

PART I

The Political Economy of Sovereign Debt

The chapters that comprise this section focus on the most sweeping issues of sovereign debt—the role that this debt plays in the essential economy of a nation and how sovereign debt interacts with societal dimensions beyond the merely financial. As the introduction has tried to make clear, sovereign debt has a worldwide economic importance that it has never had before, and this is due to the economic difficulties and societal challenges faced by so many of the heretofore most successful nations of the world. Accordingly, this section focuses on the overarching theory of sovereign debt, the levels of debt that nations can sustain, the problem of default, and the sanctions that lenders use to enforce their claims against governments that are reluctant to pay as promised.

In addition, these articles examine the effect of sovereign debt and defaults on the overall economic productivity of a nation. Further, some of the most egregious episodes in the history of sovereign debt arise from countries with a “resource curse”—a valuable resource that promises a horn of plenty but that has historically been associated with slow economic growth and a reluctance or inability to pay on sovereign debt.

A sovereign’s ability to conduct war depends on money. As Cicero noted more than 2,000 years ago, “Endless money forms the sinews of war.” Had Cicero lived in our time, he might have added: “And many nations attempt to fashion these sinews from debt,” as many nations have attempted to construct these sinews by issuing sovereign debt, and success or failure in sovereign debt management has meant victory or defeat in many wars. Thus, sovereign debt connects with matters of great societal import—in some instances, sovereign debt determines the very survival of the state and society.

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CHAPTER 1

Sovereign Debt

Theory, Defaults, and Sanctions

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For more than 2,000 years, sovereign governments have borrowed and frequently defaulted. In many instances, the sovereign borrower possessed overweening power compared to the unlucky lender, leaving the hapless creditor little or no means of collecting the debt. In more recent historical times, sovereign borrowers have been smaller, weaker, and poorer nations, and their lenders have been financial institutions lodged in the world's most powerful states. On some occasions, those lenders were able to enlist the military power of their own countries to enforce their private claims against the sovereign borrowers to make them pay. (These governments were presumably willing to use their military power on behalf of their financial institutions because doing so met the perceived interests of the governments themselves, or at least the interests of those individuals who held office.)

These episodes of gunboat diplomacy or supersanctions were quite effective and far from rare in the period of 1870–1914, a time of widespread adherence to the gold standard in exchange rates. A clear instance of gunboat diplomacy occurred at the turn of the twentieth century. A revolution in Venezuela that began in 1898 destroyed considerable property, and the government stopped paying its foreign creditors. In response, Great Britain, Germany, and Italy blockaded Venezuelan ports and shelled coastal fortifications, compelling Venezuelan compliance. The experience of Egypt provides an example of a nongunboat supersanction. Under the leadership of Isma'il Pasha from 1863 to 1879, Egypt borrowed and spent, notably to finance a war with Ethiopia. Unable or unwilling to pay these debts as promised, Pasha sold the Suez Canal to Great Britain in 1875. With Egypt's debts still not satisfied, Great Britain pressured the Ottoman sultan to depose Isma'il and replace him with his son Tewfik Pasha in 1879. In response to a period of missing debt payments and internal unrest, Great Britain took effective control of Egypt's finances in 1882 and directed Egypt's financial resources to the repayment of its foreign debts.¹

Today, attempts to secure repayment by gunboat diplomacy or seizing another sovereign state's finances are considered a bit outré, a circumstance that leads to the two central questions of the theory of sovereign debt: If the creditor cannot force the

sovereign borrower to repay, why would the sovereign ever do so? Correlatively, without an ability to force repayment, why would any potential creditor ever lend to a sovereign borrower? The theory of sovereign debt addresses these two puzzles.

