

"BURDEN SHARING" IN SOVEREIGN DEBT REDUCTION

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ABSTRACT

We examine a concerted debt reduction deal between a sovereign debtor, a private creditor, and an official creditor, who insures the deposits of the commercial bank. The results show that a weakening of the financial position of the commercial bank reduces the contribution of the commercial bank to the debt reduction program, while increasing those of the official creditor. However, the net terms faced by the debtor nation are independent of the strength of the commercial bank. This result is robust to changes in the assumed seniority of official and private debt.

Our results also suggest that standard interpretations of the degree of "burden sharing" between official and private creditors may underestimate the contribution of the private creditor and overestimate that of the official creditor. We show that a debt reduction program which leaves both creditor values unchanged will typically have commercial banks retiring debt at "unfairly" high prices, and contain a net contribution by the official creditor.

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