



DE-RISKING THE FUTURE OF EUROPE

REFORMING THE MACROFINANCIAL ARCHITECTURE

The Euro Area Road to Sovereign Debt Restructuring

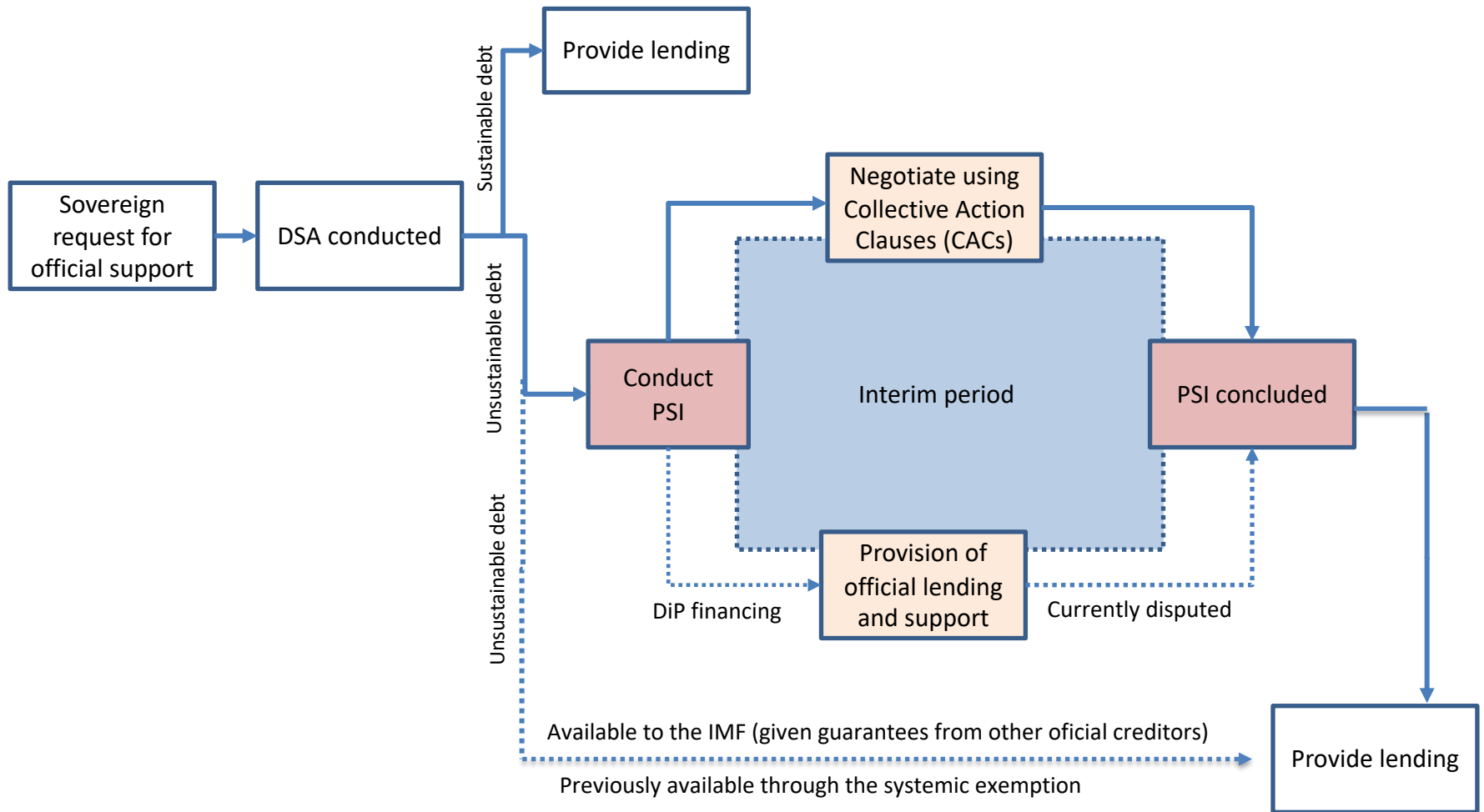
Aitor Erce – EIB & ADEMU

Wednesday 11 September 2019

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London School of Economics
Old Building - Houghton Street, London

The Euro Area Road to Sovereign Debt Restructuring



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Status-quo seen as inadequate

Greek holdouts would have not been avoided by **two-limb CACs** (Fang et al. 2019)

Using the local-law advantage (greek retrofitting) may lead to long-term reputational costs (Buccheit, 2019)

