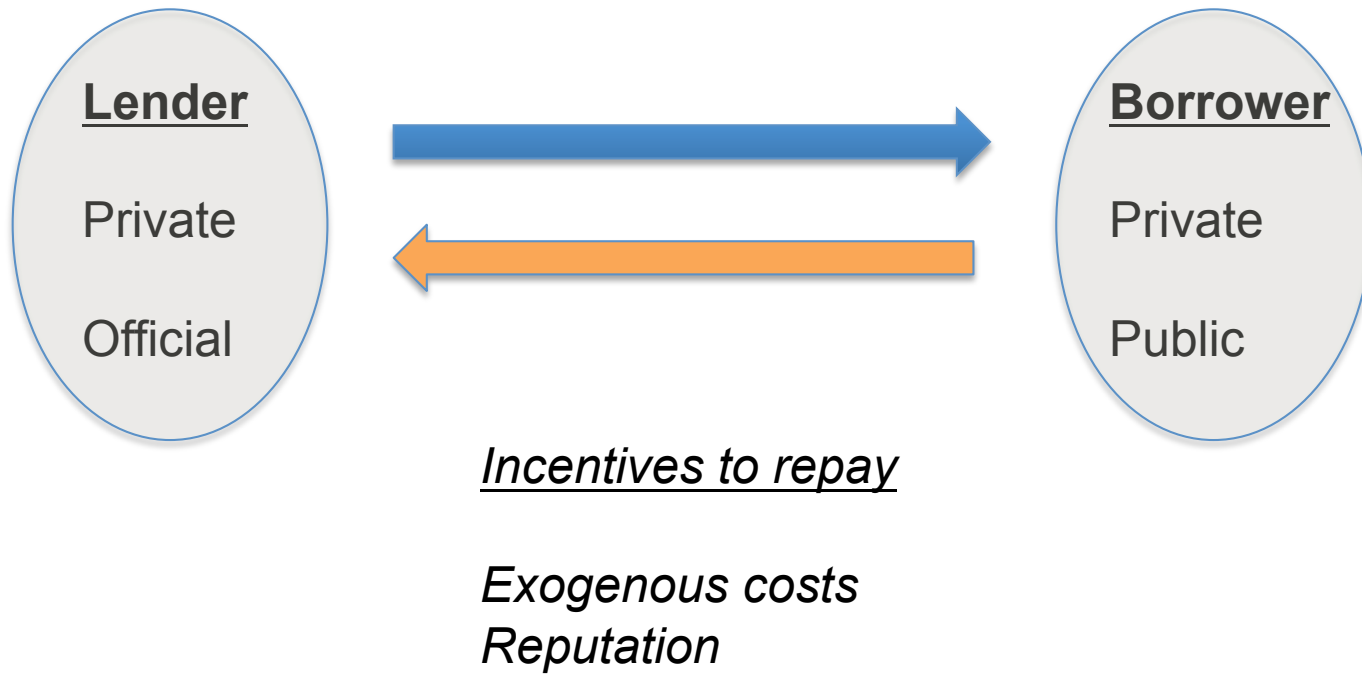


Discussion of Tirole's  
"Country Solidarity"

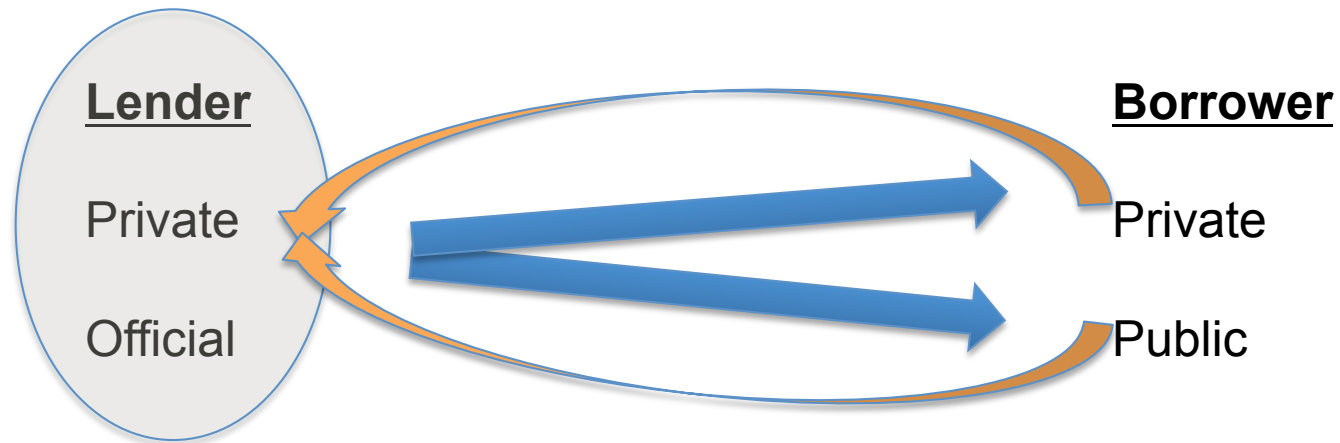
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# Literature 1/2



