Review for Central Banking

Jerome Roos, **Why Not Default? The Political Economy of Sovereign Debt,** Princeton University Press, Princeton and Oxford, 2019, 398 pages

Governments go back on their word more often than most of us might like. Election promises are dishonoured, tax rates changed, and entitlement thresholds amended, but outright defaults on government debt seems to have become very infrequent.

Jerome Roos's new book (adapted from his PhD thesis) focuses on the specific question of why there are not more unilateral sovereign defaults (as distinct from negotiated and agreed writedowns). There are few formal binding enforcement mechanisms, especially for local currency debt. No one sends in the gunboats to enforce payment. And yet unilateral defaults have become very uncommon, while debt crises have not. Heavily burdened governments mostly keep on servicing their debts – often at considerable cost to their own citizens – even though defaulting sovereign borrowers have often been able to re-enter credit markets relatively quickly, without facing prohibitive additional risk premia.

In the first section the book Roos draws out three factors that, he argues, have made it much less likely that, for any particular burdensome level of debt, a sovereign will unilaterally default. The first of these is a more concentrated financial sector and more centralised international credit markets. The second is a more active role for the governments of creditors' states and of international institutions like the IMF, and the third factor centres on the role of the domestic elites who play a bridging role to the foreign creditors His central hypothesis is that unilateral default is likely only when all three have broken down: creditors are widely dispersed, official creditors have given up on a country, and the elites are discredited, either at home or abroad. Default can also become relatively more attractive if a highly-indebted country is already running a primary surplus, and thus has no ongoing need for new credit.

The bulk of the book is made up first of a review of sovereign defaults in history, and then separate sections (50 pages each) on each of a series of three case studies: the Mexican debt crisis from 1982, Argentina's default in the early 2000s. and the Greek crisis of this decade. The case studies are sufficiently rich in institutional and political detail – although perhaps less so for economic detail – that readers who are not that familiar with the individual cases will be able to make sense of some of the key political choices and debates.

Roos argues that the case study approach sheds light that no econometric approach, involving a much larger sample of countries but much less institutional detail, could provide. In many respects no doubt that is true. And yet I came away from the book with a sense of "case not proven". It is difficult to see how three case studies, each fascinating in its own right, could robustly establish a hypothesis. Perhaps that is particular evident in the case of Greece, where both the run-up in the debt, the lack of transparency around it, and the handling of the crisis and its aftermath were so closely linked to (idiosyncratic) battles around the euro-area, its institutions and structures, and Greece's continued membership. How easily does the Greek experience generalise?

An implied theme of the book is that highly-indebted governments may at times be serving the interests of outsiders (creditors or foreign governments) and their own financial sector elites more than the medium-term economic interests of their citizens. Appealing as that story is in some respects, unpicking all the aspects of the political relationship between Mexico and the United States, or between Greece and the EU, would require going well beyond narrow debt-related issues. But perhaps that is consistent with Roos's political economy story: Argentina had no such close ties, and Argentina was the sovereign which finally chose to unilaterally default.

A single PhD thesis can address only a subset of the issues around sovereign debt. But in thinking more broadly it might be worth looking not just at past defaults (including those of the 1930s) but to look for the dog that didn't bark. There will have been episodes where countries chose not to default (or seek to come to an arrangement with their creditors) even in the face of enormous debt burdens (one could think for example of the foreign debt positions of both Australia and New Zealand in the 1930s). One might also want to bring into the picture choices around surprise inflations, which represent another form of unilateral default on local currency debt - in economic substance, even if not in rating agency classifications. And it would have been intriguing to have seen a case study on a highly indebted African country (Zambia perhaps), where the ongoing flow of foreign development assistance and budgetary aid complicated the political economy in thinking about how to respond to an unsustainable debt burden.

Roos has given us a thought-provoking book which will repay the investment of any reader with an interest in sovereign debt. Almost certainly, we haven't seen the last sovereign debt crisis, or the last default, and this book may help people – and not just potential lenders - think through more deeply some of the factors that influence whether or not debts are likely to be paid in full if things go badly wrong for the borrowing country. If it is likely to be particularly difficult to escape the debt burden - and there still is no sovereign equivalent to corporate insolvency/personal bankruptcy provisions - it might be better to attempt to put in place institutions limiting the ability of domestic politicians to run up large public debts in the first place.

Michael Reddell

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