

The Unpayable Debts Problem, What To Do, and What Happens If We Don't

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Pre-Pandemic Debt Build Up

- Since 2009 boom in EM *sovereign* and *corporate* debts in dollars.
- Driven by low interest rates, search for yield
- Crossover investors have been key (Calomiris, Larrain, Schmukler and Williams 2020).
- They especially prefer index-eligible debts, which means greater than \$500 million.
- Has produced surge in borrowing (reaching), offset somewhat by cash accumulation, but apparently much of that cash is local currency (evidence on carry response of issuers).

Current Trifecta Disaster

- In face of big buildup, now we have dollar appreciation and a global recession.
- Reminiscent of 1979-82 on the heels of petrodollar driven buildup of debt in 70s.
- This produced Latin America's lost decade.
- This was both an economic and a political disaster (delaying the building of good institutions due to the discrediting of global liberalism).

Workouts Fast This Time?

- The G20 and the IMF/WB have done the easy part (which was not so easy): getting governments to agree to bilateral public debt relief.
- But this is mainly for IDA countries. The “best” EMs, ironically, are the ones most in trouble now because they were able to borrow massive private debts in international bonds, held by many investors.
- The good news is that about 80% (rough estimate) of EM sovereign debt has CACs (I am unsure about corporates). That combined with sudden observable shock could mobilize coordination better than past.
- But I am skeptical that this will happen quickly.

It Needs To Happen IMMEDIATELY

- Delay will cause a collapse of private investment, financial gridlock from moratoria, and will constrain sovereigns' ability to offer assistance to borrowers and banks (as they face binding constraints on their own debt capacity).
- Deepening recession will mean that banks face crippling losses on domestic debts, and massive insolvencies of borrowers and banks will ensue (RFC type actions are needed, but again, debt capacity is lacking in many countries).
- Judicial systems lack ability to timely deal with debt restructuring, and government policy must find a way to resolve those uncertainties too (moratoria and “cultura de no pago” do not spur recovery).

What To Do?

- *Corporate and Sovereign \$ Debts.* Joint IMF/WB task force to establish suggested, model-based haircuts/restructurings for corporates and sovereigns (parsimonious models for sovereigns and corporates). By creating objective criteria for size of writedown, should encourage creditor participation.
- *“Punto Final” Programs.* Creditors can be encouraged to participate by incentives that offset some of the writedown losses for those that agree early.
- *Domestic Debts.* Similar incentives can help with domestic debt writedowns.
- *RFC Preferred Stock.* The banking systems are not facing liquidity problems. Government assistance should take the form of preferred stock, if possible, or other means if that is not enough. Sovereign debt writedowns will help build debt capacity to fund these subsidies.

Give Authority To Competent People

- There are many experienced economists whose research and policy experience qualifies them to work on this task force. They should be given real authority to build a (good, not perfect) model that will create a credible basis for haircut suggestions within a month. Who? People like Reinhart, Laeven, Claessens, Schmukler, Trebash, Demirguc, Dell'Ariccia.
- Those economists (and their bosses) should partner with experienced legal professionals and buy-side representatives to consider incentives for creditors that will be adequate to get coordination to happen.
- Can the G20/IMF/WB stomach all that? My guess is not. But I'd like them to surprise me.

If Not?

- Delays will spell disaster for GDP growth globally, by creating chaos in domestic banking and in global debt markets.
- Eventually, problems will be “resolved” by inflation, debt redenomination, and/or much more severe haircuts than would otherwise have occurred. Everyone will be worse off that way.
- Even worse, there will be a political backlash against global liberalism, as those that did most to pursue liberal policies are shown to be the ones harmed most.