Agreement to:

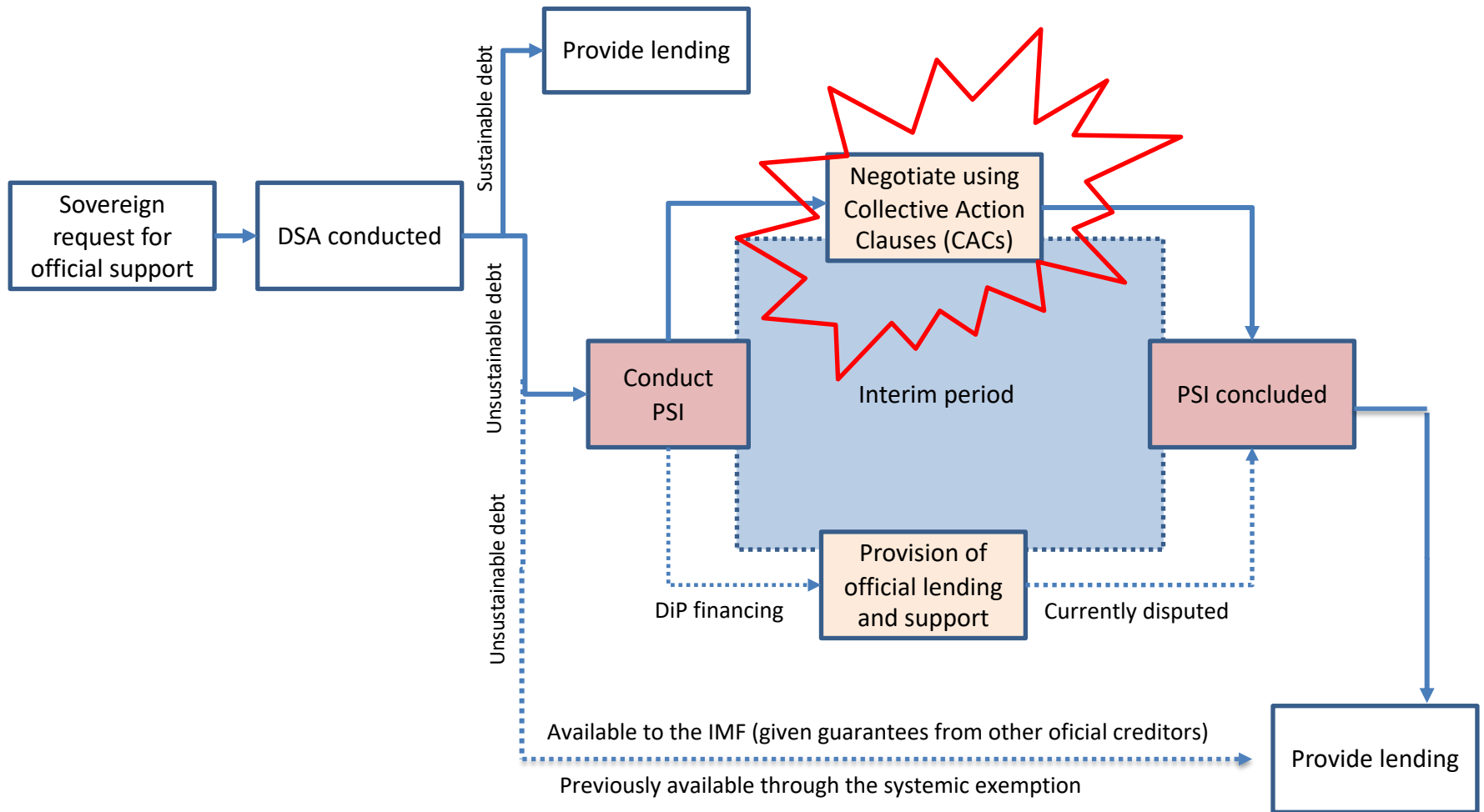
- Enhance CACs with **single-limb** voting procedure
- EC/ECB/ESM cooperation (in DSA & program design)

Do we need other policies to ease restructuring and limit official loans when sustainability is at stake?

Do we have what we need? An outline to my talk

1. Take a step forward and consider the proposed mechanism for achieving debt relief – enhanced CACs
 - Equitable burden-sharing?
 - Watch GE effects?
2. Take a step back and look at the framework leading to the decision to restructure sovereign debt
 - Who defines and how to define debt to be sustainable? (DSA)
 - What weight for PSI on the policy mix?

