JEL Classification Numbers
E62, F34

Summary of
WP/92/57

"Endogenous Creditor Seniority and External Debt Values"

by Michael Dooley and Mark R. Stone

It is now conventional to treat the external debt of a developing country as an integral part of the fiscal problem faced by the debtor government. This paper provides an empirical analysis of both the internal and external debt of developing countries under the assumption that the government utilizes these two markets to minimize its borrowing costs.

A simple accounting framework is used to measure the "flow" contribution of different creditors to the financing of the primary fiscal deficits of 17 developing countries. The data suggest that, in the years following the debt crisis, debtor governments relied on domestic credit markets to finance primary deficits and, in many cases, net payments to external creditors. This pattern of implicit seniority for external creditors appears to have been reversed after 1987 as residents of debtor countries became less willing to finance their governments on relatively favorable terms.

The apparent change in the pattern of payments of debtor governments helps explain market prices for external debt but does not account fully for the decline in market prices during 1985-89. The rise in market interest rates, which exerted a negative influence on debt prices over the sample period, also appears to be important. This finding is significant in that it is consistent with the increases in debt prices and the corresponding fall in international interest rates observed after the time period studied.