What will happen if a country goes bankrupt

- Governments, in theory, and in an ideal world, pay their obligations with revenue from taxes and investment.
- However, just as we as individuals frequently spend over our means and turn to credit, governments do similarly by issuing bonds with the promise of repaying the bond's value plus interest at the maturity rate.
- Internal and external debts make up national debt, commonly referred to as sovereign debt.
- External debts are foreign-currency-denominated bonds issued by the government and sold to foreign investors. Internal debts are debts owed to those within the country.
- Internal debts can be funded by fiscal and monetary policy- by raising taxes and printing more money- but external debts can divert funds away from other revenue-generating activities since they must be paid in foreign currency, which the government does not control.

When a country fails to repay its debts, it does not go bankrupt; instead, it defaults on the loan.

The government, not the country, defaults.

- Apart from its infamous default of $1.8 billion as the first developed country to default on an International Monetary Fund (IMF) loan in 377 BC, Greece was the first country to default on its debt in 377 BC.
- Greece has defaulted on its debt for about half of its history, dating back to its independence in 1829.
- Spain, on the other side, has defaulted the most times, with 15 defaults between the eighteenth and nineteenth centuries.
- Member nations of the IMF frequently seek a bailout from the IMF before defaulting on their loans, as the IMF not only provides financial resources but also technical experience to handle the bailout programme.
- However, bailout money never comes without strings attached, such as austerity (reducing spending), currency depreciation, and trade liberalisation, all of which are outlined in the Washington Consensus.

When a country's ruling party changes, the new government frequently defaults on the debt it inherited from the previous one.

There are a variety of reasons why a country defaults on its debt, including a **simple reversal of global money flows and insufficient revenues.**

For example, Jamaica's $7.9 billion loan default in 2010 was caused by government overspending and the decline of the country's most important industry, tourism.

When a country defaults, what happens next?

- The assets are repossessed by creditors in the case of an individual or corporate bankruptcy.
- However, a country's assets cannot be confiscated by its creditor, and the government cannot be made to pay with money it does not have during a default.
- However, there is no certainty that this applies to the country's assets located outside of the country.
    - When Argentina defaulted in 2012, its navy training ship, which was based in Ghana at the time, was seized.

The delinquent country's creditor's only option is to renegotiate the conditions of the loan. Government bonds will be rescheduled for postponed payment or 'haircut,' which means the value of the bonds will be reduced.

After defaulting on a $81 billion loan in 2011, Argentina promised to pay a third of its debt to creditors. In this regard, between 2005 and 2010, 93 percent of the debt was swapped for performing securities, and it wasn't until 2016 that Argentina returned the vulture fund for 75 percent of the remaining debt.

What are the ramifications of going into default?

- The creditor's loss of principle and capital as a result of partial debt cancellation or debt restructure is the immediate cost of defaulting.
- Due to the lower likelihood of retaliation, the government is more likely to eliminate debts owing to foreign private creditors.
- Furthermore, government defaults result in soaring inflation, unemployment, and political pressure on the defaulting government, just as they do in any other crisis.
- Because domestic banks hold the majority of domestic debt, bank runs occur as a result of a lack of faith in the financial system.
- Bank runs occur when a large amount of money is taken out of a bank as a result of public panic and lack of faith.
- Capital controls are in place to prevent this, with the government attempting to limit the amount of money that each depositor can withdraw.
- To avoid a banking crisis, Greek banks were closed for nearly 20 days in June 2015, bank transfers to foreign banks were restricted, and cash withdrawals were capped at €50 per day.
- As aggregate demand diminishes and the foreign market loses faith in the country's currency, a sovereign debt crisis might lead to economic and currency crises.

- A default country's lack of access to the credit market is another unavoidable consequence.
- It will be charged a high interest rate on its loan, or it will not be granted a loan at all.
- The defaulted country's credit rating will suffer, preventing foreign investment in the country.
- If a country is no longer able to pay its bills, the International Monetary Fund (IMF) usually steps in.
- It may, for example, write off part of the government debt or provide emergency loans. Of course, all this is subject to terms.
- The country is often obliged to carry out a major restructuring of its public finances.
- What's more, a write-off by the IMF doesn't necessarily mean that all the creditors will agree – if the IMF writes off debt for one country, it obviously means a financial loss (which may be severe) for another.
- After a lot of legal and diplomatic back and forth, however, a 'solution' always emerges, as was the case with the Greek bailout, for example.
- In 2022, countries are therefore no longer allowed to 'truly' go bankrupt. There's too much at stake for this to happen. Movement of capital, investments, financial and geopolitical interests and more no longer end at national borders. The global economy is so tightly interwoven that a real bankruptcy would trigger a chain reaction. And so a (creative) solution is always found.
- Does this mean that a country can actually continue to accumulate debts and pile up its defaults?
- In principle, yes, but the country, and in particular its residents and entrepreneurs, will be footing the bill, as emergency loans and debt restructuring each have their price. It often means that a country comes under some kind of supervision and will only get more money if it puts its house in order. Of course, this has a major impact on those who live, work and do business there.
- After all, restructuring is usually synonymous with tax increases, rising poverty and unemployment, chaos and a loss of purchasing power.