Restructuring through single-limb CACs



Restructuring through single-limb CACs

Are single-lib CACs enough?

What role of non-CAC liabilities?

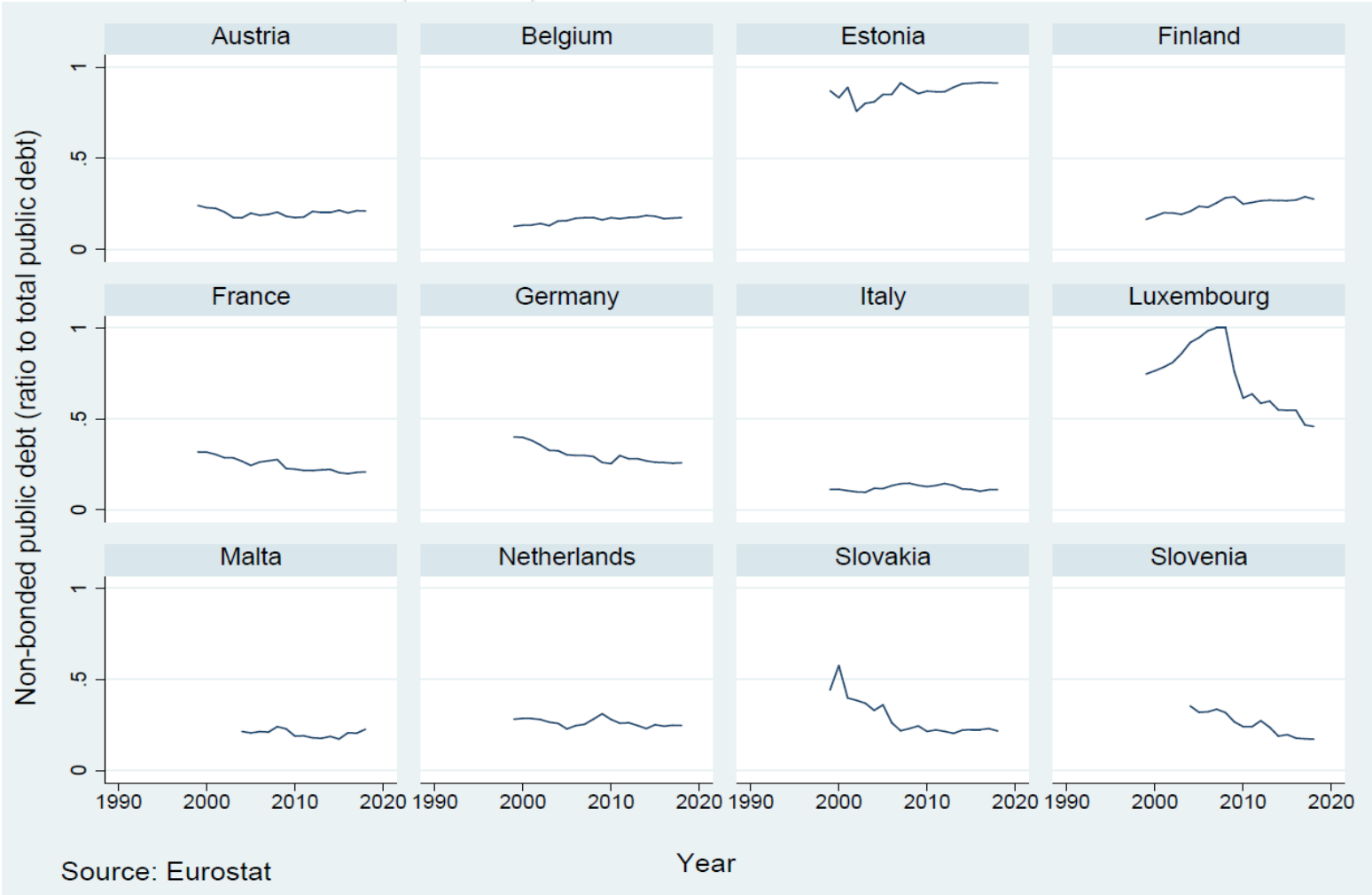
Ex-ante: + Non-negligible role

+ Fair burden-sharing via CAC-like clauses in loans (Scheinder 2018)

Ex-post: + CAC bond easier to restructure

+ Seniority drives borrowing towards no-CAC claims (Bolton & Jeanne 2010)