Before turning to a direct consideration of these issues, three preliminary points deserve mention. First, sovereign borrowers typically really do hold a different position from mere individuals or firms that borrow. While ordinary borrowers can be forced to repay through legal sanctions, sovereign borrowers today completely escape supersanctions and largely evade effective legal sanctions that might force repayment. Second, even in the post-supersanction period, and even with the inability to enforce collection with legal sanctions, sovereign lending remains quite robust. Despite a large number of defaults, sovereign debt is mostly repaid as promised. Third, the theory of sovereign debt attempts to explain the occurrence of lending and repayment in strictly economic terms. That is, the explanations that economists offer turn merely on the self-interest of the lender in extending credit and the borrower in making repayments. Economists never attempt to explain lending or borrowing behavior by reference to any moral obligation of fulfilling the promise to repay that borrowers make when they secure loans.

REPUTATIONAL EXPLANATIONS

One of the key rationales offered to account for the existence of sovereign lending turns on reputation. The argument asserts that sovereign governments want to maintain a reputation as a good credit risk to assure future access to international funds, so they repay the debts they owe now. As a result, lenders feel sufficient confidence to extend funds. There is no doubt considerable, yet somewhat limited, truth in this view. But the desire for continuing access to funds works hand in hand with the sanctions that do still prevail in the arena of sovereign debt. While these sanctions fall considerably short of the supersanction of invasion, they can have considerable force. For example, if lending institutions can punish a small developing nation that defaults by interfering with its international trade or by seizing that nation's assets held abroad, these sanctions can provide additional reasons for debtor countries to repay. Thus, the threat of sanctions also stimulates countries to repay. So reputational concerns interact with responses to limited sanctions to encourage sovereign debtors to pay.

From the point of view of theory, however, there is a question of whether reputational considerations alone are sufficient to make sovereigns pay. In the parlance of the theory of sovereign debt, if the value of a good reputation is sufficient to make lenders pay as promised and sufficient to encourage lenders to extend funds, then reputation is said to support sovereign lending.

To simplify matters, assume that there is a single lender (or that all lenders act monolithically), and if a country defaults, it is excluded from borrowing forever. Several studies advance reputation as grounds for sovereign lending (Eaton and Gersovitz 1981; Eaton, Gersovitz, and Stiglitz 1986). The first thing to notice about such theories is that they pertain to an environment in which borrowing continues infinitely, or at least indefinitely from year to year. If the borrower knows that the current year is a terminal year, after which there will be no lending, the borrower would refuse to repay for the simple reason that there is no fear of exclusion from

future borrowing. But lenders, also knowing that the current year is the terminal year, would also recognize that they will not be repaid, so they will not lend for that final period. In the second-to-last year, the borrower would not repay because it would know it could not borrow in the terminal year for the reasons just given. But the lender is assumed to have the same information, so it would not lend in that penultimate year, because it would realize it would not be repaid. This argument of backward induction can be repeated for all years from the horizon back to the present, thereby showing that explanations of sovereign debt based on reputation alone can work only in an environment of perpetual lending and borrowing. Or at the very least, there must be some continuing probability of borrowing and repaying into the indefinite future.

If withholding future lending is the only sanction that lenders can impose, other potential breakdowns in lending arise. For simplicity, consider an environment of a single borrower and a single lender. Assume that the maximum debt capacity of the borrower is 100 units and the lender advances one unit in each loan up to this limit. When the debt capacity of the borrower reaches the limit of 100 units, the lender refuses to make new loans. However, at this point, the reputation for repayment has no prospect of securing future loans, because the borrower has borrowed so much it knows it can never borrow any more. In this situation, the threat of exclusion from future loans has no force, and a reputation for repayment has no value in securing future loans. Having reached this limit of borrowing with no future prospects for loans, the borrower would refuse to repay the loan. However, the lender will also recognize this prospect and will not allow that situation to arise.

But now consider the situation in which the lender has advanced 99 units of credit. The borrower knows that it cannot secure the additional loan of one unit of borrowing for the reasons just given. So the borrower will not repay the loan at the 99 units of borrowing. The lender, too, recognizes this rationale on the part of the borrower, so it will not be willing to fall into this position of extending credit up to 99 units either. The same process of backward induction that applied for each period from the terminal period back to the present also applies from some hypothetical upper loan limit back to an initial loan, with the result that the lender can never extend even the first loan.

