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

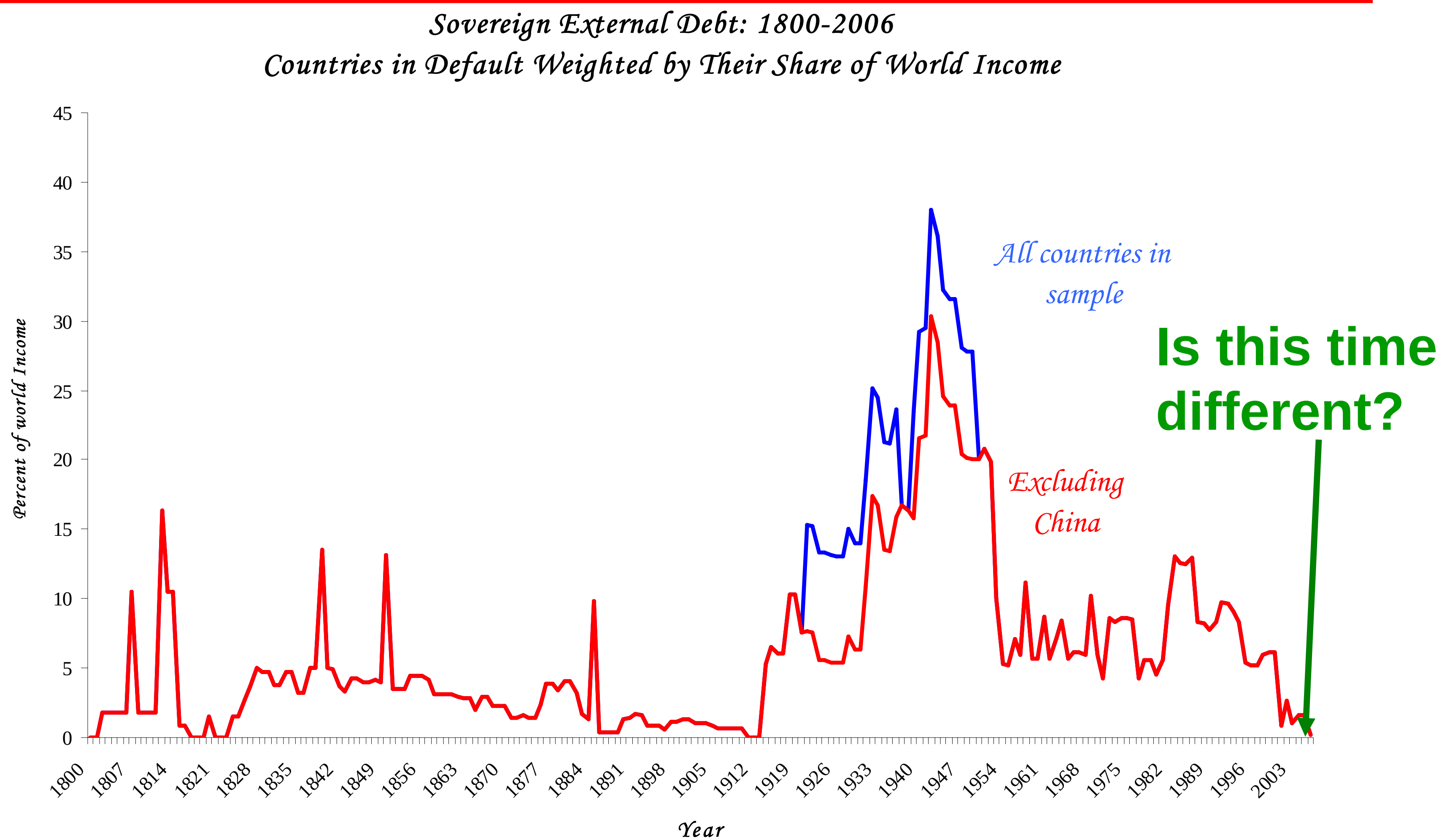
Kenneth Rogoff, Harvard University

Presentation to United Nations General Assembly

New York City, October 25, 2012

Since advent of debt, sovereign debt crises have been a recurring problem

Sovereign Default Cycles 1800-2009



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 INLUDING debt reorganization and additional finance

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

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.

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”

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.

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

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.

NEW YORK TIMES BESTSELLER

THIS TIME IS DIFFERENT

Eight Centuries of Financial Folly

CARMEN M. REINHART
&
KENNETH S. ROGOFF

"[A] masterpiece."
—Martin Wolf, *Financial Times*