - Deadweight loss
 - Moral hazard for *both* creditor/debtor
-

II. Are costs higher in currency unions?

Lessons from the U.S.

- ❑ State defaults: 1830s, 1890s, 1930s
 - ❑ Growing talk of future defaults:
(California, Illinois, New Jersey)
 - ❑ Sub-state level defaults
-

Special problems in currency unions

- Tarnishing brand name

 - Stability of banking system
 - Maintaining access to liquidity
 - Solvency after default
-

What did Greece tell us?

- CU raised bias against restructuring
 - Large costs of delay
(end-2010-mid-2011)
 - Foreign private exposure fell 25 %
 - 10-year yield rose 500 bps
-

III. Making space for timely restructuring Isn't the IMF enough?

□ IMF crisis response

- Short-term: financing/demand restraint
- Long-term: structural reform/growth

□ Constraints on financing

- Access limits
 - Credibility of conditionality/program
-

What Happened?

- ❑ 1980s: restructuring through BACs
 - ❑ 1990s: exceptional access
 - ❑ 2000-10: Case-by-case
 - ❑ Greece:
 - Ease exceptional access conditions
 - Schism between program/market
-

Needed: Global and CU SDRMs

- ❑ Systematic approach to restructuring option
 - ❑ Statutory approach to mechanics
 - ❑ In CU, SDRM as fourth pillar
-