These two thought experiments—when borrowers and lenders both know they have reached the last period for a loan or when they know that they have reached the upper bound of lending—show the limits to reputation alone as a rationale for explaining sovereign borrowing. In both cases, the certainty on the part of both lender and borrower makes the venture fail. Thus, it is uncertainty about the future that makes reputation valuable in sustaining lending. A borrower's reputation for paying as promised possesses value because of the prospect of securing a loan or expanding borrowing in the future.

BEYOND REPUTATIONAL EXPLANATIONS FOR SOVEREIGN DEBT

There are further limits to the reputational understanding of sovereign lending. Consider a country that has fluctuating production due to variable weather or other factors that affect harvests. Such a country might need to borrow in lean

years to finance consumption, while repaying outstanding loans when harvests are bountiful or at least normal. Given these circumstances, this country might engage in sovereign borrowing followed by repayment with many repetitions in this cycle. For convenience, assume that the borrower country has reached its credit limit. At first glance, it may seem that the debtor nation has a choice of repaying with the prospect of future borrowings or defaulting and bearing the risk of future macroeconomic fluctuations on its own account.

However, a famous paper (Bulow and Rogoff 1989) shows that this is a false choice. Consider a country that has been borrowing in hard times and repaying when times get better but that has now borrowed up to the maximum any lender is willing to advance. In this situation, the country can also choose to refuse repayment and use the funds it owes to save against future macroeconomic shocks, earning interest until the shock occurs and the funds are needed. Thus, the country will be better off to default once it secures its maximum level of borrowing.²

Bulow and Rogoff (1989) consider an alternative to default and saving. The defaulting country might purchase insurance that pays when the country experiences future adverse macroeconomic events. Such an insurance contract would pay in those years in which production fell short. Therefore, Bulow and Rogoff contend, the country will also be better off if it defaults and purchases the macroeconomic insurance (or defaults and saves). As Bulow and Rogoff put the point, "Small countries will not meet loan obligations to maintain a reputation for repaying because, under fairly general conditions, it is impossible for them to have such a reputation" (p. 49). The purpose of Bulow and Rogoff's argument is not to assert that reputation plays no role in understanding international lending to sovereigns, but to prove that reputation by itself is not adequate to explain the world of sovereign debt that we actually observe, especially if both the prospective borrower and the prospective lender have perfect information about the incentives of the other party. As a consequence, lending "must be supported by the direct sanctions available to creditors, and cannot be supported by a country's 'reputation for repayment'" (p. 43).

Other limitations with simple reputational explanations are also evident under real-world considerations. For example, early reputational explanations assumed that lenders acted monolithically, that if a sovereign defaulted against one lender, no other lender would advance funds, and that one default meant permanent exclusion from international borrowing. Both assumptions are empirically incorrect. Sovereign debtors are often successful in gaining additional funds from not only the same lender against whom they defaulted but also new loans from other lenders. Further, sovereign borrowers are often successful in playing one lender off against others. As we will see, history offers considerable evidence of notorious defaulters quickly gaining renewed access to international credit markets.

Given that reputation alone cannot support or rationalize the occurrence of sovereign debt, other adverse consequences or lender-imposed sanctions must play some role. Many models of sovereign default consider the effect that a default on one lender may have on the willingness of other potential lenders to advance funds. However, the consequences of default may be quite a bit broader. If a nation defaults on one obligation, this can adversely affect a variety of other trust relationships that the sovereign may also value. As the leading exponents of this theory have maintained, default in one arena can lead to adverse "reputational

spillovers" that affect trust relationships much more broadly. Thus, the fear of collateral damage from these spillovers can make it rational for the sovereign to honor its promises to pay when it might choose to default based on very narrow considerations of that borrowing relationship alone (Cole and Kehoe 1997). For example, if a sovereign defaults to a foreign bank, other suppliers for that government may require payment in advance before shipping goods or providing services. Similarly, a default by a government on an international loan may signal to domestic constituencies that the government is not to be trusted. So the default on a bank loan may provide a signal to labor groups, voters, and citizens generally that their government is not to be trusted. If a sovereign default impairs other important trust relationships that the sovereign values, this raises the total cost of the default. Thus, even though it might appear rational on narrow economic terms for the sovereign to default, the total cost of default might be high enough to encourage the sovereign to avoid default and to pay as promised.

