Sovereign Debt Crises and Restructurings: Is There a Better Way?

Kenneth Rogoff, Harvard University
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Since advent of debt, sovereign debt crises have been a recurring problem

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Sovereign Default Cycles 1800-2009

Sovereign External Debt: 1800-2006
Countries in Default Weighted by Their Share of World Income

Is this time different?

Reinhart-Rogoff, THIS TIME IS DIFFERENT  Kenneth Rogoff Harvard
The UN has long played a significant role in sovereign debt proposals

• 1979: “International Debt Commission” proposal by Group of 77 in preparation for UNCTAD meeting. (see ROGOFF and ZETTELMEYER, 2002)
  – Would consist of “eminent figures” with recognized knowledge of debt and development
  – Examine debt and development problems of requesting country
  – Make recommendations in broader context of development INCLUDING debt reorganization and additional finance

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Later Proposals Added Private Debt

- Oeschli (1981) was the pioneering proposal, and many others followed for an international bankruptcy regime.
- Sachs (1995) proposal particularly influential, arguing that IMF would be more effective operating like an international bankruptcy court.
- IMF Sovereign Debt Restructuring Mechanism (2001) is the next milestone.

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What problems do an international bankruptcy regimes aim to solve?

• Holdout problem (most recently seen in creditor instigated internment of Argentine ship in Ghana)

• Idea of Establishing Seniority (Sachs, Bolton-Skeel) and others.

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But holdout problem can be inventively managed

• Outside Argentine case, holdout problem has not proved that severe in recent bankruptcies
• Other approaches have been developed, including incorporating collective action clauses into bonds
• Holdouts most likely to be successful when they are small “nuisance” players that are cheaper to pay off than to fight.
• Ergo, not always a first-order problem
Seniority very hard to establish

- In a corporate debt restructuring, there are assets that the senior creditors can possess
- No parallel in sovereign debt, making seniority very difficult to establish (Bulow and Rogoff, 1988)
- IMF claims seniority but is helped by small size
- Europe is case in point. As official creditors become large, they become vulnerable
- “PIGS GET FED, HOGS GET SLAUGHTERED”

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EUROPE IS A GOOD CASE STUDY

• There are proposals for a European SDRM
• If it cannot be done in Europe, then it seems unlikely to succeed on a global basis
• Europe’s problems underscore the important of strengthening global governance as an extremely important component of making any new international bankruptcy regime successful.

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What about United States, Japan or Germany?

• Mechanisms for resolving sovereign debt workouts has largely been envisioned as problem for improving management of developing country debt problems.

• But as unlikely as a default in one of the largest countries might seem, it would be folly to build a mechanism that cannot handle a default in one of the world’s largest economies

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Finally, A Deeper Question

• Why is such a large percentage of international flows channeled through debt?
• Equity and direct foreign investment are arguably somewhat more robust than debt
• Thus an international bankruptcy regimes that weakens creditors rights is not necessarily inefficient
• Perhaps ideal regime is one with strong creditor rights but extensive indexation of debt to GDP, commodity prices, etc., depending on country circumstance.

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