Claims other than long-term bonds aren't negligible



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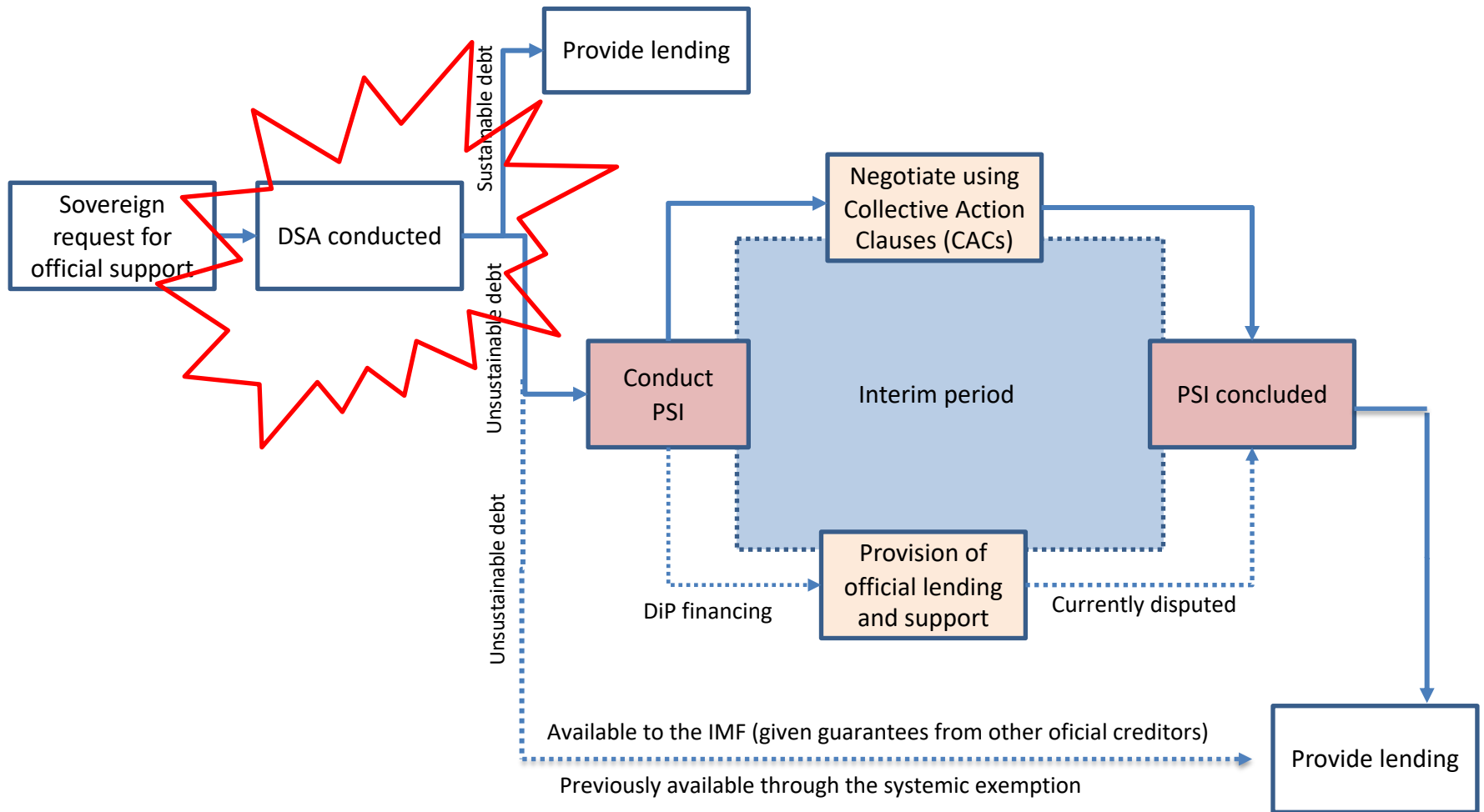
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A step back – determining sustainability



A step back – determining sustainability

What is a sustainable debt level?