Default by a sovereign borrower is almost always a choice, and because the default is by a government, such a choice necessarily has a political element. Recent research finds that states with certain political circumstances are more likely to default than others. There is a long-standing view that states with a weaker central government afford better protection for property rights and experience higher rates of economic growth (De Long and Shleifer 1993). More recent research suggests that similar factors may influence the probability of sovereign defaults. In brief, weaker central governmental authority coincides with a lower probability of sovereign default (Kohlscheen 2010; Saiegh 2009; Stasavage 2007). Thus, countries with coalition governments tend to default less than those dominated by a single strong party (Saiegh 2009). From a historical perspective, city-states with a strong merchant class default less often than do large territorial states; similarly, states with stronger constitutional restraints on the executive power have a lower probability of default than do those with a very powerful executive (Stasavage 2007). Further, faced with imminent default, states increase the riskiness of their economic policies in an effort to "gamble for redemption"—that is, to secure sufficient funds to avoid default (Malone 2011, forthcoming).

While the interaction of political factors and the propensity to default on sovereign debt remains incompletely understood, the general landscape of this interaction appears to be related to familiar issues in the realm of public choice economics. In particular, the interests of various political factions play a large role in determining the ultimate choice that states make with respect to default (Hatchondo, Martinez, and Sapriza 2007; Hatchondo, Martinez, and Sapriza 2011).

CREDITOR SANCTIONS AND SOVEREIGN DEFAULTS

We have already briefly considered an era in which rather extreme sanctions were enforced to collect sovereign debts. Assuming that invasion and gunboat diplomacy are no longer viable, what sanctions are available to creditors to encourage sovereign borrowers to pay as promised? This section briefly considers three famous episodes of sovereign default interacting with creditor sanctions across a

span of more than 400 years. Together, they illustrate much of the broad range of the effectiveness and failure of creditor sanctions.

Defaults of the Spanish Empire in the Sixteenth Century

Historically, sanctions have sometimes been quite effective in securing repayment, even when the debtor appears to have all of the power in the relationship. In the late sixteenth century, the Spanish Empire under King Philip II from the house of Habsburg (reigned 1556–1598) held sway over much of Europe. Fueled by its silver revenues from the New World, Spain led European forces to victory at Lepanto in 1571 to turn back the Ottoman ascendancy in the Mediterranean, Spain's armada embarked on a failed invasion of England in 1588, and its armies pursued a brutal war in the Netherlands over much of Philip's reign. But the flood of silver from the mines of Latin America was not enough to sustain Spain's expenditures. Sovereign debt would play a determining role in Spain's attempt to solidify its control over the Netherlands.

During his 42-year reign, Philip borrowed from the banking magnates of Europe, and Spain defaulted four times: 1557, 1560, 1575, 1596. The most serious default and the one most illustrative of the impact of sanctions was Philip's default on Spain's obligations to a coalition of bankers led by the Genoese in 1575. This default occurred at a critical moment in the war with the Netherlands: "The Habsburg default of 1575 led to a serious dislocation of international money markets at a delicate moment: prior to 1 September 1575 the Spanish position in the Netherlands had shown promise; after this date it proved impossible to satisfy the demand of the royal troops stationed in the Low Countries for pay and arrears. The Sack of Antwerp ('the Spanish Fury') which took place in the early days of November 1576 was a direct result" (Lovett 1980, p. 899).

