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Gesovitz reviews Michael Tomz's influential book on the role of reputation in sovereign debt restructuring. He argues that despite evidence to the contrary reputation theories of sovereign lending still dominate scholarly output on sovereign debt. Although, he thinks that Tomz's theory of reputation is not fully developed and is weak, he praises the empirical nature of the book and its ability to trace the relationship between sovereign lenders and borrowers for a long period of three centuries (2007). This paper seeks to review Gesovitz's treatment of the theory of reputation in the sovereign debt market. It does so by reference to the article and brief references to Tomz's original work that Gesovitz reviews.

Gesovitz uses both micro and macroeconomic terms in his review. He argues that although many models of sovereign debt assume that default is punished by disruption of capital market access, there is considerable controversy as to whether this is true in practice. He cites Tomz argument that this reflects the nature of the problem: realized borrowing is affected by the country's demand for credit, and so different equilibrium outcomes need not reflect a reduced supply of credit (2009).

In addition to acknowledging that demand plays a major part in sovereign borrowing, Gesovitz also invokes Ricardo's treatment of capital mobility in international commerce. Ricardo had earlier observed that capital mobility was necessary for trade but there were also concerns among business groups and individuals that want to invest in foreign markets that they might not be able to get their capital back (Gesovitz 476). This is a reflection of how fear is associated with investments in foreign lands especially unstable economies. At play in economics is the idea that the willingness to pay by

recipients of capital is made after a cost benefit analysis. This is not often the case in sovereign lending evidenced by the boom in sovereign lending in the 1970s and 80s when mostly Arab nations discovered oil and lenders began targeting their market without giving heed to cost-benefit analysis of the sovereign borrowers.

In international markets sovereign governments face less punishment than the downgrading of bond rating. Gesovitz brings into the fray solvency and liquidity as alternatives to the willingness to pay (2009, p. 476). Gesovitz argues that instead of focusing on the willingness to pay, solvency or liquidity both lenders and borrowers focus on reputation as a measure of a country's ability to honor its commitments (2009).

In this review, Gesovitz also analyzes the assertion by Tomz that there is no clear evidence that previous default hinders access to international capital markets. Along with this, there is no robust evidence that countries that have defaulted on their sovereign obligations end up paying a higher premium on subsequent debt issues (2009). Most of the sovereign debt literature assumes that after defaulting, a borrower is punished with exclusion from the international credit markets for an infinite period of time. The evidence suggests that this assumption is flawed: not only are sovereigns often able to borrow again soon after the settlements of their defaulted debts, but more importantly, credit markets are eager to lend to them (Tomz 2009). The historical evidence for this assertion has been succinctly documented somewhere.

This paper analyzed how concepts of demand, supply, willingness to pay, capital, debt and credit play out in the sovereign debt market.

References

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References