

Globalization and Financial Markets (I): Sovereign Risk

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July 10-14, 2006

This course examines the workings of financial markets in a globalized world, focusing on theoretical results, empirical evidence and policy implications. The first part of the course analyzes the problems associated with sovereign risk, while the second part studies the origins and effects of asset bubbles. Both parts are self-contained and students can either enroll for the entire course or for only one part.

This is the syllabus for the first part. Lecture notes will be distributed during the course. There is also a reading list below that contains papers of related interest.

Lecture 1. Stylized facts. Basic theory

A brief history of sovereign debt and default. Canonical models of sovereign risk. Inefficient borrowing and default. The role of seniority. The debt overhang.

Lecture 2. Reputation

Reputation, default and retaliation. The Bulow-Rogoff result and its limits. Empirical evidence on default: direct penalties and exclusion from financial markets.

Lecture 3. Interactions between domestic and foreign debt markets

Perfect discrimination and a separation result. Interactions between domestic and foreign debt markets. The effects of globalization revisited: theory and evidence.

Lecture 4. Secondary debt markets

Debt buybacks in theory and practice. Secondary markets as a solution to the sovereign-risk problem. Large agents, imperfect information and other limits to the argument.

Lecture 5. Towards a framework for crisis resolution

History of ideas and current proposals. Dealing with panics. Buying time and aligning incentives. Solving collective action problems.

Reading list:

Amador, M., "A political economy model of sovereign debt repayment," mimeo, Stanford, 2003.

Bolton, P., "Towards a statutory approach to sovereign debt restructuring: lessons from corporate bankruptcy practice around the world," *IMF Staff Papers*, 2003.

Bolton, P. and O. Jeanne, "Structuring and restructuring sovereign debt: the role of seniority," CEPR discussion paper No. 4901, 2005.

Bolton, P. and D. Skeel, "Inside the black box: how should a sovereign bankruptcy framework be structured?," *Emory Law Journal*, 2004.

Borensztein, E., M. Chamon, O. Jeanne, P. Mauro, and J. Zettelmeyer, "Sovereign debt structure for crisis prevention," *IMF Occasional Paper 237*, 2004

Broner, F., G. Lorenzoni and S. Schmukler, "Why do emerging economies borrow short term?," mimeo, CREI and Universitat Pompeu Fabra, 2005.

Broner, F. and J. Ventura, "Globalization and risk sharing," mimeo, CREI and Universitat Pompeu Fabra, 2006.

Broner, F., A. Martin and J. Ventura, "Sovereign risk and secondary markets," mimeo, CREI and Universitat Pompeu Fabra, 2006.

Bulow, J. and K. Rogoff, "Sovereign debt: is to forgive to forget?" *American Economic Review*, 1989.

Bulow, J. and K. Rogoff, "A constant recontracting model of sovereign debt," *Journal of Political Economy*, 1989.

Bulow, J. and K. Rogoff, "Sovereign debt repurchases: no cure for overhang," *Quarterly Journal of Economics*, 1991.

Chamon, M., "Can debt crises be self-fulfilling?" IMF wp 04/99, 2004.

Cole, H. and P.J. Kehoe, "Reviving reputation models of international debt," *Federal Reserve Bank of Minneapolis Quarterly Review*, 1997.

Cole, H. L. and T.J. Kehoe, "Self-fulfilling debt crises," *Review of Economic Studies*, 2000.

Eaton, J. and M. Gersovitz, "Debt with potential repudiation: theoretical and empirical analysis," *Review of Economic Studies*, 1981.

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- Eichengreen, B., "Historical research on international lending and debt," *Journal of Economic Perspectives*, 1991.
- Eichengreen, B. and P.H. Lindert (eds.), The International Debt Crises in Historical Perspective, MIT Press, 1991.
- Fernandez, R. and R.W. Rosenthal, "Strategic models of sovereign-debt renegotiations," *Review of Economic Studies*, 1990.
- Gelpern, A., "Building a better seating chart for sovereign restructurings", *Emory Law Journal*, 2004.
- Grossman, H. I. and J.B. van Huyck, "Sovereign debt as a contingent claim: excusable default, repudiation and reputation," *American Economic Review*, 1988.
- Haldane, A., A. Penalver, V. Saporta and H. Shin, "Analytics of sovereign debt restructuring," *Journal of International Economics*, 2005.
- Hellwig, C. and G. Lorenzoni, "Bubbles and private liquidity" mimeo, UCLA and Princeton, 2003.
- Husain, I. and I. Diwan (eds.), Dealing with the Debt Crises. The World Bank, 1989.
- Kletzer, K. M., "Asymmetries of information and LDC borrowing with sovereign risk," *Economic Journal*, 1984.
- Kletzer, K.M. and B.D. Wright, "Sovereign debt as intertemporal barter," *American Economic Review*, 2000.
- Kraay, A., N. Loayza, L. Servén, and J. Ventura, "Country portfolios," *Journal of the European Economic Association*, 2006.
- Krugman, P. "Financing vs. forgiving a debt overhang," *Journal of Development Economics*, 1988.
- Martinez, J. and G. Sandleris, "Is it punishment ? Sovereign defaults and declines in trade," mimeo, Columbia University, 2004.

- Obstfeld, M. and A. Taylor, Global Capital Markets: Integration, Crisis and Growth, Cambridge University Press, 2004.
- Obstfeld, M. and K. Rogoff, Foundations of International Economics, The MIT Press, 1996. Chapter 6.
- Prasad, E., K. Rogoff, S. Wei, and M. Kose, "Effects of Financial Globalization on Developing Countries: Some Empirical Evidence," *IMF Occasional Paper* No. 220, 2003.
- Rogoff, K. and J. Zettelmeyer, "Bankruptcy proceedings for sovereigns: a history of ideas, 1976-2001" *IMF Staff Papers*, 2002
- Rose, A.K., "One reason countries pay their debts: renegotiation and international trade," *Journal of Development Economics*, 2005.
- Roubini N. and B. Setser, Bailouts or Bail-ins? Responding to Financial Crises in Emerging Markets", Institute for International Economics, 2004.
- Sachs, J. "Theoretical issues in international borrowing," *Princeton Studies in International Finance*, No. 54, 1984.
- Smith, G. and J.T. Cuddington (eds.), International Debt and The Developing Countries, The World Bank, 1985.
- Sturzenegger, F. and J. Zettelmeyer, "Haircuts: estimating investor losses in sovereign debt restructurings, 1998-2005", IMF wp 05/137, 2005.
- Sturzenegger, F. and J. Zettelmeyer, Defaults in the 90s: Learning to Deal with Crises, miemo, Universidad Torcuato di Tella, 2006.
- Tirole, J., "Inefficient foreign borrowing: A dual- and common-agency perspective," *American Economic Review*, 2003.
- Wright, M., "Private capital flows, capital controls and default risk," *Journal of International Economics*, forthcoming.
- Wright, M., "Reputations and sovereign risk," mimeo, Stanford, 2003.