This is how citizens pay the bill for their government's bad management.

Why Is Rupee Falling? (june 22 news)

The value of the Indian rupee to the US Dollar works on a demand and supply basis.

If there is a higher demand for the US Dollar, the value of the Indian rupee depreciates and vice-versa.

If a country imports more than it exports, then the demand for the dollar will be higher than the supply and the domestic currency like Rupee in India will depreciate against the dollar.

The rupee's fall these days is mainly due to high crude oil prices, a strong dollar overseas, and foreign capital outflows.

The rupee has been on the decline since early this year, especially after supply chain disruptions in view of the Russia-Ukraine war, global economic challenges, inflation, and high crude oil prices, among other issues.

Besides, there have been heavy foreign fund outflows from the domestic markets as the foreign institutional investors (FIIs) have sold shares worth $28.4 billion so far this year, outstripping the $11.8-billion sell-off seen during the Global Financial Crisis of 2008.

The rupee has depreciated 5.9 per cent versus the dollar so far this calendar year.

As money flows out of India, the rupee-dollar exchange rate gets impacted, depreciating the rupee. Such depreciation puts considerable pressure on the already high import prices of crude and raw materials, paving the path for higher imported inflation and production costs besides higher retail inflation.

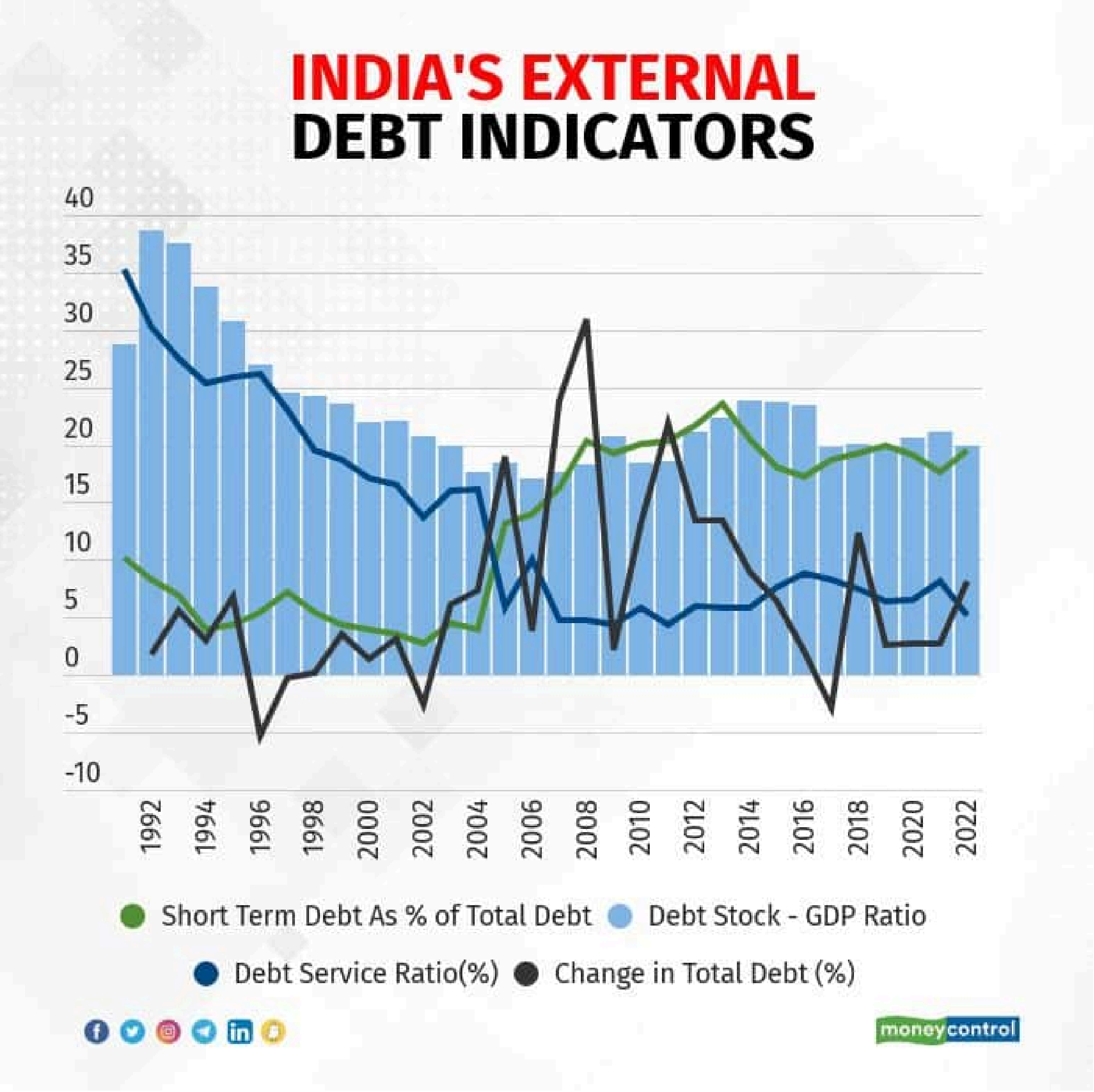
Meanwhile, the US Federal Reserve recently increased the interest rates, and the return on dollar assets increased compared with those of emerging markets such as India. Speculations are there could me more aggressive rate hikes by the US Fed and that may further dent the Indian currency.