While scholars generally agree that the default of 1575 resulted in a shortage of funds to meet Spain's military payroll and thus hampered the conduct of war in the Low Countries, they disagree on just how the bankers' sanctions brought Philip to heel. Philip paid his troops in coins, so it was absolutely necessary to obtain specie in the Netherlands. According to one leading explanation, this transfer of funds was under the management of the banking houses of Europe through letters of credit, as well as via physical shipments of bullion. When Spain defaulted, the bankers strangled the transfer of funds from Spain to the Netherlands, leaving the troops without pay: "The Genoese imposed an embargo on specie transfer on Philip. The Crown was unable to get appreciable funds to its troops in Flanders, with the result that in November 1576 troops mutinied over arrears and sacked Antwerp, a strategic entrepôt in Spanish possession" (Conklin 1998, p. 510).

Emphasizing the importance of the bankruptcy of 1575 and the bankers' consequent sanctions for the conduct of war in the Netherlands, Drelichman and Voth (2008) offer an alternative account of the sanctions that brought Philip to heel. In their view, the refusal of all bankers to lend following the default was the effective sanction. Drelichman and Voth maintained that transfers of specie actually continued at a healthy pace after the default: "There is no evidence that the Genoese 'transfer embargo' had any effect on the availability of funds in the Flanders theatre of war" (p. 22). Instead, Drelichman and Voth assert that the bankers of Europe successfully maintained their antilending cartel until Philip knuckled under to

their financial demands, and it was this cessation of lending that kept the Spanish troops in Flanders unpaid.

Whether the interruption in pay to the Spanish troops stemmed from an embargo on transferring funds or from a refusal to lend, the sanctions imposed by Spain's creditors were the leading factors in forcing Philip to settle and resume payments on Spain's debt, which he did in 1577. As a result, lending resumed, paving the way for Philip's last default in 1596. While it might appear on first inspection that a coalition of bankers might have little power relative to the greatest empire in an age of empires, the fact turns out to be quite otherwise. Clearly, the bankers managed to make Spain comply with their demands, whether by blocking the transfer of coin to the Low Countries or by refusing to sustain Spain's need for additional financing.

Peru and Its Guano

In more recent times, the typical sovereign borrower has been a developing country with an economy based on the export of raw materials that acquires bank loans from international banks. As an exporter, the borrower country clearly gains from international trade and participates in the international financial system. Against this background, the role of sanctions in sovereign lending is to raise the cost of default sufficiently high to make repaying the foreign obligations in the self-interest of the sovereign debtor.

One of the most instructive instances of the value of sanctions comes from a situation in which sanctions were never actually enforced—a tale of a dog that did not bark—and it involves nineteenth-century Peru.³ In the early 1820s, Peru fought for its independence against Spain and floated bond issues in London to finance its revolution. But Peru defaulted in 1826 and remained in default until 1849, with its bonds trading as low as 20 percent of par. As the low price of Peru's bonds during this period indicates, Peru's creditors had few effective sanctions to make Peru pay, and the bond market saw little prospect of Peru's actually paying on the bonds. However, Peru reached a settlement with its debtors in 1849 and then enjoyed more than 20 years of easy access to world capital markets at attractive borrowing rates. During this period, it floated many bond issues for purposes ranging from debt management to financing railway construction and other wars.

What rescued Peru from the mire of default? As with most sovereign defaults, Peru's problem from 1826 to 1849 was not its ability to pay, but its willingness. Peru's change from unwilling defaulter to active participant in world capital markets began with the travels of Alexander von Humboldt, a famous German scientist who traveled to Peru in 1802 and wrote of the rich deposits of guano on Peru's Chincha Islands, which lie 20 kilometers off Peru's coast. Production had already started in the early 1840s, but in 1849, the government of Peru attempted to rationalize the production and sale of this potentially valuable resource.

