Discussion of
Recovery Before Redemption: A Theory of Delays in Sovereign Debt Renegotiations

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This paper

- Ambitious work on an important and timely topic
  - Sovereign debt renegotiations

- Many aspects
  - Facts
  - Theory
  - Calibration
Facts

- Very interesting set of stylized facts

1. Sovereign defaults take time to resolve (8 yrs.)
2. Haircuts are substantial (40%)
3. 1. and 2. positively correlated
4. 1. and 2. associated with larger output declines on year of default
5. Defaults likely to occur when output is below trend / likely to end when output is on trend
6. Debt/GDP ratio basically unchanged after exiting default

- Great: perhaps some additional discussion
  - Fact 1: relationship with previous evidence on exclusion (Gelos et al., 2008)
  - Fact 4: growth vs. level of output at year of default
Theory

- Design a model to explain these facts (delay)
  - Model with SOE and international creditors
  - Endogenous default with bargaining
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• Problem: strong incentives to settle fast
  – Delay is costly for country: autarky
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  - Asymmetric information (signalling)
  - Creditor coordination (hold-up)
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• In this paper: intuitive new take
  – Same ol'lack of commitment
Theory: intuition

- Model of endogenous default with bargaining:
  - Output stochastic
  - One-period bonds
  - Default \(\rightarrow\) output loss and autarky until settlement
    * Each round of bargaining: one party proposes / the other accepts or rejects
    * Identity of proposer is stochastic
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- Imagine country defaults when conditions are bad: low output / high bargaining power
  - Incentives to settle right away?
  - Not for creditor: better to wait until conditions change
  - But all anticipate this: why not give creditor this expected value today?
    * Lack of commitment: if country defaulted today, why not again tomorrow?
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- Key ingredients:
  - Randomness (conditions might change...)
  - Persistence (...but not right away)
Theory: thoughts

- *If* this is the idea...I like it!
  - Sensible and no new complications

- *If* this is the idea...please say so!
  - This section is very hard to read
    - * Basically proves existence of equilibrium
  - Why not discussion of the mechanism and intuition

- Examples to illustrate main points (now in the calibration part):
  - If no persistence: does delay disappear?
  - If persistence only in output: delay? ✓
  - If persistence only in bargaining power
    - * Delay only if country has the power
Implications

• Role of debt maturity
  – Country would like to compensate creditors today...
  – ...but likely to default tomorrow on one period bonds
  – Would longer maturities alleviate this? In model, I think so
  – Empirics: are faster settlements associated to a lengthening of the maturity structure?
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- Role of creditor bargaining power after default (think more broadly about this power)
  - In standard model: good before default, bad afterwards
  - Here, potentially good after default: could country gain by giving up bargaining power?
    * If so, what prevents it from giving it up?
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- Calibration / empirics:
  - Interpretation of bargaining power?
    * In paper, calibrated to generate outcomes
  - Are there any observable dimensions?
    * Case studies? Countries in default with weak politics (low bargaining power) and strong economy
Conclusions

• Interesting and timely topic...

• Compelling idea...but it is buried in the paper!

• Flesh out a bit more the implications of this view