# Literature 2/2

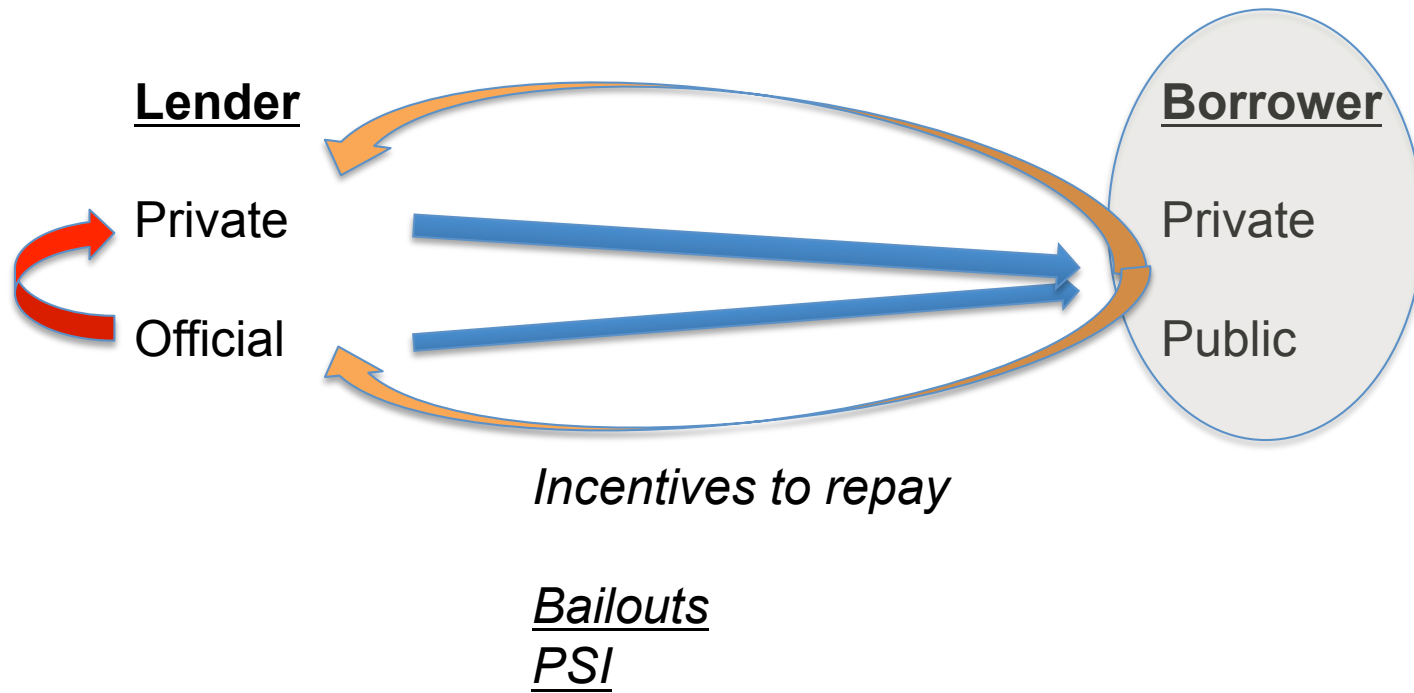


*Incentives to repay*

*Enforcement of private claims*

*Interaction with public debt*

# This Paper



## 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



# Unemployment Insurance Spending (% GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Denmark	4,0	4,2	4,2	3,8	3,1	2,6	2,4	3,0	3,4
<b>Germany</b>	<b>2,7</b>	<b>2,8</b>	<b>2,8</b>	<b>3,5</b>	<b>3,3</b>	<b>2,8</b>	<b>2,6</b>	<b>3,1</b>	<b>2,9</b>
Ireland	1,3	1,3	1,2	1,1	1,2	1,3	1,7	3,1	3,7
Greece	0,8	0,7	0,8	0,8	0,7	0,8	0,7	1,0	0,8
<b>Spain</b>	<b>1,6</b>	<b>1,6</b>	<b>1,6</b>	<b>1,6</b>	<b>1,6</b>	<b>1,6</b>	<b>2,1</b>	<b>3,2</b>	<b>3,2</b>
France	1,9	2,1	2,1	2,0	1,7	1,6	1,5	1,8	1,9
Italy	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,8	0,9
Netherlands	1,8	2,1	2,1	2,0	1,8	1,5	1,3	1,9	2,0
Finland	2,7	2,9	2,8	2,6	2,4	2,1	2,0	2,9	2,5
UK	0,3	0,4	0,3	0,3	0,3	0,3	0,3	0,5	0,5
Norway	0,7	0,9	0,8	0,6	0,4	0,3	0,2	0,4	0,5