Europe, with its high demand for fertilizer, was the main market for the Peruvian guano, but Peru's principal unsatisfied creditors on its defaulted sovereign debt were also based in Europe, most notably in Great Britain. As a consequence, the Peruvian government feared that its guano exports would be seized in repayment of the outstanding debts. These fears were of real weight. The holders of the defaulted bonds had already noted in 1847 that the guano was by itself sufficient

“to provide for the liquidation of its [Peru’s] foreign debt, and that consequently the [British] government is bound by every principle of public faith and national honour to proceed to that stipulation without further delay.” For its part, the Peruvian finance minister noted that “until the foreign debt is settled, the remission of guano abroad . . . could bring major complications that we must avoid” (Quoted in Vizcarra 2009, p. 371).

While these fears of seizure may have been exaggerated, Peru certainly faced the problem of restricted access to capital markets. With its bonds sitting in default, further financing from abroad was unlikely. Further, Peru very much needed new financing to make the extraction and sale of its guano possible. Loading a ship with guano could take a month, and the voyage to Europe was lengthy so the transportation cost was high. Further, “procurement of vessels and coordination of sales, foreign warehousing, and marketing were also costly and demanded a certain degree of expertise that the Peruvian government lacked” (Vizcarra 2009, p. 367). Peru solved this dilemma by contracting with a highly reputable British merchant bank, Anthony Gibbs and Sons, to manage this process and to collect its sales receipts in Europe. Peru authorized the Gibbs bank not only to collect all the guano revenues but also to withhold 50 percent of them to service Peru’s foreign debt. The Gibbs company had considerable reputational capital of great value, so it was unlikely to cooperate with Peru to defraud new lenders.

With these new arrangements in place, Peru now had the means to capitalize on its guano deposits. Key to this was an arrangement that gave Peru’s creditors confidence that Peru would pay. Because the proceeds from selling guano were realized outside the boundaries of Peru and passed through the hands of Gibbs and Sons, who had the confidence of Peru’s foreign creditors, Peru had solved the problem of being able to make a “credible commitment” to pay its debts.

As an alternative to allowing Gibbs and Sons to control its guano-based cash flows, Peru might have tried to secure new financing to allow it to exploit its guano and to receive payment in Peru when the guano was loaded. However, given its record of defaults, new borrowing was unlikely. What lender would want to lend merely on Peru’s promise of future payments? But having the revenues from guano realized outside the country by a reputable third party gave lenders the confidence they needed to advance new funds.

The Russian Federation in 1993

Shortly after the breakup of the Soviet Union, the Swiss firm known as Noga, led by Nessim Gaon, signed a deal with the first post-Soviet government in 1991. Noga exported goods including medicine and pesticides to Russia in exchange for oil, and the Russian Federation explicitly waived sovereign immunity. The deal quickly fell apart, after \$1.5 billion in trade had already occurred, and Russia refused to send any more oil. Noga, claiming a loss of approximately \$100 million, sued in 1993 and secured a court ruling that froze Russian government bank accounts in Luxembourg and Switzerland. Noga secured more legal victories, including an order by a French court to seize the bank accounts of many Russian state enterprises holding funds abroad.

Beyond freezing bank accounts, Noga also pursued other avenues of harassing the Russian government: “In 2000, the Royal Museum of Art and History in

Belgium was forced to abandon a show of Russian Art Treasures when it could not gain legal guarantees against the seizure of the art. . . . In 2000, a French presidential decree was made to prevent the seizure of president Putin's personal aircraft at Orly Airport in Paris. . . . [In 2000] the Russian tall ship Sedov . . . was impounded in the port of Brest in France. . . . Threats of seizure in 2000, led Russia to halt shipments of nuclear warheads to the USA for reprocessing until President Clinton signed an executive order guaranteeing immunity of the uranium from seizure" (Wright 2002, pp. 36–37).

