Discussion of Tirole’s

“Country Solidarity”

Thomas Philippon

New York University, NBER, CEPR
Literature 1/2

- **Incentives to repay**
- **Exogenous costs**
- **Reputation**

- **Lender**
  - Private
  - Official

- **Borrower**
  - Private
  - Public
Incentives to repay

Enforcement of private claims
Interaction with public debt
This Paper

Lender

Private

Official

Borrower

Private

Public

Incentives to repay

Bailouts

PSI
Date 2

• Lemma 2

• In bad state, default if $d_M > \phi_P$ and bailout otherwise

• In good state, agent willing to pay $\Phi_A$ to avoid default.
  • If $d_M > \phi_P + \Phi_A$ then default
  • Otherwise official debt forgiveness or even support to repay private debt
Date 1 – $b_p=0$

• What would A do? Maximize blackmail ex-post, with either $d_M = \phi_P$ or $d_M = \phi_P + \Phi_A \rightarrow$ Prop 1: A pick high debt when $R > R^*$

• What if A could offer a contract to P?
  • Borrow safely $b_M = d_M = \phi_P$, Borrow from P and pay back in good state
  • No default
  • Control over M borrowing is needed
  • IC of P not binding: spontaneous bailout in bad state $\rightarrow$ Eurobonds not needed
Date 1 – $b_p > 0$

- Symmetric environment
- Countries can decide to become jointly liable
- Joint liability more likely to be optimal when shocks are more independent, and spillover costs large relative to specific default costs
- PSI region
Discussion

• All currency areas share some features:
  • Balanced budget rules for local governments
  • No direct refinancing of local governments by the central bank
  • No bail out by the central government
  • A large federal budget

• Risk Sharing: Budget vs Bailout
  • Earmarked transfers
  • Credibility

• Eurobonds and avoidable defaults
<table>
<thead>
<tr>
<th>Country</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>4.0</td>
<td>4.2</td>
<td>4.2</td>
<td>3.8</td>
<td>3.1</td>
<td>2.6</td>
<td>2.4</td>
<td>3.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Germany</td>
<td>2.7</td>
<td>2.8</td>
<td>2.8</td>
<td>3.5</td>
<td>3.3</td>
<td>2.8</td>
<td>2.6</td>
<td>3.1</td>
<td>2.9</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>1.1</td>
<td>1.2</td>
<td>1.3</td>
<td>1.7</td>
<td>3.1</td>
<td>3.7</td>
</tr>
<tr>
<td>Greece</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.7</td>
<td>1.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Spain</td>
<td>1.6</td>
<td>1.6</td>
<td>1.6</td>
<td>1.6</td>
<td>1.6</td>
<td>1.6</td>
<td>2.1</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>France</td>
<td>1.9</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>1.7</td>
<td>1.6</td>
<td>1.5</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Italy</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.8</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>1.8</td>
<td>1.5</td>
<td>1.3</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Finland</td>
<td>2.7</td>
<td>2.9</td>
<td>2.8</td>
<td>2.6</td>
<td>2.4</td>
<td>2.1</td>
<td>2.0</td>
<td>2.9</td>
<td>2.5</td>
</tr>
<tr>
<td>UK</td>
<td>0.3</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Norway</td>
<td>0.7</td>
<td>0.9</td>
<td>0.8</td>
<td>0.6</td>
<td>0.4</td>
<td>0.3</td>
<td>0.2</td>
<td>0.4</td>
<td>0.5</td>
</tr>
</tbody>
</table>