

Research Seminar "Quantitative Economics"

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Abstract

Seniority and Sovereign Default: The Role of Official Lenders

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Abstract

This paper studies official multilateral lending in the sovereign debt market. Official multilateral debt receives priority in repayment, even though this is not legally required. It represents an important portion of total sovereign debt and increases both before and during a default. Defaults on official multilateral debt are infrequent, last relatively longer and are associated with greater private lenders losses. I develop a model with private and official multilateral lenders where the latter benefits from a greater enforcement power in repayment. This allows the model to rationalize the aforementioned empirical facts and generates non-monotonicity in the private bond price. In small amount, official multilateral debt has a positive catalytic effect which is quantitatively strong but short lived. Sovereign borrowers value the use of official multilateral debt and would not necessarily prefer other seniority regimes.