Noga pursued its claims with remarkable persistence over the years. In 2001, Noga attempted to seize two Russian fighter jets at the Bourget air show, but the jets escaped with the warning and collusion of the show's organizers (Wright 2002, p. 37). In subsequent years, Russian planes were unaccustomedly missing from other European air shows, apparently due to fear of Noga's attempted seizures (Nadmitov, n.d., p. 56). Over the years, Noga continued its pursuit of restitution, winning a victory in a French court as recently as 2008 (Aris 2008). But Noga's quest apparently ended in 2009, when Noga lost a decision in the U.S. Court of Appeals for the Second Circuit.⁴

Although writing seven years before the final legal resolution of the matter, Sinyagina-Woodruff summarizes the ultimate outcome quite well: "Seizure of external assets, even with the blessings of international arbitration, can be more problematic still. The ongoing saga of the firm Noga which has struggled for almost 10 years to enforce court decisions against the Russian government, illustrates that. . . . This story demonstrates that the threat of seizing property outside the country's borders, a key 'stick' in some sanctioning theories of sovereign borrowing, is not credible and therefore cannot motivate repayment" (Sinyagina-Woodruff 2003, pp. 521, 538).

Why didn't Russia pay and avoid the embarrassment and interference with its image abroad? After all, the \$100 million is a trivial amount in the broad scheme of Russian foreign debt. Some have speculated that Russia did not want to embolden other small creditors and wanted to show its ultimate mastery of the situation by settling with creditors equally and in its own way.

CONCLUSION

This chapter has attempted to survey some of the most important dimensions of sovereign debt. Today, sovereign borrowers are generally immune to physical force as a means of compelling repayment. So this fact raises the question of why sovereigns should ever repay, and the questionable incentives for sovereign repayment give rise to the question of why anyone should ever lend to a sovereign.

We have seen that, while a reputation as a reliable and responsible borrower may play an important role in understanding the behavior of borrowers and lenders, reputational considerations alone cannot account for sovereign repayment. However, when considerations of reputation are broadened to include the effect of default on constituencies beyond direct participants in borrowing and lending, reputational spillovers can have considerable effect. Further, the behavior of sovereign borrowers is largely influenced by political considerations and is related to the relationship between the executives and other political constituencies.

In addition, creditor sanctions do have an important role in securing repayment and in explaining the continuing existence of the sovereign debt market. Sanctions have mixed results in forcing payment. In some instances, the denial of further loans can be effective, especially if there is concerted action by a number of lenders. In a more swashbuckling era, governments could more successfully interfere with the international trade of smaller nations, thereby denying them the benefits of trade and making repayment more attractive than remaining in default. As the case of Peru and guano on the one hand, and Noga and Russia on the other hand illustrate, a creative and cooperative effort between creditor and defaulter, with sanctions held in the background, may prove to be a more effective means of securing repayment.

NOTES

1. For details on both of these episodes and many other supersanctions of both types, see three papers by Kris James Mitchener and Marc D. Weidenmier: "How Are Sovereign Debtors Punished? Evidence from the Gold Standard Era," Working Paper, September 2004; "Supersanctions and Sovereign Debt Repayment," in Robert W. Kolb, ed., *Sovereign Debt: From Safety to Default* (Hoboken, NJ: John Wiley & Sons); and 2010, "Supersanctions and Sovereign Debt Repayment," *Journal of International Money and Finance* 29, 19–36.
2. Bulow and Rogoff (1989) consider an alternative to default and saving. The defaulting country might purchase insurance that pays when the country experiences future adverse macroeconomic events. Such an insurance contract would pay in those years in which production fell short. Therefore, Bulow and Rogoff contend, the country will also be better off if it defaults and purchases the macroeconomic insurance (or defaults and saves).
3. This account of Peru's debt draws on W. M. Mathew. "A Primitive Export Sector: Guano Production in Mid-Nineteenth-Century Peru." *Journal of Latin American Studies* 9:1 (1977), 35–57; and Catalina Vizcarra, "Guano, Credible Commitments, and Sovereign Debt Repayment in Nineteenth-Century Peru," *Journal of Economic History* 69:2 (2009), 358–387.
4. See cgsh.com/zh-CN/US/russian_federation_wins_appeal/. Accessed August 21, 2010.

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