

20th Banca d'Italia Workshop on Public Finance

Thursday, March 22nd - Session 2

Discussion by [Karsten Wendorff](#), Deutsche Bundesbank

| A look into classic fiscal literature

The House Lannister of Casterly Rock

„A Lannister always pays its debt“

| The papers: Common views

Defaults in EMU can not be excluded

Avoiding defaults via public support may make sense

The design of support and default mechanisms matters

Incentives are important: Should be reflected in design

Issue is complex and difficult, further research needed

Paper 1: Life before default

Comprehensive overview on support programmes

Relatively positive assessment of interest and maturity relief: Incentives not in focus but crucial!

Agree: ESM important institutional component of EMU

BBK: Increase firepower: Automatic maturity extension in bond contracts (no default, keep investors liable....)

Monetary policy: Target2 not „all you can eat“

Paper 2: Default

Agree in principle with important takeaways:

- **Restructuring mechanism can be welfare enhancing**
- **More market discipline could be welfare enhancing**
- **Impact on financial market to be considered**

I am not convinced (yet) by automatic haircut mechanism

BBK: Maturity prolongation no default; Restructuring mechanism focus on procedures but not on automatic haircut (rather CACs...)

Paper 2: Default

DSGE-Modell: Competent executed, innovative feature

However, some doubts/questions:

- **Why tax smoothing as government target?**
- **Unrestricted support at risk free rate drives results?**
- **No costs of default at end of programme? Financial market problems when national banks hold debt?**
- **Include benefits of having restructuring mechanism (less uncertainty) and political costs of programme?**

Paper 3: Life after Default

Agree in principle with important takeaways also for EMU

- Default against private lenders: Negative implications particularly if large restructuring (hit national economy)**
- Default against public lenders: Less clear (transfers)**

But EMU reasoning rather not to be derived from paper

- Lower income countries, some years ago**
- EMU: Financial markets important, official lenders are other EMU countries, domestic debt important**

Paper 3: Life after Default

Some more remarks

- **Empirical results not so overwhelming (significance)?**
- **Aspect of „stigma“ very prominent. But: Maybe something else? Political aspects, long default process?**
- **At the end of paper: Very careful wording with regard to interpretation of results (I would agree) – certain contrast with rest of paper**

| A Small House in the North

The house Flints of Widows Watch

“Ever vigilant”

The house Mormons of Bear Island

“Here we stand”