Avoiding Avoidable Debt Crises
Lessons from Recent Defaults

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Sovereign Debt and the Financial Crisis
Tunis, March 29-30, 2010

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Debt trends after the crisis

• Reversal of previous trends
• Large increase in External Debt (ED) in ECA and LIC
• Public external debt debt is becoming more important
  – Careful about the sample (only 60 developing and transition economies)
Total external debt of developing and EM countries has been increasing...

Recent Evolution of Total External Debt as a share of GDP
...with a switch from private to public sector borrowing...

Recent Evolution of External Debt (million USD)
…especially in ECA…

Recent Evolution of PPG External Debt as a share of GDP
...and big reversal of progress in LICs

Recent Evolution of External Debt in Low Income countries (million USD)
Explaining recent debt growth

• We conducted an empirical exercise aimed at estimating the determinants of debt growth during the recent crisis and...
• …we didn't find much
• Too early to tell
• The sample might not be representative
• So, we looked at four recent default episodes
  – The main innovation of the paper is that it combines a description of the economic circumstances that led to the default with a detailed analysis of the legal mechanisms used in the resolution of some of these defaults
The roots of recent defaults

• We looked at the defaults of Grenada (2004), Belize (2006), Seychelles (2008), and Ecuador (2008)

• Three of these defaults were caused by a combination of:
  – External demand shocks (Seychelles)
  – Natural disasters (Grenada)
  – External imbalances (Belize, Grenada, and Seychelles)
  – Fiscal imbalances (Belize and Grenada)

• The case of Ecuador is instead unique because it was based on the presumed illegitimacy/illegality of parts of the country's external debt
  – The role of debt audits
The policy agenda

• Avoid overborrowing
  – Address internal political economy problem
  – How to evaluate long term debt sustainability?

• Develop contingent debt contracts
  – International policies

• Deal with defaults
  – Do we need something new and, if so, why?

• Develop principles for responsible sovereign lending and borrowing
  – The most challenging task, but we are working on it!
Will this time be different?

• Too early to tell…
• …but two open questions:
• Will there be externalities linked to Ecuador's action?
  – Repricing of risk?
• Why didn't the dog bark?
  – No sudden stop in major EMs
  – Have some countries really graduated to Advanced Emerging Market status? (Ghezzi, Levy Yeyati, 2009)
  – And if so, is it because of redemption or just abstinence (Hausmann and Panizza, 2010)
Will this time be different?

- Too early to tell...
- ...but..
- ...things are rarely different
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