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Full Article

Time for a haircut: political regimes and sovereign debt restructurings

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ABSTRACT

Conventional wisdom claims that reputation leads sovereign states to full debt repayment. However, defaults are recurrent, some debtor countries take a lot of time to end them, and some extract costly concessions from investors. This article argues that these differences are largely explained by the political regimes in the borrowing countries. While previous research examines whether democracies make more credible commitments, we analyze how democracies affect bargaining with foreign investors after a default occurs. Democracies, with their institutional checks, electoral uncertainty, greater transparency, and public deliberation, make swift decision-making harder, create incentives to pander and posture, and give leverage to minimize the win set of viable agreements. We test our theory on a comprehensive dataset of debt restructurings with private creditors in the period 1975–2017. The event history analysis indicates that democracies experience longer restructurings and the double-hurdle regression analysis shows that democracies obtain larger creditor losses. Further, there is interesting variation among democracies and autocracies. Our findings suggest that political regimes are crucial to explaining why cooperation fails in international debt markets.

KEYWORDS:

IPE debt international regimes democracy duration analysis

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Supplementary Material

Supplemental data for this article can be accessed on the publisher's website.

Notes

[1] The firm Poliarquia repeatedly surveyed voters after a New York court decided that Argentina should pay to vulture funds. In June 2014, 64% supported repayment; in July 2014, it dropped to 57%. By December 2014, only 49% supported repayment (Nelson and Steinberg 2018, sec. Appendix).

[2] We avoid double counting in the country-year analysis and combine restructurings within the same country-year by estimating the average duration and average haircut only for the cases of Russia (1999–2000) and Ukraine (1998).

[3] We use the ordinal Polyarchy variable from the Varieties of Democracy Project, grouping full autocracies and electoral autocracies on one side and full democracies and partial democracies on the other. As time goes by, there was an increase in the number of debtor states with democratic regimes that reached a restructuring settlement (74).

[4] In a log-normal model, the dependent variable is understood as the log of the time elapsed until a failure occurs.

[5] We also incorporate the haircuts of Antigua and Barbuda (2010), Argentina (2010), Ukraine (2015), and Belize (2017). Data availability reduces the number of cases compared to those used in the duration analysis.

[6] As DiGiuseppe and Shea (2019, 15) note, the model is also convenient in that it does not require an exclusion restriction in the first hurdle equation.