Sovereign Domestic Debt Restructuring: Handle with Care

Discussion:
Carmen M. Reinhart
World Bank
SUERF BAFI Bocconi Seminar, February 23, 2022
Roadmap of remarks

• Why the topic and the paper are **REALLY** important and timely.
• Defining domestic debt in the modern era (easier said than done)
• Revisiting the episodes: Rethinking “how domestic was domestic”
• The road ahead: Filling in our knowledge gaps (the paper and everyone else).
Central Government Debt: Sub-Saharan Africa and Western Hemisphere, 1971-2021

Share of domestic debt as a percent of total debt

*Domestic debt is not “new” but it is increasingly important for many countries—especially because debt levels (domestic and external) have risen markedly in recent years (see following figures).*

Median share for
42 Sub-Saharan African Countries

Note: Deliberately kept the scale at 0-100% to highlight that external debt is still extremely important especially for many smaller EMDEs. Big six are Nigeria, South Africa, Ethiopia, Kenya, Ghana and Ivory Coast.

Median share for
28 Western Hemisphere Countries

Note: The Big six are Argentina, Brazil, Chile, Colombia, Mexico, and Peru

Sources: Barrot (2022), Reinhart and Rogoff (2009 and 2011), and author’s calculations. Note: The domestic/foreign split is based on ownership.
Domestic central government debt as a percent of GDP:
Sub-Saharan Africa and Western Hemisphere, 1971-2021

The 2014-2021 debt surge in two stages:
(1) The commodity price crash of 2012-2015
(2) The pandemic crash of 2020-2021.

Sources: Barrot (2022), International Financial Statistics (IMF), Reinhart and Rogoff (2009), World Economic Outlook (IMF), and author’s calculations.
Defining “domestic debt” is critical and not trivial: In the modern era lines have been blurred.

<table>
<thead>
<tr>
<th>Era</th>
<th>Legal (governing law and jurisdiction of issue)</th>
<th>Residency of creditor</th>
<th>Currency denomination</th>
</tr>
</thead>
<tbody>
<tr>
<td>1800-1990 (with few exceptions)</td>
<td>Domestic law</td>
<td>Domestic creditors</td>
<td>Domestic currency</td>
</tr>
<tr>
<td>Modern</td>
<td>Domestic law</td>
<td>Domestic and foreign</td>
<td>Domestic and foreign currency</td>
</tr>
</tbody>
</table>

Debts recorded in countries’ treasuries do not have common standards on the definition of “domestic”. Furthermore, for many the definition changed over time. The World Bank Debt Reporting System (external debt), 1970-present is based on ownership. The League of Nations, IMF, UN, and Reinhart and Rogoff (2009), followed the hybrid definition used in country reports. Pre-1990s hybrid measures posed no problem in distinguishing domestic from external but that is not the case, especially in the past two decades.
Varieties of domestic debt restructuring in an era of blurred definitions
(I am ignoring here defaults on pure external debt around these cases)

Pre-1990s (mostly), Nicaragua, 2008: Area I -- (most domestic law and currency debt is still held by domestic creditors)
Argentina, 2002 pezoization: Area III, (but FC debt)

Domestic law

Domestic currency

Foreign creditors

VI

VII

V

III

IV

Domestic creditors

Mexican Tesobonos, 1994-1995 (a near default): Area VI (but foreign currency debt)

Jamaica, 2010: Mostly in Area I
But also in Areas III and VI
Greece 2011 and 2012: Mostly Areas I and V (for eurozone creditors); but also in Area VI
Cyprus 2013: Similar to Greece, with different shares.

Most of Brazil’s debt (not in restructuring) is currently in Area I -- but a non-trivial share is in Area V. Ditto for Mexico, Thailand and many others.
The road ahead: Filling in knowledge gaps

- **Data gaps I:** Largest (but improving) on ownership dimension CFA zone is an example—and domestic debt issuance has skyrocketed there. Who holds the debt is critical for assessing the economic impacts of restructuring.

- **Data gaps II:** Time series on domestic arrears are scarce to non-existent (IMF, 2019 for Africa is a much-needed gap-filling effort); by contrast, external arrears are documented (1970-2020) in the World Bank’s DRS database.

- **Hidden de jure domestic debt restructurings:** Regulatory changes impacting domestic banks and pension funds (see next two points).

- **Fully quantifying creditor losses (haircuts):** In the pure external restructurings (see Sturzenegger and Zettlemeyer, 2007, Cruces and Trebesch, 2013, Meyer, Reinhart, and Trebesch, 2022), these are quantified; progress is needed on the domestic front. Filling this gap addresses seniority and Comparability of Treatment (CoT) issues. Meyer (2021), who focuses on 1900-1980, is a pioneer in this regard.

- **The VERY BIG de facto versus de jure haircut problem:** Much more than contractual changes impact haircuts (inflation and financial repression for domestic creditors à la Reinhart and Sbrancia, 2015); currency crashes for external creditors, in the cases of LC debt.
References cited


