

Discussion of

A Theory of International Official Lending

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Fiscal Policy and Sovereign Debt
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The views expressed herein are those of the authors and should not be attributed to the IMF, its Executive Board, or its management.

The *want* operator

This paper seeks a **theory** which

- rationalizes the **seniority** structure of sovereign debt
 - ... marketable debts: can default, high recovery
 - ... official bilateral (**Paris Club**) debt: can default, low recovery
 - ... multilateral debt: cannot default
- relates seniority to **information** and monitoring
 - ... official bilaterals provide debt relief in “justified” defaults
- helps understand and/or design the sovereign debt **architecture**

Main result

- Market + PC + IMF decentralizes a constrained-optimal allocation
 - ... Constraints from information frictions + moral hazard

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How it works

Decentralization

Constrained-optimal allocation

- State variable: promised utility v
- Goods $c(v), m(v)$ at utility v
- Values $v^{z,s}(v)$ after TFP z , signal s
... $v^{H,s}(v)$ constant
- Constraints
 - ... *PK*: deliver v at state v
 - ... *IC*: no gambling for A_H
 - ... *SUST*: no reverting to autarky
 - ... *P*: non-negative profits
- Timing is key!
 - can cheat before seeing type (*IC*)
 - can cheat and not export (*SUST*)
 - cannot cheat after seeing type

Equilibrium with three types of debt

- Taxes to control consumption
- Three types of debt
... to generate three cont. values
- Multilateral
... undefaultable
- Bilateral
... reduction when $z = s = L$
- Market
... defaultable (gov't choice after s)
... when *SUST* binds
- Dynamics: $v^H(v) > v \leq v^{L,s}(v)$
- Gov't and lenders share β

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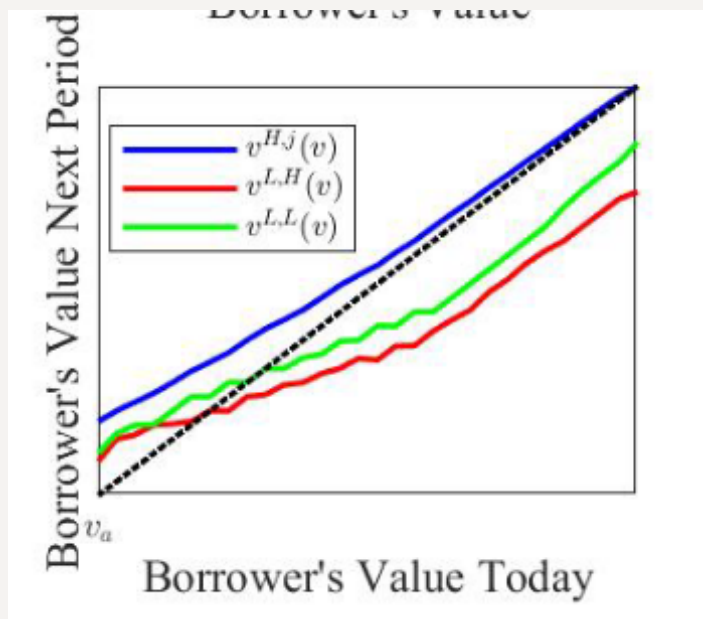
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Three and a Half Comparisons

Efficient Sovereign Default

- Setup reminiscent of Dovis (2019)
 - ... plus the **signals**
- Critical difference in timing: choose action **after** observing type
 - ... or TFP shock affects the consumption good rather than exports
- **Revelation** principle: gov't reports A , planner allocates subject to $IC, SUST, PK, P$
- Decentralize with short debt and consol
- Can give m^* because the country wants to keep going when v is large
 - ... here it is always tempting to **gamble**
 - ... **empirical** predictions about imports?

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Non-Defaultable Debt and Sovereign Risk

- Decentralization reminiscent of Hatchondo, Martinez, and Onder (2017)
 - ... plus the bilateral lender (signals)
- Critical difference: restriction to **Markov**-perfect equilibrium
- Multilateral lender increases gov't welfare, but only for a while
- In MPE, **pecking order** of lending sources
 - First max out risk-free lending, may take longer depending on β
 - When m is exhausted, model isomorphic to one-lender, $\tilde{y}(z) = y(z) - rm$
- Best equilibrium stipulates borrowing **pattern** from Multilateral
 - ... With uninformative signals, how different is borrowing from M

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The Perils of Bilateral Sovereign Debt

- Roldán and Sosa-Padilla (2025) has market + bilateral lender
 - Bilateral lender is **undefaultable** but **bargains** over borrowing terms
 - Key result: bilateral interest rate aggressively decreasing in market spreads
 - Welfare is hurt by the presence of the bilateral lender
- Here adding both IMF and PC help
 - In best SPE, should be obvious
 - What about **worst** SPE? (as in DAVIS and Kirpalani, 2023)

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Questions and Comments

Comments

- How different is the **best SPE** from a **Markov** equilibrium here?
... With two lenders, quite different
- Would like to see much more the **issuance** decisions and tradeoffs in equilibrium
... how much myopic losses are there for the government?
- Quibble: is $L(v) = \max_{\sigma \in \Sigma} L(\sigma)$ subject to $v(\sigma) = v$ important?
- Clarification of **timing**
... Mapping to untargeted features of the data?
... When does official debt relief come? How does it **correlate** with default?
- What is the **incentive constraint** of the bilateral lender?
 - How do the three interest rates **compare**? Is $r^{OM} < r^{OB} < r^M$?

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Concluding remarks

A Theory of International Official Lending

- Very nice paper!
- **Market** + **IMF** + **PC** decentralizes a best equilibrium
... if the moral hazard + signal structure is the relevant friction
- **Who** is the **bilateral** lender? What are we asking of them?