Discussion of

A Theory of International Official Lending

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The *want* operator

This paper seeks a **theory** which

- rationalizes the seniority structure of sovereign debt
  - … marketable debts: can default, high recovery
  - … official bilateral (Paris Club) debt: can default, low recovery
  - … multilateral debt: cannot default
- relates seniority to information and monitoring
  - … official bilaterals provide debt relief in “justified” defaults
- helps understand and/or design the sovereign debt architecture

Main result

- Market + PC + IMF decentralizes a constrained-optimal allocation
  - … Constraints from information frictions + moral hazard

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How it works

Decentralization

Constrained-optimal allocation

- State variable: promised utility v
- Goods $c(v), m(v)$ at utility v
- Values $v^{z,s}(v)$ after TFP z, signal s
  - … $v^{H,s}(v)$ constant
- Constraints
  - … *PK*: deliver v at state v
  - … *IC*: no gambling for A_H
  - … *SUST*: no reverting to autarky
  - … *P*: non-negative profits
- Timing is key!
  - can cheat before seeing type (*IC*)
  - can cheat and not export (*SUST*)
  - cannot cheat after seeing type

Equilibrium with three types of debt

- Taxes to control consumption
- Three types of debt
  - … to generate three cont. values
- Multilateral
  - … undefaultable
- Bilateral
  - … reduction when $z = s = L$
- Market
  - … defaultable (gov't choice after s)
  - … when *SUST* binds
- Dynamics: $v^H(v) > v \lesseqgtr v^{L,s}(v)$
- Gov't and lenders share β

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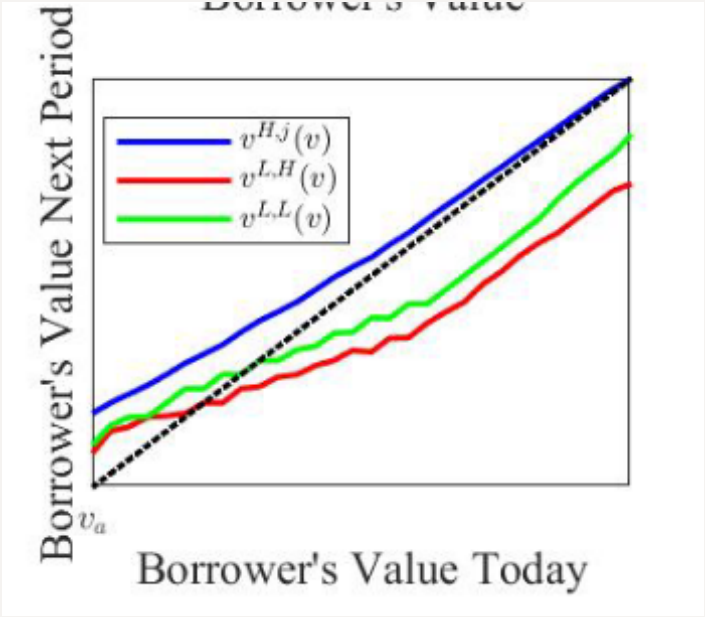
Dynamics of the Constrained-Optimal Allocation



Three and a Half Comparisons

Efficient Sovereign Default

- Setup reminiscent of Dovis (2019)
  - … plus the signals
- Critical difference in timing: choose action after observing type
  - … or TFP shock affects the consumption good rather than exports

- Revelation principle: gov't reports A, planner allocates subject to IC, $SUST$, PK, P
- Decentralize with short debt and consol

- Can give $m^\star$ because the country wants to keep going when v is large
  - … here it is always tempting to gamble
  - … empirical predictions about imports?

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Non-Defaultable Debt and Sovereign Risk

- Decentralization reminiscent of Hatchondo, Martinez, and Onder (2017)
  - … plus the bilateral lender (signals)
- Critical difference: restriction to Markov-perfect equilibrium

- Multilateral lender increases gov't welfare, but only for a while
- In MPE, pecking order of lending sources
  - First max out risk-free lending, may take longer depending on β
  - When m is exhausted, model isomorphic to one-lender, $\tilde{y}(z) = y(z) - rm$

- Best equilibrium stipulates borrowing pattern from Multilateral
  - … With uninformative signals, how different is borrowing from M

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The Perils of Bilateral Sovereign Debt

- Roldán and Sosa-Padilla (2025) has market + bilateral lender
  - Bilateral lender is undefaultable but bargains over borrowing terms
  - Key result: bilateral interest rate aggressively decreasing in market spreads
  - Welfare is hurt by the presence of the bilateral lender

- Here adding both IMF and PC help
  - In best SPE, should be obvious
  - What about worst SPE? (as in Dovis and Kirpalani, 2023)

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Questions and Comments

Comments

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  - … With two lenders, quite different
- Would like to see much more the issuance decisions and tradeoffs in equilibrium
  - … how much myopic losses are there for the government?
- Quibble: is $L(v) = \max_{\sigma \in \Sigma} L(\sigma)$ subject to $v(\sigma) = v$ important?
- Clarification of timing
  - … Mapping to untargeted features of the data?
  - … When does official debt relief come? How does it correlate with default?
- What is the incentive constraint of the bilateral lender?
  - How do the three interest rates compare? How frequently is $r^{OM} < r^{OB} < r^{M}$?

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Concluding remarks

A Theory of International Official Lending

- Very nice paper!
- Market + IMF + PC can decentralize a constrained-optimal allocation in the **best** SPE
  … if the moral hazard + signal structure is the relevant friction
- **Who** is the bilateral lender? What are we asking of them?