Discussion of:

Sovereign debt standstills

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Summary

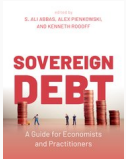
- A very interesting paper that is after important questions:

  What policies can help resolve sovereign debt distress?

  - ▷ Defaults can be costly for borrowers and lenders
  - ▷ Lots of market inefficiencies: lack of commitment, non-contingent debt
  - ▷ Can policies (Pareto) improve the market allocation?

  Debt relief: debt standstills, haircuts, or something else?

  - ▷ "Practitioner's" policy recommendations vary wildly
  - ▷ Mostly guided by past debt resolutions experiences
  - ▷ Can quantitative models help us shed light on this question?
  - ▷ This paper focus on "preventive" debt standstills and face-value haircuts



Main setup

- Quantitative sovereign default model
  - Exogenous long-term debt
  - Output loss and stochastic market exclusion after default
  - Zero recovery
- Shares features of their previous work.
  - Voluntary debt exchanges, JME 2014.
- The possibility of these policies is unknown ex-ante
  - Unanticipated debt relief

Gains and losses from standstills

- Policies: standstill & haircut
  - no payments for T^{DS} periods. No costs of "default"
  - debt may increase (fall) by $(1 + r^{DS})$ each period
  - default and borrowing is possible during the standstill

- For $r^{DS} \leq 0$, borrowers welfare increases from standstills
  - If no/mild interest (negative haircut) applied

- Lenders may gain or lose from standstills
  - market value with no standstill (after shocks are known but before decisions)

$$MV(b,y) = b\left[1 - \hat{d}(b,y)\right]\left[1 + (1-\delta)q(\hat{b}(b,y),y)\right]$$

  - market value with standstill

$$MV^{DS_j}(b,y) = b\left[1 - \hat{d}^{DS_j}(b,y)\right]\left(1 + r^{DS}\right)q^{DS_j}(\hat{b}^{DS}(b,y),y)$$

Comment 1: accounting for gains and losses

- In a 1-period bond economy with zero recovery and 1-period standstill
  - ▷ market value improvement from policy

$$MV^{DS}(b,y) - MV(b,y) = b\left[\left(1-\hat{d}^{DS}(b,y)\right)q(\hat{b}(b,y),y) - \left(1-\hat{d}(b,y)\right)\right]$$

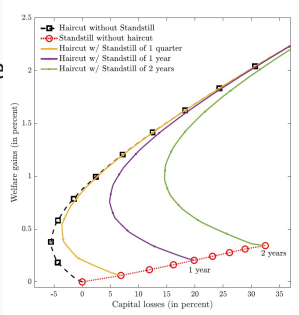
  - ▷ So, if no-default, lenders always lose from the policy.
  - ▷ With long-term bonds, this is less straightforward. Even with no default, borrower's can be on the wrong side of the Laffer curve. Some haircut is preferred for lenders (and borrowers).
  - ▷ But for very large shocks, is $q^{DS_j}(\hat{b}^{DS}(b,y),y) > \left[1+(1-\delta)q(\hat{b}(b,y)y)\right]$ possible? Fig 1, c seems it is. Is this driven by a strong expected recovery in income in these cases?

- It would be valuable some more details/decomposition around this main result

- Also, why not look also at the effects on the default decision?

Comment 2: Unanticipated debt relief

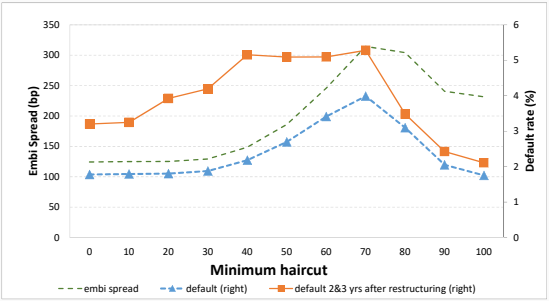
- COVID was an unexpected shock
  - Treat the policy interventions also as unanticipated
  - An extra (unexpected) contingency can improve welfare
  - In many cases, borrowers and lenders benefit from the policy (Pareto improvement)
  - In other cases the borrower's gains may compensate lender's loses



- But, can we draw policy recommendations beyond a large unanticipated shock?
  - Is it possible to extrapolate to "recurrent" debt crises?
  - Borrowers may be better-off committing to never use a "voluntary debt exchange"?
  - Anticipated capital losses by lenders will need to be compensated via higher yields and/or less lending, thus welfare may not increase

Comment 3: Interventions after default

- Voluntary debt exchanges (no missed payments) are prevalent in the data
- But so are defaults with restructurings ex-post
  - In a new paper on policy interventions and default we study the effects of haircuts and reprofilings after default in a quantitative model
  - On average, additional haircuts improve welfare, even after compensating the lenders or starting from a zero debt economy
  - But, all else equal, generate incentives that “practitioners” may find unappealing



Conclusion

- Very interesting paper and I am looking forward to see more
- Recommendations by practitioners and policy makers on how to deal with sovereign debt distress may be right, or may make things worse
- Quantitative sovereign default models can enrich the debate on what policies would be most adequate
- This paper can be an important contribution to that end