How does a weak rupee impact you and the economy?

- Since India mostly depends on imports, including crude oil, metals, electronics, etc. the country makes payments in US dollars.
- Now if the rupee is weak, it has to pay more for the same quantity of items.
- In such cases, the cost of raw materials and production goes up which gets passed on to the consumers.

- On the other hand, a weakening domestic currency boosts exports as shipments get more competitive and foreign buyers gain more purchasing power.
- However, in the current scenario of weak global demand and persistent volatility, exporters are not supportive of the currency fall.
- The falling rupee's biggest impact is on inflation, given India imports over 80 per cent of its crude oil, which is the country's biggest import.
- The global crude prices have sustained at over $100 a barrel since Russia's invasion of Ukraine in February this year.
- High oil prices and a weaker rupee will only add to inflationary pressures in the economy

- India's external debt in March 2022 stood at $620.7 billion, which is 19.9% of Gross Domestic Product (GDP).
- In terms of maturity, short-term debt comprised 19.6% of GDP and long-term debt comprised 80.4% of GDP.
- In terms of currency composition, the US dollar dominates the debt at 53%.
- The Non-Resident Indian (NRI) Deposits and Foreign investment in Government securities are part of external debt but are based in Rupees.
- Hence external debt is also held in Rupees and its share is 31%.



An important indicator is the Debt Service Ratio (DSR), a measure of a country's ability to service debt given current receipts. India's DSR has declined from around 40% in the 1990s to around 5% today.

What are the sources of external debt?

Within long-term debt, we see changes in sources of borrowing since 1991. In 1991, external debt mainly came from multilateral and bilateral sources whose share was 40% of total long-term debt, which declined to 17% in 2022.

The share of IMF also declined from around 4-5% in the early 1990s to 0-1% in the 2000s before rising to 3.7% in 2022.

The government is the major borrower of multilateral and bilateral loans and the only borrower in the case of IMF loans.

From 1991-2022, the share of External Commercial Borrowings (ECBs) and Non-Resident Indian (NRI) deposits has risen from 12% to 37% and 12% to 22%, respectively. ECB are loans taken by corporate entities for their overseas investments whereas Indian banks receive NRI deposits.

Within short-term debt, the major share is held by trade-related credits used by the trading community for managing exports and imports. Of the 19.7% short-term debt as a share of total external debt, the share of trade credit is 18.9%.

Is India's external debt position at risk?

Given the overall figures, India's external debt position is hardly at risk. The external debt position has remained stable since the 1991 economic reforms. The Finance Ministry, in an annual review, conducted a cross-country analysis of the external debt in 2020. It noted that the "total external debt of the world as at end-December 2020 was US $94.5 trillion, while that of India was estimated at US $563 billion occupying 24th position globally".

In a 2020 research paper, Reserve Bank of India (RBI) economists noted external vulnerability remained minimal. In a 2022 note, RBI economists said the threshold level of external debt is 23-24% of GDP, implying India could raise growth by maximizing external debt!

Having said that, India cannot be complacent. The Indian rupee has depreciated recently, creating concerns over macroeconomic stability including external debt. India is running high inflation, accompanied by large twin deficits of the budget deficit and current account deficit. The RBI has started to increase policy rates, which will slow growth, leading to a higher ratio of external debt to GDP in the future.