Ongoing MAC DSA review [vs. muted euro area reaction]

Issues (multiple sources of biases)

How? Technical hurdles (Corsetti 2019)

Judgement (Lang & Presbitero 2018)

Who? Conflicting objectives (Baglioni & Bordignon 2019)

Use the European Fiscal Board

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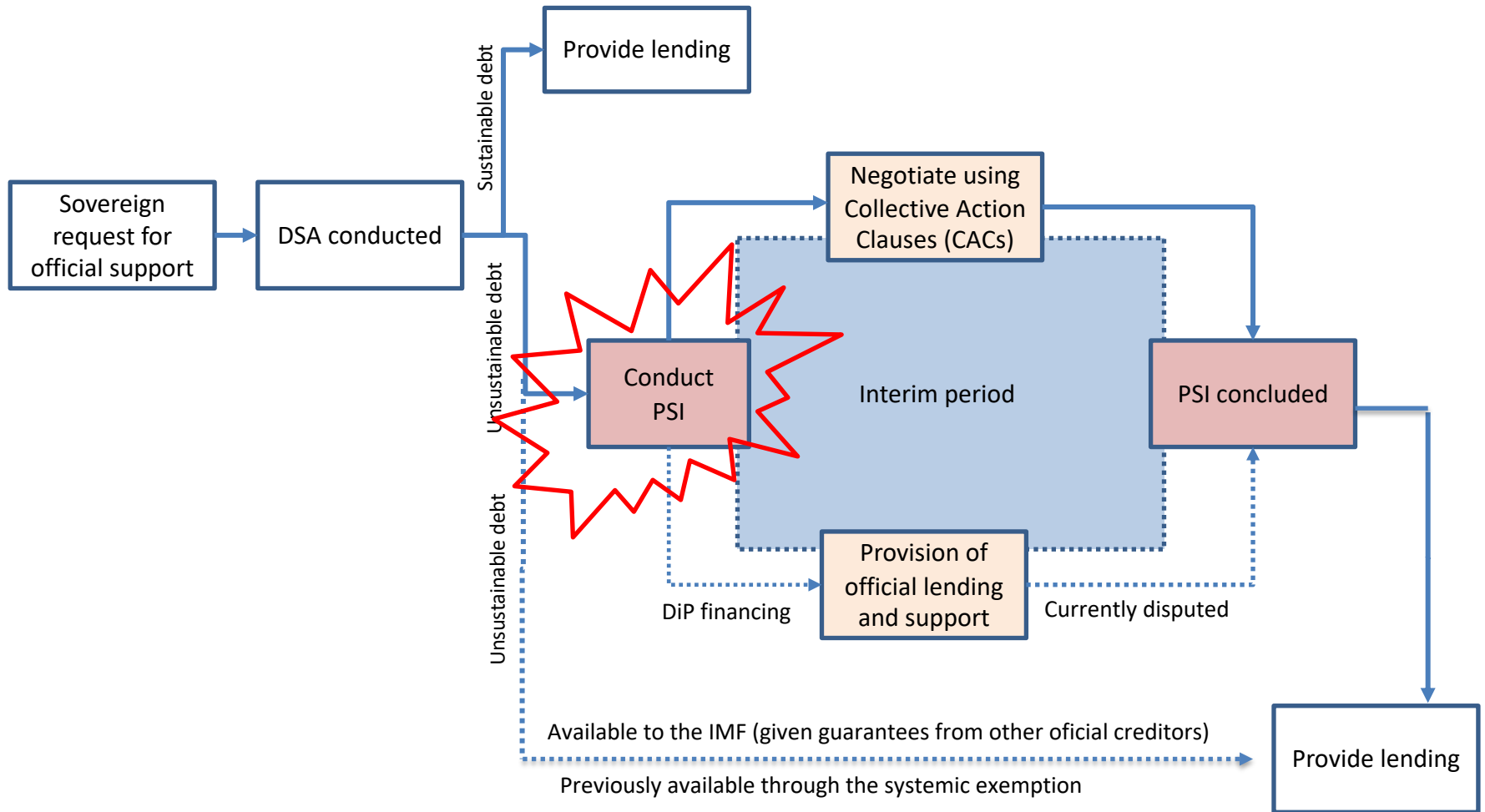
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A step back – restructuring policies and spill overs



A step back – restructuring policies and spill overs

When is restructuring the right policy?

Self-interested solidarity (Tirole 2015)

Cross-border costs can be substantial

Time-inconsistency (Schadler, 2013)

IMF's "Systemic Exemption" for Greece

Spillover analysis to ex-ante discipline action

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To conclude

Setting statutory approach is difficult and could be destabilising

Single-limb CACs are not bullet-proof but if we devise a less bias-prone way to implement the current framework, and avoid that sovereign financing tilts away from CAC-instruments, it is not evident what other reforms are needed

The role of spill overs raises a key question: should the euro area apply the IMF approach or should systemic considerations remain a determining factor? The answer is crucial. Embedding the DSA with a formal way to evaluate spill over costs could help reduce its biases and make restructuring policies more effective



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THANKS!

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