Sovereign External Borrowing and Multilateral Lending in Crises

Leopoldo Avellan[†], Arturo Galindo[‡], Giulia Lotti[†§]

[†]Inter-American Development Bank [‡]Banco de la República [§]CAGE Warwick

Research Question

Given private flows procyclicality, are Multilateral Development Banks' (MDB) flows different? Beyond the cycle, how do they match up in fiscal crises?

Data

- Net flows (i.e. disbursements net of principal repayments) from MDBs, Regional Development Banks (RDBs), the World Bank and private creditors (source: International Debt Statistics);
- 4 types of fiscal crisis: credit events, exceptionally large official financing from IMF, implicit domestic public debt default, and loss of market confidence (source: Gerling et al., 2017);
- 108 countries in 1980–2015;
- Push and pull factors included as further controls (US VIX, 10-year US government bond yield, global commodity prices of copper and an index for the price of crude oil; trade openness, financial development, whether the country has a fixed exchange rate regime, the de jure financial openness Chinn & Ito index, real GDP growth and public debt).

Empirical Strategy

To study sovereign lending in fiscal crises, we conduct an event analysis in 5-year windows around the year in which a fiscal crisis criterion is triggered:

$$y_{i,t} = \alpha_i + \gamma_i t + \sum_{k=-2}^{2} \beta_k FiscalCrisis_{h,i,t+k} + \epsilon_{i,t} \qquad (1)$$

$y_{i,t}$ are net flows scaled by trend GDP;

α_i are country fixed-effects; $\gamma_i t$ are country/trends;

$\epsilon_{i,t}$ clustered at country level.

Results

When a country is engaged in a program with the IMF, MDBs increase their lending, not only in the beginning of the crisis, but in subsequent years too.

MDBs boost their support exactly when the IMF starts a program and not before, signaling strong coordination.

Private creditors do not increase their net flows, but they do not retrench them either.

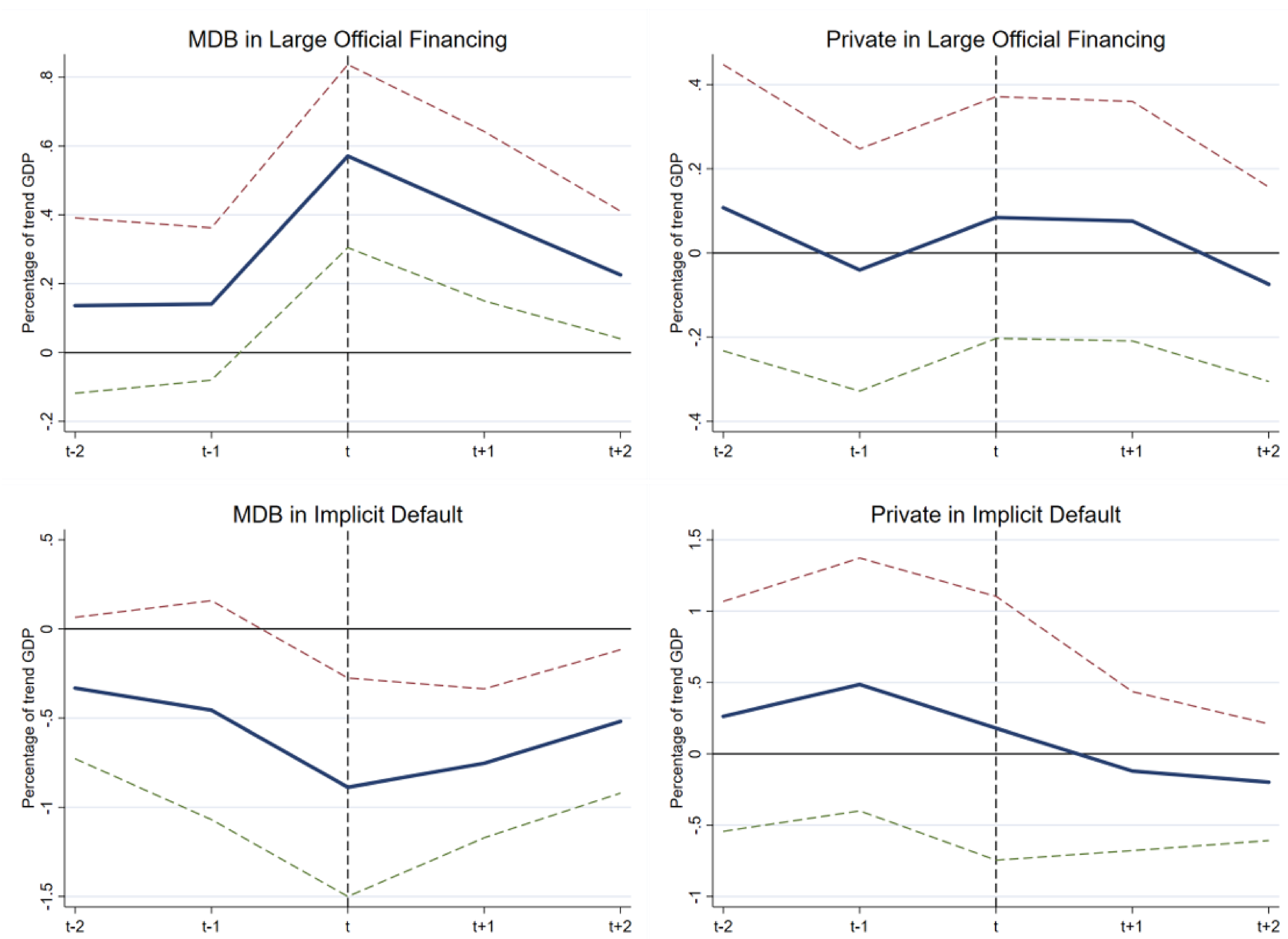

Fig. 1: Dynamic of Net Flows in Selected Crises

In implicit public domestic defaults, we observe a retrenchment of net flows from MDBs in the crisis year, as well as in the immediate aftermath, while private creditors do not change their lending.

Not only multilateral flows retrench, but they do not increase before the implicit public domestic default occurs, which corroborates the hypothesis that multilateral lending does not push countries into fiscal mismanagement.

Robustness Checks

As robustness checks, we:

- demean net flows and standardize them by country standard deviations;
- use a different Hodrick-Prescott parameter to filter the GDP series and scale net flows by trend GDP;
- add push and pull factors as controls;
- introduce in equations two lags of the dependent variables and re-estimate through system-GMM.

Conclusion

Unlike private lending, multilateral sovereign lending does not retrench in most fiscal crises.

Evidence of synchronization between MDBs and the International Monetary Fund during fiscal crises, particularly in some regions.

Event analyses show that this synchronization persists after several periods.

Taken together, results strongly support the notion that MDBs play an important role in crisis mitigation and suggest that this role neither erodes the discipline between International Financial Institutions within the International Financial Architecture, nor it creates incentives towards fiscal mismanagement in recipient countries.