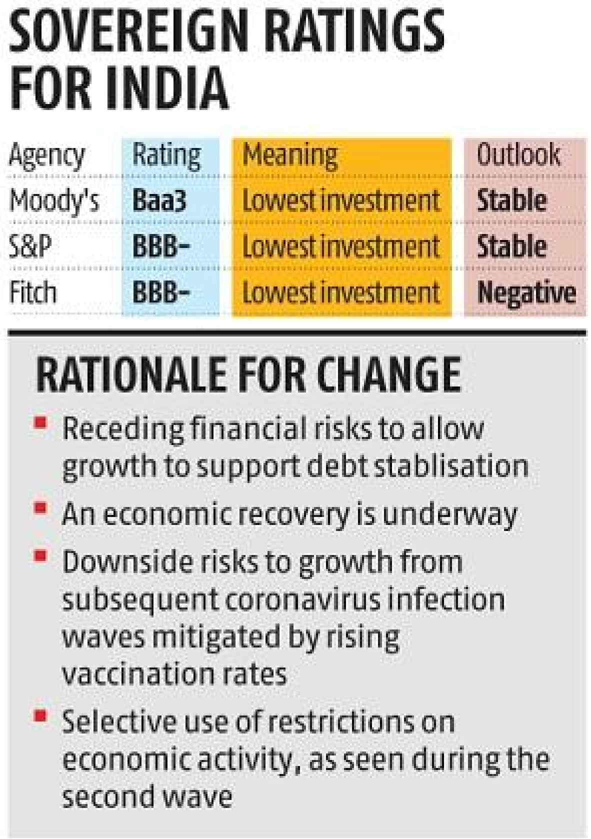
There has also been a shift in sources of external debt from multilateral/bilateral sources to ECBs and NRI deposits. This implies that external debt risks have shifted from the government to the private sector and banking system.

While the government can avail of concessional facilities and roll over the liabilities, the same opportunities are not available to the private sector and banks. Policymakers have been alert to the risks. The RBI took several steps recently to arrest currency depreciation and encourage higher NRI deposits in the country. The RBI has also taken a step to internationalize trade in the rupee, which should also hopefully lower dollar-denominated liabilities in the future.

India’s credit rating (Oct 2021 news)(though moody has retained India's credit rating at baa3 this year as well)

Ratings agency Moody's has changed India's sovereign rating outlook to “Stable" from “Negative" and affirmed the country's rating at “Baa3".

- “Baa3" rating is the lowest investment grade, just a notch above junk status (Speculative).



SOVEREIGN RATINGS FOR INDIA

Agency	Rating	Meaning	Outlook
Moody's	Baa3	Lowest investment	Stable
S&P	BBB-	Lowest investment	Stable
Fitch	BBB-	Lowest investment	Negative

RATIONALE FOR CHANGE

- Receding financial risks to allow growth to support debt stablisation
- An economic recovery is underway
- Downside risks to growth from subsequent coronavirus infection waves mitigated by rising vaccination rates
- Selective use of restrictions on economic activity, as seen during the second wave

Key Points

- Sovereign Credit Rating (SCR):
  - SCR is an independent assessment of the creditworthiness of a country or sovereign entity.

  - It can give investors insights into the level of risk associated with investing in the debt of a particular country, including any political risk.
  - In addition to issuing bonds in external debt markets, another common motivation for countries to obtain a sovereign credit rating is to attract Foreign Direct Investment (FDI).
  - At the request of the country, a credit rating agency will evaluate its economic and political environment to assign it a rating.
    - Moody's considers a Baa3 or higher rating to be of investment grade, and a rating of Ba1 and below is speculative.
    - S&P gives a BBB- or higher rating to countries it considers investment grade, and grades of BB+ or lower are deemed to be speculative or "junk" grade.
- Economic Survey's Stance on SCRs:
  - India has consistently been rated below expectation as compared to its performance on various parameters during the period 2000-20.
    - India remained a clear outlier on several parameters such as GDP growth rate, inflation, general government debt, political stability, rule of law, control of corruption, investor protection, ease of doing business, sovereign default history, etc.
  - India's ability to pay can be gauged not only by the extremely low foreign currency-denominated debt of the sovereign but also by the comfortable size of its foreign exchange reserves that can pay for the short term debt of the private sector as well as the entire stock of India's sovereign and non-sovereign external debt.

- India's fiscal policy should be guided by considerations of growth and development rather than be restrained by "biased and subjective" sovereign credit ratings.
- It recommended that developing economies must come together to address this bias and subjectivity inherent in sovereign credit ratings methodology to prevent exacerbation of crises in future.